Country Report

Denmark

Current pension system: first assessment of reform outcomes and output

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European Social Observatory
www.ose.be

Research Project
"ASSURER UNE PENSION ADÉQUATE DANS UN CONTEXTE EUROPÉEN"
Supported by the
Belgian Federal Public Service Social Security

May 2010

Een onderzoeksproject uitgevoerd door
het Observatoire social européen (OSE)
in opdracht van
de Directie-generaal Sociaal Beleid
van de Federale Overheidsdienst Sociale Zekerheid.

Un projet de recherches de
l'Observatoire social européen (OSE)
à la demande de
la Direction générale Politique sociale
du Service public fédéral Sécurité sociale

DENMARK

The Institutional Architecture

Denmark is one of the few countries in the world that copes well with the challenge of providing its citizens with both a flexible labour market and with socially adequate old age pensions that are also fiscally sustainable. The complex mix of Danish *flexicurity* and old age security has developed over the last two decades as an incremental process, leading to the so-called Danish employment miracle. This brought the unemployment level form over 12% in the early 1990s to a nadir of 1.7% in 2008, while securing reasonable income replacement to the vast majority of the population.

Denmark is often described as one of the first that adopted a multipillar pension system consisting of both Beveridgean (a flat-rate residence-based national pension) and various Bismarckian elements, of which private occupational pensions based on collective agreements have the lion's share. The universal character of basic income security in old age, coupled with quasi-mandatory supplementary pension savings means that most of the elderly are not at risk of social exclusion during retirement.

The main problem with regards to occupational pensions is directly related to their linkage to collective agreements. Contributions are precluded to people who are temporarily outside the labour market, due to parental leave, unemployment or sickness. This is amended by augmented contributions to the funded components of the first pillar, which, however, do not compensate entirely for the loss of income.

In sum, improvements to the system are of course possible, however, the Danish social security system's defects are negligible in comparative perspective.

The **first (state and mandatory) pillar** consists of two tiers and it is universal in coverage.

The *first tier* is a residence-based national pension (*folkepension*), which is composed of two different elements: i) the basic amount, which is flat-rate and tied to length of residence; and ii) the income-tested pension supplement

The *folkepension* is PAYG and tax-financed from general budget revenues, where the central government reimburses municipalities for their pension expenditures. The normal retirement age is currently 65 for men/women but will increase to 67 during the period 2024-2027 by half year each year. The minimum qualifying period for Danish citizens is 3 years of residence between the age of 15 and 65/67 and 10 for non-Danish citizens (including the last 5 before retirement).

The full basic amount is earned after 40 years of residence and is reduced pro-rata by the number of years of residence missing to 40. The maximum monthly rate of the basic amount before tax for 2009 was DKK 5,254 (in 2008 DKK 5,096, i.e. circa 17.5% of average earnings). The basic amount is subject to means-testing based on income from work only (other pensions are not taken into account). In 2008, the basic amount was reduced for annual earnings greater than DKK 259,700 (if living with a partner, DKK 179,400).

The maximum monthly rate of the pension supplement before tax for 2009 was DKK 5,289 for singles and DKK 2,470 for couples (in 2008, DKK 5,130 and DKK 2,396, respectively). The actual amounts are tested against all sources of personal income (including ATP, SP and occupational pensions) apart from the public pension. Hence, in 2008, for yearly individual earnings greater than DKK 57,300, the targeted pension supplement was reduced by 30% of the excess income. For couples this income test was calculated on income beyond DKK 115,000 at a rate of 15%.

Early retirement is possible through various arrangements. The *anticipatory pension*, which may be awarded to persons aged 18 to 65. Eligibility depends on the applicant's working capacity, in case it is permanently reduced or to such an extent that the applicant is unable to provide for himself or herself by means of a remunerated job. At 65 the recipients of an anticipatory pension are transferred to the *folkepension*. The maximum monthly benefit granted by the anticipatory pension for 2009 (before tax) was DKK 15,704 for singles and DKK 13,348 for married or cohabiting couples.

