Social Security

# International Update:

## Recent Developments in Foreign Public and Private Pensions

June 2005

## Europe

### Italy

**Regulatory and management uncertainties have stalled the development of Italy's funded second-pillar pension system.** Last year's pension reform encouraged the development of a funded supplementary pension system by redirecting workers' severance pay, known as *Trattamento di fine rapporto* (TFR), into private pension funds. To date, the government and the social partners have been unable to agree on how €14 billion (US$17.1 billion) of TFR accruals will be transferred or invested under a reformed pension system. However, it has been reported that a formal agreement between the parties is expected by October 6.

Today, employers allocate about 7 percent of employee earnings toward the TFR, which guarantees a return approximately equal to inflation and is paid out as a lump sum upon termination of employment for whatever reason (for example, unemployment or retirement). Last year's reform provided that employees be given a period of 6 months to decide whether to leave their accumulated severance pay with their employer or have it transferred to an occupational pension plan. Alternatively, employees are allowed to assign the accumulated TFR to the social security system to improve their future pension benefit. If a worker fails to make a choice, the TFR accumulations will be transferred into the pension funds. The 6-month decision-making period was scheduled to begin in July, but the Ministry of Economy and Finance announced on June 10 that it would be delayed until January 1, 2006.

Other factors delaying implementation are the lack of regulations for investing TFR accumulations and lack of clarity over which public agency will regulate the funds. The 2004 reform bill made the pension regulator the sole authority, but recent unrelated legislation has complicated matters by transferring part of that body's jurisdiction to the public agency responsible for regulating the Italian securities market.

**Sources:** International Benefits Information Service (IBIS), December 2000, August 2004, and April 2005; Watson Wyatt Worldwide, *The Multinational*, May 2002, and *Global News Briefs*, August 2004; Hewitt Associates, Pension Reform Legislation Approved (Italy), August 2004; *Financial News*, August 1, 2004; BNP Paribas, *EcoWeek*, January 24, 2005; http://www.IPE.com (Web extension of *Investment & Pensions Europe*), February 22; March 2, 4, and 24; April 27; May 4, 11, and 16; and June 10, 2005; Dow Jones International News, February 25, 2005; Bureau of National Affairs (BNA), *Pension & Benefits Daily*, March 28, 2005.

### Norway

**The Norwegian parliament has approved legislation to overhaul the nation's pension system by mandating occupational pensions for all employees and encouraging later retirement.** The reform plan was proposed by the government last December, and a compromise measure between the minority government and the opposition Labor and Center Parties was agreed to on May 21. The reforms will mainly affect persons born after 1965.

Today, all civil servants, roughly one-third of Norway's labor force, and almost half of all private-sector employees are covered by an occupational pension, usually a defined benefit plan. The new law mandates that beginning in January 2006 all private-sector employees be covered by an occupational pension as a supplement to the recently revised National Insurance Scheme. (See also the March 2005 issue of *International Update*.) The self-employed, including merchants, craftsmen, and farmers, are not brought in under the new system but will instead receive a tax reduction on savings used toward personal pensions.

Firms will be required to contribute at least 2 percent of annual employee wages to a pension plan. The government estimates that, out of a labor force of nearly 2.4 million, some 500,000 workers currently without company pension plans will benefit from the new law. However, the Confederation of Commercial and Service Enterprises has expressed concern that the increased compulsory expenses could "break the backs" of small- and medium-sized employers.

The reform also encourages later retirement by providing a higher pension to those who work longer than 43 years. Although Norway's statutory retirement age of 67 is high by international standards, it is often possible to retire at an earlier age. The new rules are expected to lead to a gradual rise in the retirement age beyond 70 years.

**Sources:** Storebrand Livsforsikring AS, *International Group Program (IGP) Country Profile, 2004: Norway* (Boston: John Hancock Financial Services, 2004); IBIS, January 2005; European Industrial Relations Observatory On-Line (http://www.eiro.eurofound.eu.int), January 2005; *Investment & Pensions Europe*, May 2005; http://www.aftenposten.no/English (Online site for *News from Norway*), May 20, 2005; *Global Insight Daily Analysis*, May 23, 2005; *AFX International Focus*, May 27, 2005.

# The Americas

## Argentina

**A recent decision by the Argentina Supreme Court could cost the government 14.7 billion pesos (US$5 billion), or 3 percent of gross domestic product, in additional pension payments.** On May 17, the court ruled that a termination of indexing pensions in 1991 was illegal and that the plaintiff is entitled to a retroactive increase in her benefit. The decision sets a legal precedent for about 1,000 pensioners who currently have lawsuits before the supreme court and another 56,000 cases filed in the lower courts. In addition, another 800,000 retirees could be eligible, but they have not yet filed suit against the government.

The case challenged the decision in 1991 by the Menem government to stop indexing pensions to changes in wages on the grounds that the newly enacted convertibility law, which pegged the peso to the U.S. dollar, prohibited indexation. However, the court found that the convertibility law contained no specific language regarding the indexation of pensions and ruled that the plaintiff is entitled to a retroactive adjustment for the period between 1991 and 1994, when a new pension system was implemented.

Today, Argentina's retirement system consists of a basic flat-rate benefit that is combined with an earnings-related portion from the pay-as-you-go public system and a choice between a privately managed individual account and an earnings-related benefit from the public system.

**Sources:** Social Security Administration, *Social Security Programs Throughout the World: The Americas, 2003* (Washington, DC: SSA, March 2004), available at http://www.socialsecurity.gov/policy/docs/progdesc/ssptw/2002-2003/americas/index.html; *La Nación* (Argentina), May 17, 2005; Dow Jones International News, May 18, 2005; OsterDowJones Commodity Wire, May 18, 2005; http://www.forbes.com, May 19, 2005.

