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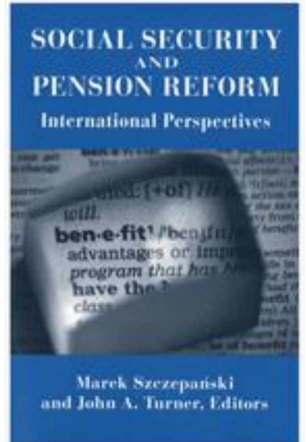

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Social Security and Pension Reform

International Perspectives

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2
Social Security and Pension Trends around the World

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Retirement income systems are in a state of change. Increasing longevity and declining birth rates cause population aging and put pressure on retirement income financing. For this reason, countries around the world are reforming their retirement income systems of pensions and social security old-age benefits. Changing views about the provision of retirement income and innovations in program design are also influencing the trends.

This chapter surveys trends in social security and pension programs around the world. It first discusses social security reforms and mandatory individual account programs, and then discusses reforms of employer-provided pension plans.

SOCIAL SECURITY AND MANDATORY INDIVIDUAL ACCOUNT PROGRAMS

Social security programs and mandatory individual account programs are considered together as part of government mandated provision for retirement.

Raising Retirement Ages

With people living longer in many parts of the world, the cost of providing social security and pension benefits in traditional pen-

sion systems is increasing because those benefits are being provided for more years. To offset this cost increase, many countries in Europe, Eastern Europe, and elsewhere have legislated increases in the early retirement age for social security benefits, sometimes called the eligibility age or minimum age for retirement. That is the earliest age at which social security retirement benefits can be received. Often those increases are legislated to occur a number of years into the future, or are phased in over a number of years. In some countries, changes have also occurred in the age at which the worker can receive a full benefit, but those changes are more aptly described as changes in benefit generosity, rather than changes in retirement ages.

Japan is raising the eligibility age for both of its social security programs (Rajnes 2007). Japan passed legislation in 1995 that raised the eligibility age for its flat rate pension (National Pension) by one year every three years, with it increasing from age 60 to 61 in 2001 and reaching 65 in 2014. Based on legislation passed in 2000, Japan is raising the eligibility age for its earnings-related pension (Employees' Pension Insurance) by one year every three years starting in 2013. With these changes, men born after 1960 and women born after 1965 have a retirement age for both programs of 65 by 2025 for men and 2030 for women.

New Zealand raised its eligibility age from 60 in 1991 to 65 in 2001. Those workers who turned 60 before March 31, 1992, were eligible for a social security benefit at age 60. The legislation, which passed August 1, 1991, took effect the following April, when eligibility increased from age 60 to 61. Beginning July 1, 1993, eligibility rose by three months for each six-month period until April 1, 2001, when the eligibility age reached 65. Thus, a five-year increase in the eligibility age phased in over nine years. A Transitional Retirement Benefit was paid over this period to those affected by the changes, with the age of eligibility for this benefit also rising until it was phased out on April 1, 2001.

Some Organisation for Economic Co-operation and Development (OECD) countries have had a longstanding eligibility age of 65, and some are raising the eligibility age even higher. In Australia, Austria, Germany, Switzerland, and the United Kingdom, the eligibility age for men has been 65 since at least 1949. In 2012, the Netherlands passed a law that will raise the retirement age in 2020 from 65 to 66. In Ireland, starting in 2014, the age of entitlement for social security benefits will

be raised from 65 to 66. In Australia, it will be gradually rising to 67 from 2017 to 2023 for both men and women.

Some countries have had a higher eligibility age in social security in the past than they do currently. In 1913, when social security was introduced in Sweden, the eligibility age was 67 (Lindquist and Wadensjö, this volume). The eligibility age in the United States was 65 in 1940 but now is 62.

In Central and Eastern Europe, a number of countries—Bulgaria, Croatia, the Czech Republic, Estonia, Latvia, Hungary, and Poland—are increasing their retirement eligibility ages as a move toward insuring the solvency of their social security systems. In 2012, Latvia enacted legislation raising the eligibility age for social security benefits from 62 to 65, rising by three months a year, and reaching 65 in 2025 (U.S. Social Security Administration 2012).

Some low-income countries in Africa retain low benefit eligibility ages for social security benefits. For example, the early retirement age is 50 in Swaziland. However, some high-income countries also have low eligibility ages. In Kuwait, the retirement age is 50, but it is increasing to 55 by 2020.

Equalizing Benefit Eligibility Ages for Men and Women

Many countries historically have had lower early retirement ages for women than for men. However, many of these countries have equalized the ages for men and women by raising over time the early retirement age of women so that it reaches the level for men. China, Cuba, Vietnam, and the former communist country of Russia are among the countries that maintain lower early retirement ages for women than men.