Partial early retirement is also an option, but is being phased out and is currently available only to people born before 1959. Eligible are people aged 60-65, residing in Denmark, employed full-time for at least 10 of the last 20 years, and continuing to work for 12 to 30 hours a week. Employees must have participated in the ATP scheme for at least 10 of the last 20 years and worked at least 18 of the last 24 months in Denmark. A self-employed person must have worked full-time during the last 5 years, been self-employed in Denmark for at least 4 of the last 5 years (including 9 of the last 12 months), and must reduce working hours on average to 18.5 hours a week. In 2008, the maximum annual partial pension was DKK 98,392 (work reduced to 12 hours p.w.). The minimum annual pension for a self-employed person was DKK 27,555.

Finally, there is a *voluntary early retirement programme* linked with unemployment insurance, which pays benefits between ages 60 (increasing to 62 during 2019-22) until the normal pension age. To qualify, individuals must have been members of the unemployment insurance fund for 25 years within the last 30 years and have paid voluntary early-retirement contributions. The benefit amount corresponds to the rate of unemployment benefits, subject to a limit of 91% of the maximum rate of unemployment benefit (differentiated for full- or part-time workers). Combining voluntary early-retirement benefits with the *folkepension* is disallowed. Hence, beneficiaries revert to the standard old-age pension once they reach the normal retirement age of 65.

Benefits arising form both components of the *folkepension* as well as from the anticipatory and partial pensions are indexed once a year to the growth of average wages (based on an index of wage increases during the two preceding years). However, if the increase exceeds 2%, then 0.3% is transferred to a fund used for the improvement of other cash benefit schemes.

The Danish first pillar's *second tier* consists of a number of fully funded supplementary schemes (and a smaller PAYG one), with varying purposes and operational structures.

The Supplementary Labour Market Pension Fund (*Arbejdsmarkedets Tillaegspension*, ATP) is meant for all employees between 16 and 67 if working time exceeds 9 hours a week. ATP was introduced already in the 1960s. It is financed through fixed-sum contributions (decided by social partners as part of collective agreements) paid by both employers (2/3 of total) and employees (1/3). Contributions depend on the number of hours worked, e.g. for a full time employee with 37 hours per week contribution was in 2009 DKR 3,240 (approx 1% of the average national wage). Their valorization changed in 2008 and is based on swap interest rates as opposed to a fixed nominal interest rate.

The ATP has the same age requirements as the *folkepension*, hence one has to retire at 65 (67 since 2027), and there is no minimum qualifying period. However, deferred retirement is also possible, until 70 before 2009 and currently at 75. From 2010 employers must pay ATP contributions for employees even if one defers retirement and also in the case she is already a pension recipient. Before 2010, contributions were not compulsory after the statutory retirement age. Deferral guarantees a much higher ATP pension, guideline increase percentages range from 8% for 1-year deferral to 130% for 10 years.

ATP pays its benefits depending on the size of the pension at 67. A monthly benefit is paid out if the benefit is greater than DKK 2,480 a year; as a yearly annuity if the benefit amounts to between DKK 1,240 and DKK 2,480; and as a lump sum if the benefit is lower than DKK 1,240 a year.

The ATP has an important social function, which is not fulfilled by the occupational private schemes due to their employment-related nature. In fact, people on maternity leave or recipients of unemployment benefits have their contributions to the second pillar discontinued. To compensate for that, the ATP contribution is doubled with respect to the parental or unemployment benefit.

Maternity, paternity and parental benefits are granted for up to 52 weeks in total. During this period, beneficiaries pay 1/3 of the contribution, while 2/3 are paid by the respective municipality. Those caring for children beyond the maternity period and who are not employed, typically switch to another scheme, which also carries an ATP contribution.

During unemployment (which can be up to 2 and half years long), an unemployment insurance fund (or municipality if the recipient is uninsured) takes over the payment of ATP contributions. The government pays 2/3 of the contributions when unemployment insurance is exhausted and the individual is still unemployed.

