Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

October 2003

Europe

France

The parliament voted in July to approve a pension reform plan that will bring public-sector employees, who account for more than 25 percent of the workforce, into line with those in the private sector. The plan requires that, by 2008, public-sector employees will have to work 40 years instead of the current 37.5 years to qualify for a full pension. After 2008, the length of time will be adjusted periodically to take into account the increase in life expectancy.

Consuming over 11 percent of gross domestic product, the French system is one of the most expensive in Western Europe. Nearly three-quarters of the French retire by age 60, and their pensions typically replace 70 percent of pre-retirement earnings for full-time workers. Reform measures in the private sector aim to reduce incentives for early retirement before age 55. The process of gradual early retirement (available before age 60) will be abrogated on January 1, 2005, and to encourage later retirement, beginning in 2004 a delayed retirement credit of 3 percent will be applied to any covered year worked after age 60.

Earlier this summer, strikers attempted to thwart the reform by bringing public transportation to a halt. However, passage of the reform was bolstered when the general public lost patience with the striking workers and the plan gained the support of the country's biggest union.

Sources: Euro Pension Bulletin, August 2003; Christian Science Monitor, July 29, 2003; The 2003 Aging Vulnerability Index, Watson Wyatt Worldwide.

Germany

New public pension reform proposals were released in September. Among the major actions recommended by the "Rürup Commission," so named for its Chair, economist Bert Rürup, were the following:

- Increasing the pension age by one month per year between 2011 and 2035, from 65 to 67.
- Introducing a "sustainability factor" by automatically reducing benefits in line with declines in the number of people who pay into the pension system. (Today there are about four working-age people in Germany for every person aged 65 or older. By 2040, the ratio is expected to be only 2 to 1.)
- Increasing subsidies for individual and occupational pension schemes, already launched in 2002, to increase the pick-up rate.

Germany's sluggish economic growth, aging population, and falling birth rate have made pension and health care reform essential. Efforts to develop proposals date back to 1992, and even though some revisions were put into law in 2001, their implementation has been hindered by long-standing reform deadlock.

The fate of these proposals is uncertain. They are causing intense strain within the ruling Social Democrat-Green coalition. Moreover, the opposition controls the Bundesrat (upper house), and its cooperation is essential. Commentators think that small changes such as the sustainability factor and a delay in benefit increases will probably pass in the end, but raising the retirement age is more problematic. Current polls find that 86 percent of the public opposes such a change. Already Chancellor Schröder has indicated that the Rürup report "is not the Bible."

Sources: European Interests (Issue 2), 2003; Deutsche Bank Research, September 2003; Federal Ministry of Health and Social Security, September 2003; Mannheim Research Institute, June 2003; FIAP, August 2003; Michigan Retirement Research Center, August 2003.

Italy

Italy's three largest labor unions called for a four-hour strike for October 24 to protest a government plan to reform the country's overburdened public pension system. The decision to strike was made after meeting with Prime Minister Silvio Berlusconi on September 29. Berlusconi's government has agreed on a pension reform plan that includes increasing the mandatory retirement age and raising the required number of years worked to collect a full pension. Starting next year, the government's plan

focuses on giving workers incentives to delay their retirement and on shifting money from the nearly bankrupt state pension system into private pension plans. Beginning in 2008, the plan would abolish so-called seniority pensions, which currently allow Italians to retire at age 57 if they have worked 35 years. Italians would be allowed to retire only if they had worked for 40 years or had reached age 60 for women and 65 for men.

Italy's public pension system consumes over 12 percent of gross domestic product. It is one of the most expensive in Western Europe and is generally the only source of retirement income.

Despite the trade unions' outrage, the plan has been criticized by Italian industrialists and independent economists as not being radical enough. Berlusconi's attempt to scale back Italy's pension system in 1994 resulted in more than a million protesters in the streets and contributed to the fall of his first government.

Sources: Financial Times, October 1, 2003; Dow Jones Business News, September 30, 2003; Bloomberg, September 29, 2003; Center for Strategic and International Studies and Watson Wyatt Worldwide, The 2003 Aging Vulnerability Index, March 2003.