Changes to Encourage Later Retirement

Many countries have enacted changes other than increases in early retirement ages to encourage later retirement. Among OECD countries, the Czech Republic, Denmark, Finland, France, Greece, Hungary, Poland, and Spain have enacted tighter requirements to qualify for early retirement benefits (Whitehouse and Antolin 2012). In Canada in 2012, an earlier enacted change took effect, raising benefits for workers who

postpone taking benefits past age 65, cutting them for workers who retire before age 65, and introducing a new benefit for workers who are still working. Bulgaria in 2012 also raised benefits for workers postponing retirement. In 2012, Denmark scaled back its government-subsidized program providing early retirement benefits. Sweden has instituted income tax credits for workers aged 65 and older. Portugal has reduced social security contributions for workers aged 65 and older. France has increased the actuarial reduction of benefits for early retirement. In Kenya, pension benefits received at age 65 or older are tax free, in order to encourage postponement of receipt of those benefits.

In raising the retirement age, one option is to provide for early retirement for workers who have worked for many years. Some countries with special early retirement benefits have raised the number of years required to be eligible for those benefits. France has raised the number of years from 37.5 to 40, while Belgium has raised the number of years from 20 to 35 (U.S. Government Accountability Office 2005).

In 2011, Spain passed a law that increased incentives for older workers to remain in the labor force. An innovative aspect of this reform is that the incentives are greater for workers with more years of service. For workers with less than 25 years of service, for every year an individual continues working beyond the full retirement age, the incentive will remain at 2 percent; from 25 to 36 years, 2.75 percent; and 37 or more years, 4 percent. Some countries encourage work at older ages by reducing the social security contribution rate. In Portugal, the rate the employee pays has dropped from 11 percent to 8 percent since 2009.

Retrenchment in Traditional Social Security Programs

A number of countries have cut back on the generosity of their social security benefits, resulting in falling income replacement rates in old age. These countries include France, Japan, Sweden, Greece, South Korea, and the United States. Among OECD countries, cutbacks in benefit generosity have typically reduced future benefits between one-fifth and one-quarter (Whitehoues and Antolin 2012).

Sometimes the cutback is expressed in another way, perhaps to reduce the political reaction to the change. For example, one way to cut benefits is to postpone access to full benefits to a later age, coupled

with actuarial reductions in benefits received at an earlier age. This approach has been used by Germany, Italy, Japan, Switzerland, and the United States. The United States has reduced benefits at the eligibility age by raising the Normal Retirement Age from 65 to 67 over the period 2000–2022.

Many countries have reduced benefits in traditional social insurance old-age benefits programs by increasing the years used in the earnings averaging period for calculating benefits. Spain has done so, resulting in more years of relatively low earnings being included, lowering average earnings in the benefit calculation. Finland, Austria, France, Italy, Greece, and the United Kingdom have also increased the number of years used in benefit calculation. In Italy, the increase was from the worker's last five years of earnings to lifetime earnings. Portugal increased the number of years from 10 years to all years of work. However, it also defined a transitional period, from 2002 to 2016, during which the most favorable method of calculation—the former, the latter, or a weighted average of both—could be applied in order to guarantee beneficiaries the most favorable rule to determine the pension level. In 2007, it subsequently passed a law that shortened the transitional period (See Murteira, this volume).

Benefits can be reduced by changing the calculation of cost-of-living adjustments. Germany and Japan have both moved from basing postretirement benefit adjustments on the growth of net wages rather than gross wages. With the growth of taxes and social security contribution rates, net wages grow less rapidly than gross wages. Reductions in cost-of-living adjustments reduce benefits more at older ages than at younger ages because for each retiree, the effect of the cuts is cumulative over the time period since retirement.

Countries with traditional benefit formulas have a parameter in those formulas that determines the generosity of the rate at which future benefits accrue with additional work. Japan, Norway, and Portugal have cut future benefits by reducing the benefit accrual rate in the benefit formula. For example, Japan cut the accrual rate from 1 percent per year of work to 0.7125 percent (U.S. Government Accountability Office 2005). Austria has reduced the accrual rates used to calculate the initial benefit from an annual rate of 2 percent to 1.78 percent starting in 2009.

Benefit Reductions That Affect Current Retirees

Traditionally, social security benefit cuts have been targeted so that they did not affect people who were already receiving benefits because those people were considered to be particularly vulnerable. Because of their age, for many returning to work to offset the benefit cuts was not an option. That policy of protecting current beneficiaries has changed in some countries.

In most countries, benefits in payment are indexed so that they at least keep pace with the rate of inflation and thus maintain their real (inflation-corrected) value during retirement. Greece and Norway have cut benefits by reducing the indexing of benefits in payment. Sweden's automatic adjustment mechanism can involve a reduction in indexing of benefits in payment so that it is less than the rate of inflation.