On average, a full ATP benefit after 40 years of employment grants a replacement rate of 7%. Even though the amount seems negligible, it is of crucial importance for low-income workers.

The Special Pension Savings scheme (*Særlig Pensionsopsparing*, SP) is a fully funded scheme for employees, self-employed and recipients of unemployment and sickness benefits. The contribution rate is 1% of earnings (no ceiling is applied) and investments are managed centrally. As from 2005, members choose their manager and portfolio. Benefits are paid out as a lump sum or over 10 years (depending on the accumulated amount). Contributions to the SP scheme have been suspended since 2004 and the scheme is officially closing down in April 2010. Those who are currently insured must either withdraw now or transfer the accumulated sums into another fund.

The Supplementary Labour Market Pension Scheme for Disability Pensioners (*Supplerende arbejdsmarkedspension*, SUPP) was introduced in 2003 and is a voluntary funded scheme to top up disability pensions. SUPP contributions equal 2.8% of the disability pension, whereof 2/3 are paid by the government. SUPP benefits are either paid out as an annuity, if the accumulated sum exceeds DKK 17,813.23 (as of 2009), or as a lump sum if it does not.

Finally, for some groups of civil servants, there is a special earnings-related pensions (*tjenestemænd*), whose participation is, however, very restricted – in fact most members are either high-ranking officials and priests. It is the only purely PAYG scheme in the *second tier*. The minimum qualifying period is 3 years. Benefits are service-related and calculated according to a final-salary formula. Full benefits amount to 57% of the last wage if the person has 37 years of employment and are reduced for early retirement or less than 37 years of qualifying period. Benefits are indexed according to the growth of civil servants' average wages.

There is an additional supplement for low-wage civil servants to compensate them for a decline in the pension benefit as a result of the new calculation system. The supplement will be phased out in 2022.

All pension benefits above are taxed as income from work or by using specific tax rates.

The **second pillar** consists of quasi-mandatory, privately managed fully funded occupational schemes. These are based on collective agreements stipulated by social partners. Their coverage has increased exponentially during the 1990s, when the private sector was formally included. Collective agreements provide supplementary pensions to an astounding 93% of Danish wage-earners aged 30-60 (some 80% of total), which is even more than in the Netherlands, the other country coping well with occupational pension coverage. Even more impressive is the fact that the remaining 20% does not pose a particularly pressing problem for the future social adequacy of Danish pension arrangement. In fact, only two categories of workers are currently not covered by collective agreements: i) young, precarious workers, which under the Danish provisions for flexicurity will with high probability land with a job

providing occupational pensions; ii) high-income private employees, usually employed as middle management or above, who do not require this type of arrangement and usually resort to other, individual forms of supplementary savings.
The retirement age is the same as in the first pillar, i.e. 65 increasing to 67, but there are possibilities to retire already at 60. Contributions to occupational pensions range between 9% and 17% of gross wages, and are to a large extent tax deductible. In 2006, the percentage for the majority of Danish workers has been raised to 10.8%. During accumulation there are quantitative restrictions to investment, but at the same time, the law specifies a minimum interest rate of 2%.
Benefits are calculated using actuarial principles, thereby basing the end value on the contributions paid in, the interest rate, average life expectancy and the risk profile of the individual fund. Since 2000, the annuity calculation must use unisex mortality tables. Occupational pensions are Exempt Taxed Taxed, meaning that pension benefits are subject to income tax at the time of payment and annual interest gains are taxed during accumulation. Annuitisation is not compulsory, as many schemes allow lump sum withdrawals. There is no guaranteed indexation of occupational pension benefits.
As already mentioned in the introduction, the main problem with regards to occupational pensions is that they do not cover other labour market risks. Periods outside of employment do not entitle to the payment of any contributions, hence, compensation is delegated to other parts of the pension system (the ATP scheme in most occasions).
Finally, the **third pillar** consists of voluntary, supplementary pension schemes, managed by banks or insurance companies. Investment is regulated, indexation is not mandatory. Contributions are tax deductible but interest and benefits are taxed. Enrolment is very high, circa 1 million people.