Slovakia

Slovakia has approved the first phase of its pension reform, to be implemented in 2004. The new social insurance law reforms the pay-as-you-go (PAYG) system by:

- Gradually increasing the retirement age to 62 for both men and women (currently 60). Those who work after these ages will receive a higher benefit.
- Eliminating both the maximum pension and the state-guaranteed minimum pension.
- Pegging the annual adjustment of benefits to the increase in the cost of living and the growth of the average wage (currently Parliament determines any increase).
- Changing the benefit formula to reflect contributions and years worked (currently based on years worked only).
- Basing contribution rates on the average wage instead of earnings while lowering rates for workers with dependent children.

Parliament is set to vote in October on the next phase of the reform, which will include setting up a second pillar with individual accounts managed by private companies.

Sources: CTK Business News, September 25, 2003; TASR, September 25, 2003; SITA, September 25, 2003; The Slovak Spectator, September 29 to October 5, 2003.

The Americas

Chile

Last month, the government of Chile announced the one-year investment returns from broadened investment options under its system of individual social security accounts—with the results averaging 7.7 percent in the widely held C fund.

Ever since the 1981 pension reform, Chilean workers have been required to contribute a percentage of their earnings to an individual account with a pension fund management company (AFP) of their choice. Until recently, however, AFPs could offer most account holders only one fund, and their investments were strictly limited under law. At the beginning, investments consisted mainly of government bonds and bonds issued by financial institutions. Over time, limits have been gradually eased, and by early 2002 the relative mix included mostly government bonds and some domestic stocks and bonds and international securities.

Beginning in August 2002, these restrictions were substantially lifted. Chilean pension fund management companies now must offer four funds with varying degrees of risk—called simply, Funds B, C, and D, and E—and have the option of offering Fund A. "A" funds may hold a maximum of 80 percent equities, while B, C, and D funds have maximum equity holdings of 60, 40, and 20 percent, respectively.

Account holders may allocate their contributions between two different funds within one AFP in whatever proportion they choose. Those who do not choose a fund, or do not actively contribute to their account, are automatically placed in a fund according to their age. As of August 2003, 60 percent of account holders participated in Fund C, and about 30 percent were in Fund B. Of the funds, C and B have the highest percentage of total assets, at 69 percent and 13 percent respectively.

The table below shows the real rate of return (before deducting administrative fees) and the relative mix of foreign and nongovernment domestic assets in each of

	Real rate of return (September 2002 to August 2003)	Nongovernmental investments in fund as percentage of total	
		Domestic	Foreign
Fund A	20.7	44.54	44.63
Fund B	11.6	50.51	29.65
Fund C	7.7	51.06	20.90
Fund D	6.5	47.31	16.52
Fund E	4.0	43.29	10.81

the five funds. In comparison, rates of returns under Fund C—previously, the only fund available to most account holders—averaged 10.3 percent during July 1981 to August 2003.

Source: SAFP Chile, September 2003.

Mexico

Mexican pension funds are set to invest in stocks beginning in 2004. The Mexican pension system, set up in 1997, has gradually been broadening the types of allowable investments. Until now, investments have been mostly limited to government instruments, but beginning with the first half of 2004, pension fund management companies will be allowed to invest in stocks. In the first year, up to 10 percent of assets may be held in foreign securities. Specific rules should be in place by the end of 2003.

Currently Mexico has 12 pension fund management companies and about 30 million account holders, representing about 72 percent of the economically active population. Approximately 42 percent of the account holders actively contribute to their individual account; total assets are about 5 percent of gross domestic product.

Source: Reuters—Noticias Latinoamericanas, September 9, 2003; AIOS, December 2002; FIAP, September 2003.

Nicaragua

Nicaragua's new pension system is set to begin operation in June 2004, 2 years after the original implementation date. Under the new mandatory "pension saving system," employers and employees will contribute a percentage of earnings to an individual account managed by a pension fund management company (administradora de fondos de pensiones, or AFP).

To date, the Superintendent of Pensions has received requests from five groups interested in forming AFPs. These groups have 65 days to present their business plan, including investment strategy, internal processes of risk regulation, and investment controls. The Superintendent must evaluate these proposals and issue licenses within 45 days. Once the AFPs receive authorization, they have up to 6 months to register individual accounts, structure their organization, and begin operation. Superintendent Ramiro Sacasa anticipates that at least two AFPs will be authorized by the end of the year. It is yet to be decided how much the Nicaraguan Social Security Institute will be allowed to charge for collecting the pension contributions.

Sources: Boletín FIAP, August 2003; The Fund Pro Latin America, September 7, 2003; Law 340; Business News Americas, September 3, 2003.