## Canada

**On May 19, the Canada Pension Plan (CPP) investment fund reported an 8.5 percent rate of return for fiscal 2005, an investment gain of C$6.3 billion (US$5.0 billion).** This year's return is down from last year's rate of 17.6 percent. (See the April 2004 issue of *International Update*.) However, the inflation-adjusted 5-year average return for the CPP fund stands at 4.48 percent, which is higher than the 4.1 percent necessary to maintain the government's pension fund over the long term.

The CPP Investment Board also announced that it will increase its domestic and foreign real estate and infrastructure holdings from the current level of C$1 billion (US$791 million). According to board president and CEO, David Denison, "[This will] enable us to invest in areas that traditionally have delivered attractive long-term returns that rise in line with inflation." Today, the CPP investment fund holds assets of approximately C$81 billion (US$64 billion).

The CPP is a compulsory, earnings-related pension program that operates on a pay-as-you-go basis. The payroll tax rate of 9.9 percent is higher than necessary to fund current benefits, and the excess taxes are invested to partially prefund future benefits. Beginning in 2022, benefit payouts are projected to exceed payroll taxes, at which point CPP assets will be used to cover the shortfall.

**Sources:** Canadian Press, May 19, 2005; *Leader-Post (Saskatchewan)*, May 20, 2005; *National Post (Ontario)*, Financial Post and FP Investing, May 20, 2005.

## Panama

**The government has agreed to temporarily suspend the social security reform law that the National Assembly passed on June 1 following a month of nationwide protest.** Some 30,000 strikers have virtually paralyzed construction and the operation of public hospitals and schools. The law would raise the retirement age and increase the contribution rates and the number of years required to qualify for a pension. President Torrijos has agreed to suspend the reform for 90 days and to begin a dialog with the unions, business leaders, and retirees, mediated by the Catholic Church.

Without reform, it was predicted that the Social Insurance Fund would go bankrupt by 2012, but according to President Torrijos, these measures would guarantee the program's solvency for at least the next 40 years. Analysts expected that the reforms would improve Panama's credit rating and could enable the government to proceed with its plans to widen the

Panama Canal (provided the expansion is authorized by a referendum).

The reform measure contains almost 200 provisions that affect all the programs run by the Social Insurance Fund: old age, survivors, disability, sickness, maternity, and work injury. The key changes to the pay-as-you-go pension program include

- Raising the retirement age for men from 62 to 65 years and for women from 57 to 60 by 2015 (the age for women was lowered from 62 in the original bill, as an apparent concession to the protestors);
- Increasing the number of required years of contributions from 15 to 20 by 2010;
- Increasing the overall contribution rate for workers from 7.25 percent to 9 percent of earnings and for employers from 10.75 percent to 13.25 percent of payroll by 2010;
- Raising the amount of contributions by broadening the definition of earnings to include such categories as bonuses, commissions, and vacations;
- Requiring the self-employed (both Panamanians and foreign workers) to participate in the system (until now, participation has been voluntary); and
- Introducing stricter sanctions for noncompliance and underreporting of income.

As a concession to the protestors, the government had agreed to add two other provisions for transitional benefits: retirement in 2007 for men aged 63 and women aged 58 who have 20 years of contributions, and a pension proportional to the number of years of contributions for those who reach retirement age without the minimum required number of monthly payments.

The Social Insurance Fund was created in 1941. Today, it has about 700,000 contributors and pays pensions to nearly 145,000 retirees. Currently, only 8 percent of the population is over 60, but that proportion is expected to triple to 24 percent by 2050.

**Sources:** United Nations, *World Population Ageing, 1950–2050* (New York: UN, Department of Economic and Social Affairs, Population Division, 2002); Associated Press, May 18, 2005; Reuters News, May 18, 2005; http://www.prensa.com, May 19 and June 1, 2005; Dow Jones International News, May 24, 2005; AP Worldstream, May 26, 2005; Latinnews Daily, May 31 and June 1, 2005; Reuters AlertNet, June 1, 2005, available at http://www.alertnet.org; EFE News Service, June 22 and 25, 2005; Europa Press—Servicio Latinoamericano, June 27, 2005.

# Reports

## The World Bank

**The World Bank has issued a report *Old-Age Income Support in the 21st Century: An International Perspective on Pension Systems and Reform* that recommends a five-pillar framework for public pension reform.** The Bank has taken its experience in pension reform in more than 80 countries, including the emerging economies of Eastern Europe and the developing countries of Asia, Africa, and Latin America, and developed a series of best practices for future pension reform initiatives.

More than a decade ago in its policy research report *Averting the Old Age Crisis*, the Bank outlined a three-pillar concept that comprised (1) a mandated, unfunded, publicly managed defined benefit system; (2) a mandated, funded, privately managed defined contribution system; and (3) voluntary retirement savings. The Bank has now added two additional pillars: a "zero pillar," which would be a publicly provided, noncontributory benefit to deal more explicitly with poverty, particularly for workers outside the formal labor market; and a "fourth pillar" to improve access to health care and housing through informal intrafamily or intergenerational support.

**Sources:** Robert Holzmann and Richard Hinz and Bank staff, *Old-Age Income Support in the 21st Century: An International Perspective on Pension Systems and Reform* (Washington, DC: World Bank, May 2005); World Bank, *Averting the Old Age Crisis: Policies to Protect the Old and Promote Growth* (New York: Oxford University Press and World Bank, September 1994).

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Editor: Susan A. Carleson.

Writers/researchers: Barbara E. Kritzer, David Rajnes, and Craig Romm.

**Social Security Administration**
Office of Policy
Office of Research, Evaluation, and Statistics
500 E Street, SW, 8th Floor
Washington, DC 20254

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