Increasing Contribution Rates

Some countries have raised contribution rates, particularly countries that have relatively low contribution rates, but increases are not limited to those countries. Kenya is an example (Turner, this volume). Contribution rates have been increased in many OECD countries, including Denmark, Finland, France, and Sweden. They have also increased in some countries with mandatory individual accounts and mandatory pensions, such as Mexico, Singapore, and Australia. Australia is raising further its contribution rate for its mandatory pension system from 9 percent to 12 percent (Clare, this volume).

Increasing the Contribution Base

Social security contributions can be increased by raising the contribution base rather than raising the contribution rate. Countries that have completely eliminated the ceiling on taxable earnings for social security financing include Finland and Norway. In 2001, Ireland eliminated the ceiling on taxable earnings for social security for employer contributions. The United Kingdom also requires employers to pay social security taxes on employee earnings without a ceiling on those earnings. Some countries have expanded the range of earnings included in taxable earnings. Japan, for example, included the twice-yearly bo-

nuses in taxable earnings. France, in addition to raising the contribution rate, increased the contribution base to include employer contributions to occupational pension plans.

New Revenue Sources

Some countries have decided that they cannot raise the payroll tax any further. For example, Japan has been concerned about the effects of increases in the payroll tax, which would raise labor costs, on the international competitiveness of its workforce. By comparison, however, China, which has large trade surpluses, has a social security tax rate that varies across provinces but averages 28 percent (Chen and Turner, this volume), substantially higher than in Japan.

In 2012, Japan legislated an increase of its value added tax (VAT) from 5 to 10 percent, starting in 2014, with the increased revenue being used to finance its social security program. Although all OECD countries use contributions from employers and employees to finance social security old age benefits, nearly all those countries also use general revenue funding. France has levied a tax of 1 percent on all income that is dedicated to financing old-age benefits (U.S. Government Accountability Office 2005). More recently, Portugal in 2012 levied a tax on pensions of more than 1,500 euros per month.

Unification of National Social Security Systems

When social security systems were started they often excluded certain groups, such as government workers, workers in particular industries that already had good pensions, or workers in industries with low wages, such as agriculture. Some countries developed multiple pension systems to cover different workers. Reforms in the United States, Chile, Nigeria, and Greece have expanded the coverage of national social security systems to include more groups of workers, in the process unifying. Part of this movement has been a trend to include government workers in the national social security program. Thailand is currently phasing out some special programs for government workers. In 2011, China established a national unified social security system for urban workers, which facilitates workers moving between different parts of the country (Chen and Turner, this volume). In Africa, Cape

Verde, Sierra Leone, Ghana, Nigeria, and Zambia have all consolidated their social security programs for formal sector workers (Republic of Kenya 2012).

Ending Provident Funds

Provident funds are defined contribution plans that typically provide lump sum benefits and have a single investment pool for all participants. These types of plans were established in many countries that were formerly British colonies or British protectorates, in part because of their simplicity. Provident funds were established in most of the former British colonies or protectorates in Africa—Gambia, Ghana, Kenya, Nigeria, Seychelles, Swaziland, Tanzania, Uganda, and Zambia. Swaziland retains such a plan; however, many countries, including Ghana, Nigeria, and Tanzania, have ended those plans and switched to social insurance types of plans. Kenya and Uganda in 2012 were considering converting their provident funds to defined contribution pensions, rather than to a defined benefit social insurance pension (Turner, this volume). Nigeria subsequently switched to a mandatory individual account system. In the Caribbean, the Bahamas, Saint Kitts and Nevis, and Saint Vincent and the Grenadines are among countries that converted a provident fund to a traditional defined benefit social security program (Gillion et al. 2000).

Social Security Privatization with Mandatory Funded Individual Accounts

Most countries provide social security benefits through traditional defined benefit pay-as-you-go systems (PAYG) based on principles of social insurance. However, many countries in Latin America, Central and Eastern Europe, and elsewhere have added mandatory individual accounts as a component of their social security programs. One of the motivations for social security privatization was the belief that this innovation would lead to a closer connection between contributions and benefits, which would lead to less distortion of incentives in labor markets.

In 1981, Chile was the first country to privatize its social security program with mandatory individual accounts. Chile completely ended

its PAYG system for private sector workers, replacing it with an individual account system, while most other countries that followed it cut back on the PAYG system and combined it with a mandatory individual account system. Since 1990, 10 other countries in Latin America have followed Chile (Kritzer, Kay, and Sinha 2011). The first countries following Chile to switch to individual accounts (with the year implemented) were Peru (1993), Colombia (1993), Argentina (1994), Uruguay (1996), and Mexico (1997). These were followed by two of the poorest countries in the region, Bolivia (1997) and El Salvador (1998). In 2008, Panama added mandatory individual accounts as part of social security for new entrants into the social security system.