The Administrative Structure

Due to the multi-tiered nature of the Danish pension system, its management is performed at multiple administrative levels. The national pension is administered by municipalities, under the supervision of the Ministry of the Interior and Social Affairs (*Indenrigs- og Socialministeriet*). The central government finances national pension expenditures and municipalities have no influence over the nature and amount of pension benefits.
ATP and SP are administered by ATP, which is a private organization set up by law and governed by the social partners under the supervision of the Ministry of Employment (*Beskæftigelsesministeriet*). As for the SP, since 2005 it is possible to move contributions to private insurance companies and since 2010 it is compulsory (so this part of the system becomes *de facto* the third tier of the first pillar). Either the ATP or a private provider, such as a bank or life insurance company, administers the SUPP scheme for recipients of disability pensions.
The Ministry of Finance manages the civil servants' pension for those working for the institutions of central government. Local governments, instead, set up a special institution, the *Kommunernes Pensionsforsikring*, which manages pensions for their employees.
As for occupational pension schemes that are part of collective agreements, there is usually one pension fund per agreement. All funds' boards are composed of employee and employer representatives. Often, employee representatives have the majority of seats. As for individual supplementary schemes, these are rather fragmented. Two associations cover private insurers: one for insurance companies (*Forsikring og pension*) and one for banks (*Finansrådet*). Both second and third pillar funds are monitored by the Danish Financial Supervisory Authority (*Finanstilsynet*) under the supervision of the Ministry of Economic and Business Affairs (*Økonomi- og Erhvervsministeriets*).

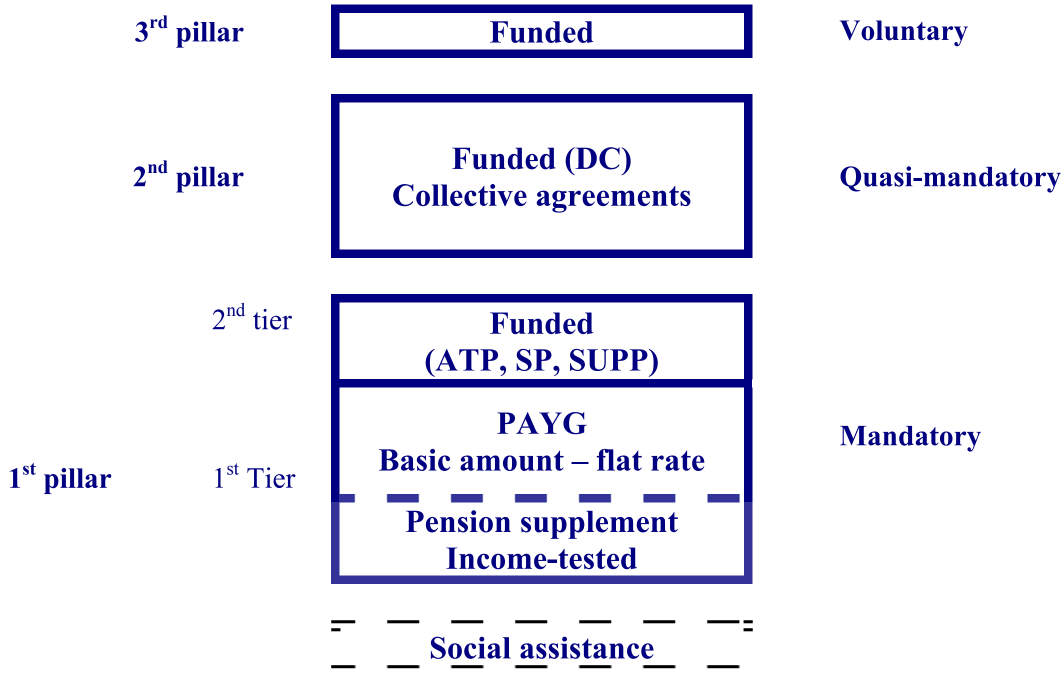
Assessment and Future Challenges

Danish retirement is sometimes described as a World Bank pension scheme due to its multi-tiered nature. If compared to the original recommendations of 'Averting the Old-Age Crisis', this seems to be a crude approximation. Danish retirement has been shaped by incremental reforms that lasted more than two decades, which have little to do with the clean slate approach advocated by the Bretton Woods institution.