Asia and the Pacific

India

October 2 is the official date for major overseas multinational companies to take over the management of India's government pension fund, which for the past 40 years has been managed by the government-owned Life Insurance Corporation of India (LIC). The Confederation of Indian Industry, a longtime advocate of privatization, predicts that the initial market size could reach 20 million accounts from the government and private sector. India's major opposition parties and trade unions have been opposed to the change. Private pension fund management will be applicable only to new entrants in the job market, who by 2033 are projected to number around 79 million. Pensions will be taxable and will be funded by employee contributions, changing a system introduced in 1871. Eighteen of 25 federal states in India offer social security to the elderly below the poverty line, but the amounts are very insignificant—between $1 and $2 a month.

With 79.5 million people over age 60 among its urban population, India ranks second only to China in the size of its geriatric population. It is estimated that unless retirement ages are raised, more than 300 million people will be eligible for pensions by 2030.

Among those waiting in line to enter the Indian pension fund market are the Pennsylvania-based Vanguard Group, with assets worth $500 billion, and State Street Corporation, with more than $8.5 trillion in assets under custody and more than $901 billion under management.

Source: Asia Times, September 15, 2003.

Israel

The recently approved 2004 state budget cuts social welfare benefits by an additional NS1.1 billion (about $247 million) and includes a clause that requires employees taking early retirement to pay the full tax rate on pension payments they receive prior to reaching full retirement age. To date, men who retired at 60 and women who retired at 55 enjoyed the reduced tax rates that cover regular retirees.

Source: Haaretz Daily, September 8 and 16, 2003.

Japan

Japan plans to overhaul its public pension system by April 2004. Official estimates indicate that the number of people aged 65 or older will swell from 18 percent in 2001 to almost a third of the population by 2025. Chikara Sakaguchi, Japan's health minister, has proposed raising employee pension contributions from 13.58 percent of annual income to 20 percent around 2022. Sakaguchi also said that the government's share of contributions to basic pension plans should be raised from a third to a half—a cost of about 2.8 trillion yen starting in 2004—and suggested that Japan consider drawing on the country's pension reserves of 104 trillion yen (about $1.2 trillion).

According to a recent Bank of Japan survey, more than half of Japanese households reported that their savings fell in 2003, while the number of families with no savings at all rose to a 40-year high of 22 percent. The National Pension Fund Association recently announced a negative yield of 14.5 percent on assets under management in fiscal year 2002—the worst since 1991 and the third consecutive year of negative returns. The decline was validated by a recent report from Greenwich Associates, which noted that unfunded liabilities for employee pension funds are far larger than for those of U.S. corporations: assets cover 62 percent of future pension obligations in Japan compared with 103 percent in the United States.

Sources: Financial Times, September 8 and 23, 2003; Bloomberg, September 6 and 23, 2003.

Philippines

Beginning March 1, 2003, the monthly social security contribution rate for Philippine employers increased from 5.07 percent to 6.06 percent—the first adjustment in the rate in more than 20 years. The contribution rate for employees did not change. This increase was sought to ease strains on the fund caused by the fact that contributions are being outpaced by growing benefit claims.

Source: Watson Wyatt Global News Brief, February 2003.

Singapore

In an effort to boost economic competitiveness, Singapore has reduced employer contributions to its mandatory individual savings accounts, the Central Provident Fund (CPF), from 16 percent to 13 percent of wages, effective October 1. Employee contributions will remain at 20 percent.

This action was in response to jobs and investments migrating to countries such as China and India, where the "low cost of doing business is extremely attractive to investors," according to Prime Minister Goh Chok Tong. Reducing employer contributions to the CPF is seen as a major step in improving the country's economic competitiveness.

Although the CPF was originally intended as a source of retirement income, Singaporeans have been encouraged to tap into CPF savings for a variety of government-approved purposes such as housing purchases, health and educational needs, and recommended investments. Some observers foresee a potential negative chain effect from the reduced savings.

Sources: Mukul Asher, "The Pension System in Singapore," 1999; "From the Valley to the Highlands," Prime Minister Goh Chok Tong's National Day Rally Speech, 2003; "Retuning the CPF," Ministerial Statement by Prime Minister Goh Chok Tong in Parliament, August 28, 2003; news clippings from The Straits Times (mid-August to mid-September 2003) and The Edge Singapore (August 25, 2003).

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