Beginning in the late 1990s, following the fall of the Soviet Union, a number of countries that were part of the Soviet Union or that were in Central and Eastern Europe added mandatory individual accounts as part of their social security systems. Kazakhstan (1997), Hungary (1998), and Poland (1999) were early leaders, but they were followed by Bulgaria (2000), Latvia (2001), Croatia (2002), and Estonia (2002) (Szczepański and Brzęczek, this volume). Other countries include Bulgaria (2002), the former Yugoslav Republic of Macedonia (2003), Slovakia (2005), and Romania (2008) (Żukowski, this volume). In addition, Lithuania, the Czech Republic, Slovenia, and Russia have enacted reforms.

Mandatory defined contribution plans have also been introduced in countries in other regions, either in addition to or in replacement of existing traditional social security programs. In 2011, Thailand introduced the National Pension Fund as a mandatory defined contribution plan to supplement its traditional social security plan. In 2010, Egypt passed a law replacing its PAYG system with a system of mandatory individual accounts. In 2010, Brunei added mandatory individual accounts to its existing mandatory social security system. Between 1988 and 2008, 29 countries followed Chile and established a funded first pillar social security system (Holzmann 2012).

Retrenchment on Privatization

Some countries that enacted reforms privatizing social security by adding individual accounts have later cut back on those reforms, reducing or eliminating the contributions to privatized individual ac-

counts. Argentina ended its system of privatized individual accounts in 2008, while Bolivia nationalized its system of individual accounts in late 2010. Retrenchment has been more common in Central and Eastern Europe than in South America, in part because of the financial crisis there and the subsequent economic downturn. In Central and Eastern Europe, Poland, Latvia, Lithuania, Estonia, Romania, and Slovakia all retrenched their privatized systems in some way since 2010 (Fultz 2012). Starting in 2010, Hungary ceased funding for its second-tier program and returned most of the accumulated funds to the participants.

Retrenchment has occurred in part because of the double payment problem, where payments are being made into the new individual accounts, while payments are still required into the traditional PAYG system to pay the benefits promised from that system. Some governments have found that it was too expensive to pay for the existing PAYG system and for the new individual accounts, particularly in an economic downturn. In 2012, the Slovak Republic reduced the contributions to the mandatory individual accounts and transferred those contributions to the PAYG system. It also temporarily permitted workers to withdraw from the system.

In 1997, China established a multipillar reform, adding funded individual accounts to a PAYG system. However, it later decided not to fully fund those accounts, taking some of the money originally designated for the individual accounts and using it to finance the PAYG benefits. Those accounts now are more like notional accounts, with an unfunded liability arising due to their total liabilities exceeding their total assets (Chen and Turner, this volume).

It was initially thought that competition among service providers would reduce high fees in mandatory individual account systems, but that has not proved to be the case. The reason may be that participants are not sensitive to fees when choosing among service providers, perhaps because they do not understand how much fees can reduce future account balances.

Chile and Mexico have taken steps to reduce fees. In Chile, every two years a bidding process determines the lowest-fee pension fund provider. All new entrants must use that provider. Mexico has taken steps to increase competition among pension fund providers as a way to reduce fees. The United Kingdom has limited the maximum fees that can be charged on stakeholder pensions, which are a form of voluntary

individual account pension. Australia has introduced a low-cost fund as an alternative in its mandatory employer-provided pension system. The United States and the United Kingdom have taken steps to have more disclosure of fee information to pension participants.

Defaults to Deal with Decision-Making Problems

Defaults have been used in mandatory individual account systems for workers who do not wish to make an investment choice. For example, in the Swedish Premium Pension system, which is a mandatory individual account system, if a worker fails to choose an investment, the worker is placed in the default investment. In 2010, Sweden changed that default so that the risk of the portfolio varies by the age of the participant, with the percent invested in low-risk assets increasing as the participant ages. In Australia in the mandatory pension fund system, if an employer does not wish to choose a pension fund for its employees, it can use the default fund for employers in its industry. In New Zealand in the KiwiSaver program, workers who do not choose a pension provider are automatically enrolled in the employer's preferred plan, but if the employer has not chosen a plan they are randomly assigned to one of six default plans. In Peru, recent reform measures encourage more competition among AFPs (Pension Fund Associations) by assigning new labor force entrants to the AFP with the lowest administrative fee. From October through December 2012, all new entrants to the system of individual accounts were assigned to Prima, the pension fund management company (AFP) that offered the lowest administrative fee in the tender held in September.

Raising Limits on International Investments

Some countries have raised the limits on international investments allowed both for mandatory pension plans and for voluntary pension plans. A few countries have no limits on these investments. In 2008, Uruguay raised from 0 to 15 percent the limit on international investments in its mandatory individual account system, and Colombia raised its limit to 40 percent. In 2009, Brazil raised to 10 percent the limits on international investments for certain pension funds provided voluntarily by employers. In 2010 and 2011, Chile raised the limits on the

percentage of a pension fund's assets in its mandatory system that can be invested in international investments, with the limit reaching 80 percent in 2011. Peru raised the limit in its mandatory system to 30 percent in 2010. In Sweden in mandatory individual accounts, and in the United States in voluntary individual account defined contribution plans, individuals can invest entirely in international investments.