In general, it can be stated that Denmark, alongside a very small number of other countries, e.g. the Netherlands, successfully combines the fiscal sustainability of its retirement system with quasi-universal social adequacy. There are very few categories of people (and almost no one among Danish citizens) who fall out of the system or do not receive socially inclusive benefits. This is, however, not only the merit of a complex, yet very articulated pension legislation, which provides coverage to advantaged and disadvantaged groups alike, but also to the flexicurity model that Denmark built up since the 1990s.

Hence, the example of Denmark illustrates that the old age problem has to be tackled both from the pension as well as the labour market side in order to secure satisfactory results. Whether the overall Danish employment-retirement system is replicable abroad is, however, questionable due to its contingent character and incremental evolution.

Figure 1 The Main Pillars in the Danish Pension System



1st Pillar, universal coverage (residence-based);
2nd Pillar, occupational schemes;
3rd Pillar, individual programmes.

Annex 1

Key Data about the Pension System in Denmark

Contribution rates	**2009**
Folkepension	**None**
ATP	**fixed amounts, circa 1% of gross wages**
SP	**1% of gross wages, but closing down**

Supplementary schemes	
Contribution rates (2006)	**between 9% and 17% of gross wages, 10.8% on average**
Coverage (of employees)	**93% of wage-earners aged 30-60 (80% of total)**
Assets in EUR bln (2007)	**185.1**
Taxation	**Exempt Taxed Taxed**
Investment principles	**Quantitative Restrictions**

Theoretical replacement rates	**Gross**			**Net**
	1st pillar	**2nd pillar**	**Total**	**Total**
2005	**45.1%**	**3.6%**	**48.7%**	**71.3%**
2050	**39.2%**	**24.8%**	**64.0%**	**76.1%**

SILC income 2004	**Total**	**Male**	**Female**
Relative income of 65+	**0.700**	**0.718**	**0.695**
Aggregate rep. ratio	**0.353**	**0.325**	**0.388**

Eligibility retirement age	
Old age	**65 for women/men (will increase to 67 during 2024-2027)**
Early retirement	**various schemes, usually not before 60**
Deferred retirement	**in ATP, up to 75**

Indexation	**to average wage growth, if this exceeds 2%, 0.3% is being transferred to a special fund financing other cash benefits**

Public pension spending (as % of GDP)	**2004**	**2020**	**2050**
	9.5%	**-**	**12.8%**

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FRANCE

The Institutional Architecture

Due to the extreme systemic fragmentation and complexity as well as sectoral labour movement entrenchment, the French pension system has been under pressure for change since the 1980s. Of the four major reform attempts so far, the Juppé Plan (1995) and Thomas Laws (1997) failed; the Balladur (1993) and Raffarin (2003) reforms succeeded. Since the elderly enjoy a relatively favourable income position in France, social adequacy is seldom mentioned during reform debates: all of them addressed the system's fiscal sustainability and all were incremental. Policymakers focussed on the calculation of benefits in the basic pension scheme, on the length of the contribution period and on the setup of capital-funded individual savings plans.

However, the bulk of the old system stayed untouched and its long-term financing problems unsolved. In addition, failure to align the different pension schemes (divided along occupational lines) means that inequality between categories of employees persist. Civil servants and employees in state-owned firms participate to so-called *régimes spéciaux*, thereby enjoying more generous conditions in terms of retirement age, qualifying period and benefit formulae.

Given their intricacy, the fact sheet will thoroughly analyze the *régime général* and provide a brief description of the privileges within the *régimes spéciaux*. Finally, supplementary occupational and individual voluntary pension schemes (the second and third pillars) are still in France in an embryonic state. Replacement rates provided by the first pillar will decline, but they did not yet trigger a migration of employees to the new savings instruments.

