Social Security

# International Update:

Recent Developments in Foreign Public and Private Pensions

January 2013

## Europe

### Luxembourg

***Correction (April 16, 2013):*** *The original version of this article, released in January 2013, erroneously described the provisions and effects of Luxembourg's pension reform law. A corrected and updated version of the article appears below.*

A pension reform law effective January 1 encourages older workers to remain in the labor force and sets up an adjustment mechanism that will help keep the public, pay-as-you-go (PAYG) pension system sustainable. Rapid aging of the population is exerting fiscal pressure on the public pension system; a report by the European Commission projects that by 2060, the ratio of workers to pensioners will decline from the current 2.4:1 to 1:1. In the absence of reform, old-age pensions would exceed contributions by 2022, and after 2030, the state pension reserve fund would be exhausted.

The new law gradually changes (by 2052) the benefit formula for the PAYG system, which consists of (1) a flat-rate benefit based on years of coverage and (2) a variable-rate, earnings-related benefit. As a result, the flat-rate benefit is increasing slightly (on average by about 0.44 percent per year), from 433.86 euros (US$572.81) a month in October 2012. At the same time, the variable-rate benefit formula is decreasing, from 1.85 percent to 1.6 percent of adjusted lifetime earnings a year.

Once the new law is fully implemented, an insured person would have to work about 3 years longer than he or she would today to receive a benefit equal to 2012 levels; workers who do not delay retirement would receive a benefit that is about 10 percent lower than 2012 levels. Workers aged 57 to 60 with 40 years of service may continue to retire, but will receive a benefit that is actuarially reduced.

In addition, a new "reduction factor" will limit the adjustment of benefit levels to a portion of the increase in the wage level if benefits exceed contributions. (Currently, all public pensions in payment are adjusted to changes in prices and the average wage level.) The current contribution rate (also called the global funding rate) for old-age, survivors, and disability insurance is 24 percent of covered earnings divided evenly among the worker, employer, and the government. The global funding rate will be reviewed every 10 years (previously every 7 years).

**Sources:** *Social Security Programs Throughout the World: Europe 2012*, US Social Security Administration; *The 2012 Ageing Report: Economic and Budgetary Projections for the 27 EU Member States (2010–2060)*, European Commission, May 2012; "Pension Market Overview in Luxembourg: Pension Reform Proposals," Economist Intelligence Unit, June 12, 2012; "Réforme de L'Assurance Pension," Recueil de Legislation, 31 décembre 2012; "Pension Reform in Luxembourg," ABBL, January 2013; "Luxembourg," IBIS, January 31, 2013; "Pension Reform, From 1 January 2013 a Reality in Luxembourg," PECOMA, January 2013; "La Réforme des Pensions à Luxembourg, Une Réalite Depuis 1er Janvier 2013," Frontaliers, 26 février 2013.

### Slovenia

On January 1, a new pension reform law went into effect that increases retirement ages for men and women and changes how old-age benefits are calculated under the pay-as-you-go (PAYG) public pension system. The law, which was passed unanimously in December, follows a September 2010 draft law increasing retirement ages that was approved by parliament but rejected in a public referendum. (There is no indication that there will be a referendum on the new law.) According to the government, the new law will save approximately €150 million (US$198 million) in the first year, helping to reduce the country's budget deficit. A recent report by the European Commission shows a projected deficit in 2012 of 4.4 percent of gross domestic product (GDP), well above the 3 percent ceiling required under the European Union's Stability and Growth Pact. Slovenia's deficit was around 6 percent of GDP from 2009 through 2011 and, in the absence of reform, was projected to remain around 4 percent at least through 2014.

Under the previous rules, the retirement age in Slovenia varied according to a worker's years of contributions: age 63 (men) or age 61 (women) with at least 20 years of contributions; age 58 (men) with at least 40 years of contributions or age 57 and 4 months (women) with at least 37 years and 9 months of contributions; and age 65 (men) or age 63 (women) with at least 15 years of contributions. The new law gradually changes the qualifying conditions for the latter two categories, such that workers will be able to retire at age 60 (men and women) with at least 40 years of contributions or at age 65 (men and women) with at least 15 years of contributions. (The timetable for the gradual implementation of these changes is still unclear.) In addition, the new law changes the way benefits are calculated by basing old-age pensions on the highest 24 years of earnings, an increase from 18 years under the previous rules.

Slovenia's PAYG public pension system covers all employed workers, self-employed workers, and unemployment benefit recipients. Employees contribute 15.5 percent of gross earnings and employers contribute 8.85 percent of payroll for old-age, survivors, disability, and work-injury permanent disability benefits.