Notional Account Plans

In notional account or notional defined contribution systems (or nonfinancial defined contribution systems), each worker has an account, but the account is not fully funded, generally only having limited funding. Rather, it has a notional or accounting value for each participant. This system is essentially a PAYG system, though there may also be a reserve fund. A notional rate of return is assigned to each account. One of the motivations for this type of plan is that it attempts to make a closer connection between contributions and benefits, based on the view that such a connection may encourage workers to view the contribution not as a tax but as a payment for a future benefit. When Sweden reformed its social security system by enacting a notional account system, it extended the years taken into account in calculating benefits from 15 years to all years of work (Lindquist and Wadensjö, this volume).

Sweden, Poland, Latvia, Norway, and Italy—a diverse set of countries—have adopted this type of system. Egypt adopted this type of system in 2010, with implementation expected in 2013 (Holzmann 2012).

Automatic Adjustment Mechanisms

At least 12 countries have adopted automatic adjustment mechanisms as a way to maintain the solvency of their PAYG social security programs. In 1998, Brazil adopted life expectancy indexing of its social security benefits for private sector workers. At retirement age, the calculation of social security benefits takes into account the average life expectancy for the population at that age, with an annual updating of life expectancy at retirement age. Life expectancy is officially estimated by the annual household survey of the Brazilian Institute of Geography and Statistics.

Finland, Portugal, and Norway adjust the generosity of benefits received at retirement automatically for changes in life expectancy. Portugal passed legislation in 2007, introducing a sustainability coefficient in the benefit formula for calculating pensions. This coefficient equals the ratio between life expectancy in 2006 and life expectancy in the year preceding retirement. The level of statutory pension is multiplied by the coefficient, reducing the benefit level as life expectancy increases (Murteira, this volume). The August 2011 pension reform law in Spain required that a sustainability factor be introduced to the system in 2027 that will adjust the relevant parameters of the system to changes in life expectancy every five years.

In Sweden, life expectancy indexing of benefits is done by using an annuity divisor that reflects improvements in life expectancy at age 65. No further reductions in benefits for improvements in mortality occur after age 65. Thus, the life expectancy adjustment does not take into account life expectancy improvements that occur after age 65. It is expected that the failure to adjust for life expectancy improvements after retirement will be expensive, costing about 1 percent of payroll in contributions (Palmer 2000). The initial generation in the system will benefit from this feature, but subsequent generations will pay for it through the automatic adjustment process required to maintain solvency.

In Sweden, mortality experience is averaged over the previous five years to avoid year-to-year fluctuations that do not reflect longer-term trends. The Swedish system uses, as do the other systems, period mortality tables, which are mortality tables based on the experience of the cross section of older persons. For each birth cohort in Sweden, the annuity divisor adjustment is established at age 65, with a provisional adjustment made for retirements starting at age 61, which is the benefit entitlement age.

In addition to the automatic adjustment of benefits for longevity improvement, every year the Swedish government tests whether the system is in balance. If it falls out of balance, adjustments are automatically made to decrease benefits, without the intervention of elected government officials needing to decide what to do. Thus, automatic adjustment mechanisms reduce the political risk that no action will be taken until a crisis—rather, actions will be taken automatically, without the intervention of politicians.

In 2012, Greece adopted a pension system with a notional rate of return and an automatic adjustment mechanism to maintain solvency. Italy, Poland, and Latvia also have automatic life expectancy indexing in a notional account system. France in 2003 legislated an increase in the number of years of earnings required to receive a full pension from 40 to 41, rising by one quarter per year from 2009 to 2012. Thereafter, through 2020, the contribution period for full benefits will increase automatically as needed to keep the ratio of the contribution period to the average retirement period equal to its ratio in 2003, which is approximately two to one. This adjustment mechanism effectively results in a reduction in benefits that is tied to increases in life expectancy. The French government retains the right to not make these adjustments if labor market conditions, such as high unemployment, do not support the extra years of work.

In 2012, the Netherlands passed a law that will automatically adjust its normal retirement age for increases in life expectancy, starting in 2020. This provides an alternative approach for indexing benefits to improvements in life expectancy. Every five years, the government will assess whether life expectancy improvements have been sufficient to warrant an increase in the retirement age. According to projections, the retirement age will increase from 66 to 67 in 2025 and from 67 to 68 in 2040. Workers will still be able to receive benefits at age 65, but these changes in the normal retirement age result in a cut in benefits at that age by 6.5 percent for every one-year increase in the normal retirement age.