France had a fragmented **social assistance** scheme for the elderly on low incomes, the *minimum vieillesse*, for people aged 65 or in certain cases 60 (disability, war veterans etc). This was substituted in 2006 by the unified *Allocation de Solidarité aux Personnes Âgées*, ASPA. It is means-tested and guaranteed since April 2009 a minimum income of EUR 677.13 per month for singles and EUR 1,147.14 for couples. The income ceilings to receive the top up were in 2009, EUR 8,309.27 and EUR 13,765.73 respectively for individuals and couples.

The **first pillar** has a basic (PAYG service-related) and a supplementary tier, which are mandatory. PAYG schemes predominate (98% of total). The socio-occupational division of the French pension system follows four categories.

First, employees in private sector (65% of the labour force) have a relatively homogeneous first and second tier scheme, the *régime général*. The first tier provides a basic, service-related scheme (*Caisse Nationale d'Assurance Vieillesse des Travailleurs Salariés*, CNAVTS) for salaries below a social security ceiling. The second tier operates as a defined-benefit point system and is divided into distinct complementary schemes: i) *Association des Regimes de Retraite Complémentaire*, ARRCO, for employees and consisting of 67 funds; ii) *Association Générale des Institutions de Retraite des Cadres*, AGIRC, for executives and consisting of 34 funds.

Second, employees of public and para-public sectors (20% of the labour force) are members of defined-benefit and very generous schemes within the *régimes spéciaux*. They participate to supplementary second tier arrangements, such as schemes for the *Société Nationale des Chemins de Fer français*, SNCF, or the *Transports en Île-de-France*, RATP.

Third, agricultural sector employees (3% of the labour force), who participate in a separate scheme called *régime agricole*.

Fourth, non-salaried workers and self-employed (12% of the labour force), who have again specific schemes that are less generous then the *régime général* and AGIRC-ARRCO supplementary schemes (e.g. the *Caisse Nationale d'Assurances Vieillesse des Artisans*, CANCAVA).

Hence, the treatment of different working categories varies in terms of contribution rates, eligibility, benefit formulae. In 2003 there were 194 funds in the basic scheme and 135 funds providing supplementary earnings-related benefits. Employees are often entitled to pensions from two or three schemes.

The *régime général*'s first pillar consists of a service-related tier (basic pension) and supplementary schemes, based on pension points.

The *basic scheme* provides benefits for wages below a social security ceiling, i.e. EUR 34,308 in 2009. Eligibility for a full pension is 40 years of contributions (or other qualifying periods), which are planned to increase gradually to 41 years in 2008-2012. After 2012, eligibility for a full pension should follow increases in life expectancy.

The basic scheme is financed through a mix of contributions and state subsidies. Contribution rates vary between 6.55% and 16.35% of gross wage up to the ceiling.

There is a weekly pension minimum called the *minimum contributif* within the régime général (regardless of the pension received from other basic or supplementary schemes). In 2009, this was EUR 590.33 per week from 65 years on with at least one quarter registered career (or an increased amount of EUR 645.07 per week under special conditions). The minimum pension is pro-rated for shorter periods than 40 actually contributed years (41 years in 2012) and it is indexed to prices.

The *first tier*'s calculation formula is P=(T-tn)*(D/160)*SAM, where T is the liquidation rate equal to 50%; t is the abatement rate, equal to 1.25% per quarter of missing insurance; n is the number of missing quarters from a maximum of 160-164; D is the insurance period under the general scheme within a limit of 160 quarters; the *Salaire Annuel Moyen* (SAM) is the annual average reference salary of 25 best salary years indexed to prices.[1] Benefits in the basic scheme are also indexed to prices.