**Sources:** "Slovenia," *International Update*, US Social Security Administration, October 2010; *Social Security Programs Throughout the World*: *Europe 2012*, US Social Security Administration; *European Economic Forecast: Autumn 2012*, European Commission, July 2012; "Slovenia Passes Pension Reform," *Europe Online Magazine*, December 4, 2012; Republic of Slovenia press release, December 5, 2012; "Pension Reform Stepping into Force on Tuesday," *Slovenska Tiskovna Agencija*, December 31, 2012.

## *Spain*

Since January 1, the retirement age and the number of years of contributions required for a public pension are rising gradually. Those measures are part of the August 2011 pension reform law to help reduce the system's growing pension costs, currently at 10 percent of gross domestic product (GDP) a year. The rapid aging of Spain's population coupled with the highest unemployment rate in Europe (25 percent) has lowered the ratio of workers to retirees from 2.71:1 in 2007 to 2.34:1 in 2012. By 2052, the ratio is projected to be 1:1. To help pay current benefits, last fall the government tapped the pension reserve fund.

The changes to the pension rules include an increase in the—

- normal retirement age, from 65 to 67, by 1 month per year until 2018 and then 2 months per year until 2027.
- minimum number of contribution years required to receive a pension, from 15 to 25 years, by 1 year each year until 2022.
- number of contribution years for a full pension, from 35 years to 38.5 years, by 6 months every 3 years until 2025. (Workers may retire at age 65 if they have met these contribution requirements.)
- benefit for older workers who stay in the labor force beyond the normal retirement age, from an additional 2 percent to 4 percent, depending on the number of years of contributions. For workers with less than 25 years of service, the incentive will remain at 2 percent; for those with 25 to 36 years, 2.75 percent; and, 37 or more years, 4 percent.

In addition, the law requires a sustainability factor to be introduced to the system in 2027 that will adjust "the relevant parameters of the system" to changes in life expectancy every 5 years (no additional details are available).

Despite these major changes, the European Union (EU) projects that Spain's public pension expenditures will increase by 3.6 percent of GDP between 2010 and 2016, compared with 1.4 percent, the average of EU member countries. The EU has recommended changing or eliminating the annual adjustment of benefits to inflation, accelerating the gradual increase in the retirement age, and linking the retirement age to life expectancy (much earlier than 2027).

**Sources:** "Focus on Spain," *International Update,* US Social Security Administration, August 2011; Ley 27/2011, el 1 de agosto de 2011; "España Pierde Población Por Primera Vez en 40 Años," *Expansión*, el 20 de noviembre de 2012; "Spain Caps Pension Rise to Meet Deficit Target," Reuters, November 30, 2012; "Fiscal Sustainability Report 2012," European Commission, December 2012; "Spain Plans Deeper Pension Reform," Business Report, December 12, 2012; "Bruselas Advierte: Las Pensiones No Son Sostentibles Sin Retrasar la Edad de Jubilación," *Expansión*, el 18 de diciembre de 2012; "El Próximo 1 de Enero Entra en Vigor la Reforma de la Seguridad Social," *El Pais*, el 23 de diciembre de 2012; "La Sostenibilidad delas Pensiones Cae al Nivel de 2001," *Cinco Días*, el 4 de enero de 2013.

# Reports and Studies

## *World Bank*

The World Bank, in conjunction with the Swedish Social Insurance Agency, recently released a two-volume anthology entitled *Nonfinancial Defined Contribution Pension Schemes in a Changing Pension World.* The anthology contains articles and comments on the national experience with nonfinancial (also known as notional) defined contribution schemes (NDCs), addressing issues related to their implementation and design and providing analyses of the reforms introduced since the mid-1990s, particularly in Italy, Latvia, Norway, Poland, and Sweden.

The NDC approach is presented as an alternative to the most common types of pension reform, which usually entail either gradual adjustments to the traditional pay-as-you-go (PAYG) method of financing old-age pensions or a more fundamental shift toward the advance funding of pension obligations. NDC schemes combine PAYG financing—characteristic of traditional defined benefit (DB) programs—with the defined contribution (DC) structure of individual accounts, where benefits are linked more closely with an individual's contribution history over his or her entire working life. NDC systems, however, credit these contributions with a notional interest rate tied to wage growth or other overall economic indicators.

Among the conclusions drawn by contributors to the anthology, NDC schemes—

- eliminate the need for the constant adjustment of contributions and benefits in favor of a system that puts old-age pension financing on autopilot, regardless of political shifts in power and economic downturns.
- should be combined with effective minimum pension guarantees because they do not readily address pension adequacy for workers with persistently low incomes or for many women who experience interrupted work histories.
- require the allocation of budgetary funds to cover transition costs (from traditional PAYG programs to NDC programs) from the outset. According to the authors, the experience of countries such as Poland shows the need for countries to be specific about the transition costs prior to reform.
- should be accompanied by a long-term public education endeavor to explain the implications of demographic aging and its impact on public finances. This information campaign should be combined with periodic statements to individual contributors, informing them of the current and projected value of their notional account.

**Source:** World Bank, 2013.

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