Japan, Germany, and Canada have also adopted different types of automatic adjustment mechanisms. While in many countries with automatic adjustment mechanisms the adjustments occur annually, in Canada, because of the stability of its long-term financing, it is expected that its automatic adjustment mechanism will be used rarely, if at all.

One issue with these mechanisms has been how automatic they actually were in practice, with Sweden, Germany, and Italy making changes to the adjustment mechanism when unpopular adjustments were required. In 2009, Germany passed a law that for the second consecutive year overrode the automatic adjustment mechanism.

National Savings Funds for Retirement Financing

Ireland, France, China, and New Zealand have introduced separate national savings funds, separate from their social security programs, for the purpose of prefinancing future social security benefits. Subsequently, however, some of these countries ended up drawing down these funds earlier than expected (Whitehouse and Antolin 2012). In Ireland, for example, the National Pension Reserve Fund was used to help bail out Irish banks in 2011 because of the financial crisis. In 2007, Argentina established a national social security sustainability fund to help guarantee the payment of future social security benefits. In 2008, Russia established the National Welfare Fund to help pay for future public pension benefits. Norway has a large national savings fund, one of the largest pension funds in the world (Mosionek-Schweda, this volume).

Extending Coverage to More Workers

The majority of workers around the world, particularly outside of the high-income countries, lack social security coverage. This is one of the key problems facing social security programs, particularly for middle- and lower-income countries. On average, social security programs in Africa only cover 10 percent of workers (Gillion et al. 2000), partly because many workers are employed in the informal sector, which many social security programs do not cover. Part of the reason also is that many workers who should be covered by law are not participating because of contribution evasion, which is the failure of employers and workers to make mandatory social security contributions.

Many countries are attempting to extend coverage to more workers. Burundi has an innovative system where motorcycle taxi cab drivers are covered through contributions to their national association (Turner, this volume). To encourage coverage among agricultural workers, who are typically more difficult to bring into the social security system, Tanzania has a public relations campaign to encourage more people to participate in the social security system. Tunisia charges agricultural workers a lower contribution rate than urban workers. Egypt allows self-employed workers to declare their level of income, with the minimum level varying by occupation. Vietnam has a program that allows agricultural workers to make contributions in kilos of rice, and later

receive benefits in rice. Thailand, China, and India also have a matching contribution for voluntary programs for informal sector or rural workers. In 2010, the Indian government introduced a new pension initiative, which runs from 2010 through 2014, to increase participation in the national New Pension Scheme, aimed particularly at the 300 million workers in the unorganized sector who are generally excluded from formal pension provisions. The initiative includes a partial contribution match to encourage participation in the plan.

In 2012, Peru enacted a law extending mandatory coverage to self-employed workers earning more than 1.5 times the minimum wage. Chile is also extending coverage of its mandatory individual accounts to self-employed workers earning above a minimum amount, but with the choice to opt out during a five-year transition period. In 2010, Malaysia extended coverage to part-time workers. That same year, South Korea extended coverage of its mandatory employer-sponsored pension system to small employers having four or fewer employees.

Some countries in Africa have not had social security programs for private sector workers, only for workers in government and government-controlled enterprises. In 2011, Ethiopia extended social security coverage to private sector workers.

It was initially thought that individual account systems would succeed in extending coverage to more workers because of the link between contributions and account balances and thus benefits. In fact, the link is quite variable. It is variable because of financial market risk, which affects both the link between contributions and account balances at retirement and the link between account balances and annuitized benefits. Perhaps for other reasons as well, the extension of coverage in countries adopting individual accounts has not occurred. Reforms with individual account plans did not increase coverage in any of the reforming countries in Latin America (Kritzer, Kay, and Sinha 2011).

Some countries have extended coverage to uncovered workers on a voluntary basis. China has a voluntary pension system for rural workers (Chen and Turner, this volume). Kenya in 2011 launched a voluntary individual account system, called the Mbao Pension Plan (Kwena and Turner 2013; Turner, this volume), where poor workers can contribute small amounts (as little as $0.25) using mobile phone technology. This system is feasible because mobile phone costs have decreased to the extent that they are available in Kenya for as little as $5 or $10.

Noncontributory Social Security Pensions

A number of middle- and lower-income countries have established noncontributory means-tested old-age pensions to provide benefits to poor people in old age and to extend the coverage of social security programs (International Labour Office 2007). This trend has been motivated by an attempt to reduce poverty in old age and appears to be gaining greater acceptance around the world. These programs are sometimes called social pensions. Countries with social pensions include Brazil, India, Nepal, Lesotho, Botswana, Namibia, South Africa, and Mauritius. Swaziland and Lesotho have tax-financed programs that provide cash transfers to older persons (Vincent and Cull 2011). Chile adopted such a program in 2008, and also established a minimum benefit for participants who had contributed to the mandatory individual accounts and met certain other requirements. In 2008, Belize extended to indigent older men its noncontributory poverty program that already applied for indigent older women. The Maldives adopted a program in 2010. Peru and the Philippines both adopted programs in 2011.