The 50% full rate is payable to individuals having a total insurance period of 160 to 164 quarters (depending on year of birth), aged over 65 or belonging to specific categories (persons unfit for work, former concentration camp or French Resistance prisoners, veterans or war victims and female workers who have raised at least three children). The total period of insurance includes periods of contributions and equivalent periods, i.e. periods of cessation of work in the case of sickness, maternity, disability, industrial injury, military service, unemployment. For women, an additional 1-8 quarters of entitlement is awarded for each child (parental childcare may be credited to the father). Up to 12 quarters spent in higher education can be bought back and the sums spent are tax deductible.

Deferred retirement. Individuals with the requisite period of insurance for their year of birth, and who continue working after 60, qualify for a pension increase. For quarters completed after January 2009, the rate of increase is 1.25% for each additional quarter. Individuals over 65 who have not completed the requisite total insurance period are awarded a 2.5% increase of the total period for each additional quarter worked.

Early retirement. There are various possibilities. Pre-retirement operates through a programme administered by the employment fund (*Fonds National de l'Emploi*, FNE). Early retirement is possible from 57 and from 56 under certain circumstances related to working conditions. At the normal pensionable age, individuals switch to public pensions.

As for the basic scheme, early retirement is granted to people who started working before 18 and who accumulated enough qualifying periods.

[1] For civil servants the basic pension is more generous: benefits are based on last 6 months and not 25 years as in private sector. One central reform objective was to change this.

With respect to the *second tier* of the 1st pillar, the ARRCO scheme covers the majority of private-sector employees (different rules apply to AGIRC). Both schemes are PAYG and contribution rates vary between 6-7.5% for ARRCO and 16-20% for AGIRC.
Despite higher contribution rates, benefits are only earned on 6% of earnings under the ceiling of the public scheme. Between one and three times the public-scheme ceiling, benefits are earned on 16% of the salary. ARRCO functions as a canonical pension point system. Hence, for early and deferred retirement, the system is rather flexible. However, reductions are dear. Indexation and valorization of pension points is agreed between the social partners and, until 2008, valorization was to prices and indexation to wages.
As for periods out of employment, these are relatively well protected in France. A mother raising a child for 9 years (before the child reaches 16) is credited with 2 years' coverage per child in the public scheme, whether she continued to work or not during that time. Caring for a child entitles to minimum wage credits to both the public and occupational pension schemes.
Periods of involuntary unemployment, when benefits are awarded, are credited towards the state pension. For each completed 50 days of unemployment, one quarter of contributions is attributed (maximum 4 quarters per year). Subsequent periods without unemployment benefits are credited to a maximum of one year only if this follows a period of unemployment with unemployment benefits. There is no credit for periods in receipt of social assistance.
The **second (voluntary and privately managed) pillar** consists of few company schemes and numerous collective insurance contracts, usually for managers in Small and Medium Enterprises. Contributions vary. For private employees there are company schemes, life insurance contracts and group insurance contracts. For self-employed there are collective insurance contracts with generous tax deductions (*Loi Madelin*). Public sector employees can voluntarily contribute to the *Caisse Nationale de Prévoyance de la Fonction Publique*, PREFON, managed by a pool of insurers led by the *Caisse Nationale de Prévoyance* (CNP). Hospital personnel has a special optional scheme, the Comité de Gestion de Ouvres Sociales (CGOS).
Finally, the **third (voluntary and privately managed) pillar** was established only in 2004 and cosists of individual, supplementary subsidized pension savings plans. The *Plan d'Épargne Individuel pour la Retraite*, PEIR, and the voluntary partnership employee pension savings scheme (*Plan Parternarial d'Épargne Salariale Volontaire pour la Retraite*, PPESVR) are insurance contracts with mandatory annuitisation.

