GAO
Accountability·Integrity·Reliability

Highlights

Highlights of GAO-05-810T, a report to Subcommittee on Social Security, Committee on Ways and Means, House of Representatives

Why GAO Did This Study

Many countries, including the United States, are grappling with demographic change and its effect on their national pension systems. The number of workers for each retiree is falling in most developed countries, straining the finances of national pension programs, particularly where contributions from current workers fund payments to current beneficiaries—known as a "pay-as-you-go" (PAYG) system. Although demographic and economic challenges are less severe in the U.S. than in many other developed countries, projections show that the Social Security program faces a long-term financing problem. Because some countries have already undertaken national pension reform efforts to address demographic changes similar to those occurring in the U.S., we may draw lessons from their experiences.

The Chairman of the Subcommittee on Social Security of the House Committee on Ways and Means asked GAO to testify on preliminary results of ongoing work on lessons learned from other countries' experiences reforming national pension systems. GAO focuses on (1) adjustments to existing PAYG national pension programs, (2) the creation or reform of national pension reserve funds to partially pre-fund PAYG pension programs, and (3) reforms involving the creation of individual accounts.

www.gao.gov/cgi-bin/getrpt?GAO-05-810T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Barbara D. Bovbjerg at (202) 512-7215 or bovbjergb@gao.gov.

June 16, 2005

SOCIAL SECURITY REFORM

Preliminary Lessons from Other Countries' Experiences

What GAO Found

Based on preliminary work, all countries in the Organisation for Economic Co-operation and Development (OECD), as well as Chile, have, to some extent, reformed their national pension systems, consistent with their different economic and political conditions. While reforms in one country may not be easily replicated in another, their experiences may nonetheless offer lessons for the U.S. Countries' experiences adjusting PAYG national pension programs highlight the importance of considering how modifications will affect the program's financial sustainability, its distribution of benefits, the incentives it creates, and public understanding of the new provisions. Nearly all of the countries we are studying reduced benefits, and most have also increased contributions, often by increasing statutory retirement ages. Countries included provisions to ensure adequate benefits for lower-income groups, though these can lessen incentives to work and save for retirement. Also, how well new provisions are implemented, administered, and explained to the public may affect the outcome of the reform.

Countries with national pension reserve funds designed to partially pre-fund PAYG pension programs provide lessons about the importance of early action and sound governance. Funds that have been in place for a long time provide significant reserves to strengthen the finances of national pension programs. Countries that insulate national reserve funds from being directed to meet other social and political objectives are better equipped to fulfill future pension commitments. In addition, regular disclosure of fund performance supports sound management and administration, and contributes to public education and oversight.

Countries that have adopted individual account programs—which may also help pre-fund future retirement income—offer lessons about financing the existing PAYG pension program as the accounts are established. Countries that have funded individual accounts by directing revenue away from the PAYG program while continuing to pay benefits to PAYG program retirees have expanded public debt, built up budget surpluses in advance, cut back or eliminated the PAYG programs, or some combination of these. Because no individual account program can entirely protect against investment risk, some countries have adopted individual accounts as a relatively small portion of their national pension system. Others set minimum rates of return or provide a minimum benefit, which may, however, limit investment diversification and individuals' returns. To mitigate high fees, which can erode small account balances, countries have capped fees, centralized the processing of transactions, or encouraged price competition. Although countries have attempted to educate individuals about reforms and how their choices may affect them, some studies indicate that many workers have limited knowledge about their retirement prospects.