International Agreements to Facilitate Work and Retirement in Other Countries

Although for many years countries have had international agreements concerning social security benefits for workers moving between countries, there is an increased interest in global collaboration to provide these benefits. Mercosur—the Southern Common Market—signed an agreement in 2007 whereby retirees could receive their social security benefits in any country in the region without charge. The benefits are wired from the social security agency in the home country to the social security agency in the new country of residence. Formerly, the benefits were wired to a bank in the residence country, which charged money transfer and foreign exchange fees. In addition, all documentation is sent electronically, rather than by mail, which expedites the process of workers receiving benefits from other countries. In 2007, 22 countries signed the Ibero-American Multilateral Social Security Agreement, which will facilitate the provision of social security benefits to international workers in Hispanic countries. In 2011, a new Ibero multilateral agreement provides social security benefits to migrant

workers and their families in eight countries: Bolivia, Brazil, Chile, Ecuador, El Salvador, Spain, Paraguay, and Portugal.

The EU has regulations regarding the coordination of social security in EU countries. The East African Community is considering this issue (Turner, this volume). As well as these multilateral agreements, increasingly countries have bilateral agreements, sometimes called totalization agreements. New Zealand and Australia are also discussing the portability of pension benefits between those two countries as part of an effort to move those countries to a single economic market.

EMPLOYER-PROVIDED PENSION PLANS

Unisex Pensions from Defined Contribution Plans

Because women on average live longer than men, life insurance companies selling annuities generally charge a higher price to women than men for an annuity paying an equal annual benefit. Gender-based benefit calculations when annuitizing defined contribution accounts, which results in equal expected lifetime benefits for men and women the same age, is viewed as discriminatory against women by some people because it provides lower annual benefits to women than men. In 1983, the U.S. Supreme Court outlawed gender-based pensions for employer-provided defined contribution plans on the grounds that it constituted discrimination in compensation against women. In 2012, the EU outlawed that practice for all annuities, including annuities both provided through pension plans and purchased individually.

Extending Voluntary Pension Coverage

Extending voluntary pension coverage, as a supplement to mandatory pension coverage, has long been a goal for many countries. Ireland mandated that by 2003 all employers were required to provide their employees the option to participate in a Personal Retirement Savings Account, but many employers have failed to comply with this requirement, and among those that have, some have no participants in the plans provided (Hughes, this volume). In 2008, the Philippine Congress passed

a law creating private voluntary retirement accounts as a supplement to the country's public PAYG system. Under the law, public- and private-sector employees and the self-employed may set up Personal Equity and Retirement Accounts (PERAs). In 2009, a program took effect in Israel through an agreement between labor unions and manufacturing associations to extend pension coverage to workers not already having such coverage. In 2011, Chile established new rules to encourage employers to voluntarily provide pension plans. In 2012, India extended a defined contribution system designed for government workers so as to make it available to private sector workers, and Malaysia established a voluntary pension system to supplement its mandatory system.

Some countries, however, provide voluntary pension systems to workers who do not participate in social security as a substitute for social security. In 2007, Pakistan introduced a new voluntary pension system. In 2009, China extended voluntary pension coverage to 650 million rural workers by establishing the National Rural Pension Scheme. By 2011, there were more than 258 million contributors and 100 million beneficiaries (Turner and Chen, this volume).

Pension Regulators

As employer-provided pensions are increasing, many more countries gradually are adopting pension regulators. With the growing importance of defined contribution plans, pension regulators more often are not part of Labor Departments but are part of government departments focusing on financial market regulation. Kenya, Uganda, and Tanzania have all instituted pension regulatory authorities. Burundi, however, does not have a pension regulator (Turner, this volume).

The Decline in Defined Benefit Plans and the Trend toward Defined Contribution Plans

In countries with established pension systems, defined benefit plans were traditionally the primary plans in the private sector but have since declined in importance, being supplanted by defined contribution plans. Generally, the decline has been considerably less in the public sector, where defined benefit plans still predominate. These countries include the United Kingdom, Ireland, the United States, and Kenya. In the

United States, a type of defined contribution plan called the 401(k) plan has replaced defined benefit plans as the most important type of plan in the private sector, but Individual Retirement Accounts, which are defined contribution plans established by individuals without reference to a particular employer, have since replaced 401(k) plans as the most important type of retirement plan in terms of assets. The decline in private sector defined benefit plans has not occurred in all countries where they have been prevalent. For example, it has not occurred in Germany or Japan. There has also been a movement away from defined benefit plans for public sector employees, with Kenya and Brazil taking steps to end those plans for public sector employees.

Automatic Enrollment to Extend Coverage

To solve the problem of workers not participating in voluntary employer-provided pension plans when they have the opportunity to do so, there has been a trend toward automatic enrollment. In traditional plans, workers need to actively enroll in employer-provided defined contribution plans. If they do nothing, they are not enrolled. Thus, traditionally the default is nonenrollment.

A number of employers sponsoring defined contribution pension plans in the United States have adopted automatic enrollment. In the KiwiSaver program in New Zealand, starting in 2007, workers are placed in the system by default but can opt out. In the United Kingdom, starting in October 2012, all employers are required to offer a pension plan to their employees, and they are required to automatically enroll their employees (Szczepański and Turner, this volume). The requirement starts with large firms and is being phased in over four years so that it will eventually apply to all employers. The mandatory contribution rate to the plan is 8 percent, also being phased in, with 1 percent of that provided by a government subsidy.

Defaults

Along with automatic enrollment, which is a form of default, defaults have been used for investment options. Many participants are uncertain as to what a good investment choice would be. With defaults, if they take no action they automatically are signed up for the default

investment. Initially, in the United States that investment was a low-risk option, but there has been a move toward higher-risk defaults because low-risk defaults resulted in small accounts due to low returns. The defaults now generally being used are ones that reduce the portfolio risk as the participant approached retirement. These are sometimes called target-date funds, or retirement date funds.

In 2012, the United Kingdom established a nationwide default, known as the National Employment Savings Trust (NEST), which provides retirement date funds for workers whose employers do not offer a plan and who do not choose one of the other funds offered by NEST (Szczepański and Turner, this volume). This system is largely based on the KiwiSaver system in New Zealand.

Financial Education

Financial education has been a response to the problem of financial illiteracy for participants in defined contribution systems, both in mandatory and voluntary defined contribution systems (Turner and Muir, this volume). The increase in financial education provided by governments and employers is a direct result of the growing importance of defined contribution plans as voluntary or mandatory parts of retirement income systems. Financial education can cover such topics as investment terminology, asset allocation, risk tolerance, and retirement goal setting. Using financial education to address the lack of financial literacy of pension participants is not a quick fix but needs to be a long-term, sustained, and costly effort.

Several international organizations, such as the OECD and the International Organisation of Pension Supervisors (IOPS), have taken an interest in financial education for pension participants in individual account pension systems. In 2008, the OECD created the International Network on Financial Education. A survey by IOPS found that 16 out of 19 financial supervisors of pension systems provided some type of financial education (IOPS 2011). The pension supervisors not providing financial education tended to be fairly young, with intentions of providing financial education in the future.

Chile, the United Kingdom, Mexico, and the United States have all developed financial education programs. In 2009, Colombia enacted a

law providing incentives for organizations to establish low-cost programs for financial education.

Greater Transparency

With some countries moving to defined contribution plans, they also are leaning toward providing greater transparency, particularly concerning fees. The United States in 2012 released regulations requiring greater disclosure to private sector pension participants of information concerning fees. Transparency is also an issue in terms of conflicts of interest that financial advisers may have. The issue of transparency is being considered in a number of other countries, as well. In the UK, private pension companies will be forced to reveal fees and charges taken from employees' retirement savings under an agreement with the Association of British Insurers. The requirement will be implemented in 2014 for autoenrollment pension plans, and in 2015 for all other workplace pension plans.

Hybrid Plans

Traditionally, pension plans have been divided into either defined benefit plans or defined contribution plans, but hybrid plans do not fit neatly into either category. These include defined contribution plans with rate of return guarantees, such as the Riester plans in Germany. Hybrid plans developed in the Netherlands include collective defined contribution plans, which have a defined benefit plan formula but with the workers collectively bearing the investment risk. The most common hybrid plan in the United States is the cash balance plan.

CONCLUSION

This chapter has surveyed trends in social security and employer-provided pensions around the world. Many countries have reformed their social security and employer-provided pension systems. Reforms of social security programs include raising the benefit entitlement age, adopting automatic adjustment mechanisms, and raising contribution

rates. While most countries have retained traditional social insurance–type social security systems, there have been two other significant trends relating to plan type. First, countries with provident funds have been converting those funds to social insurance–type social security systems. Second, some countries with traditional social security systems have added mandatory individual accounts, but more recently a number of countries have cut back on the contributions to those accounts. An additional trend is that low-income countries have continued to look for ways to include more of their workers in their social security systems, with some countries adopting innovative programs targeted at groups who have not participated in or been covered by social security.

Trends in employer-provided pensions include a shift toward defined contributions and away from defined benefit plans, increased use of hybrid plans, and a greater usage of unisex mortality tables in calculating annuities.

Note

We have received valuable comments from Dalmer Hoskins of the U.S. Social Security Administration. This chapter draws heavily on the Social Security Administration's monthly newsletter, *International Update: Recent Developments in Foreign Public and Private Pensions*.

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