The Administrative Structure

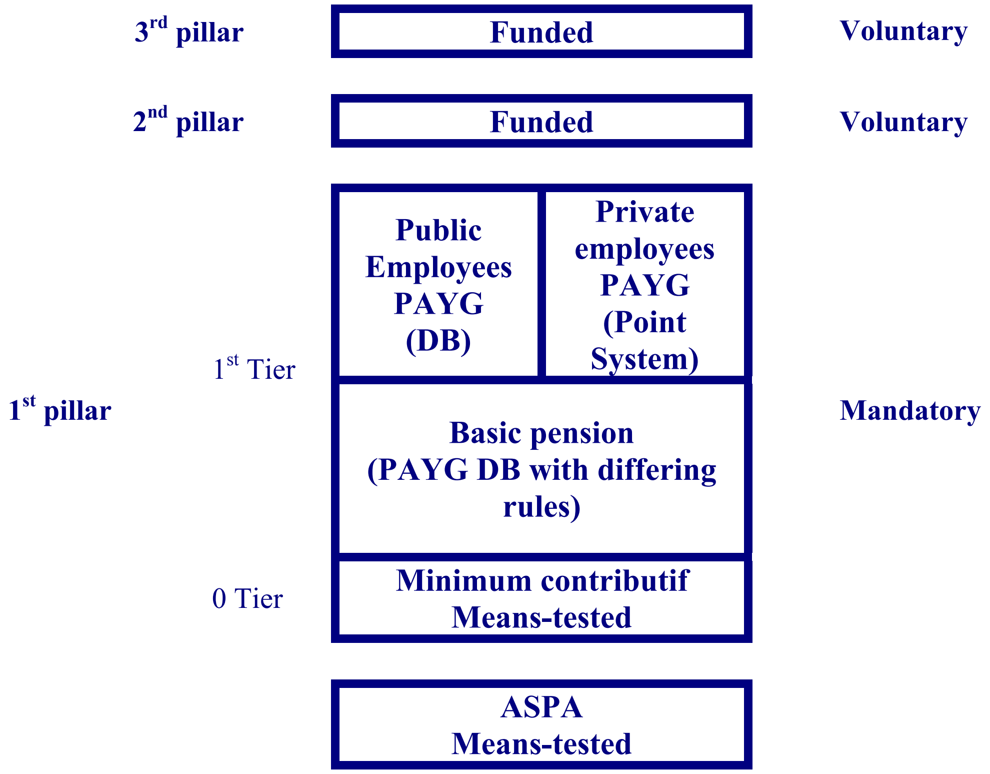
The basic and supplementary public schemes are administered by different social insurance funds organized at national, regional and local levels. The national social security office is divided according to different types of social benefits (pensions, health etc). The *Agence Centrale des Organismes de Sécurité Sociale*, ACOSS, collects social security contributions and is a public corporation.
The basic pension scheme is by an administrative council, whose members are social partners representatives. Regional and local insurance companies have their directors appointed by the administrative council after consultation with the Ministry of Labour. The directors of national insurance companies are appointed by the government. Supplementary schemes are administered similarly to the basic one, with the difference that here individual employers and employees (not their representatives) sign the agreements and manage finances with only limited state involvement.
The public pension system is divided into different categories. At the national level, the health insurance funds aggregated in the *Caisse Nationale d'Assurance Maladie des Travailleurs Salariés*, CNAMTS, coordinate insurance for healthcare, maternity, disability etc. At the

regional level 16 health insurance funds (*Caisses Régionales d'Assurance Maladie*, CRAM) disburse pension benefits for employees. At the national level, the *Caisse Nationale d'Assurance Vieillesses des Travailleurs*, CNAVTS, manages and pays benefits to salaried employees and is responsible for social assistance to elderly persons. The *Caisse Nationale d'Allocations Familiales*, CNAF, manages family-related benefits for all employees, except for farmers. At the local level, 125 national pension funds (*Caisses Nationales d'Assurance Vieillesse*, CNAF) manage and pay circa 25 pension different types of pension benefits.
The whole system is monitored by the *Ministère du Travail, des Relations Sociales, de la Famille, de la Solidarité et de la Ville*, by the Parliament, by the *Conseil de Surveillance* and the *Comission des Comptes de la Sécurité Sociale*. Since 1996, the Parliament votes annually on social security financing.
Whereas, the government sets most guidelines for basic pensions and, hence, the managerial role for trade unions is limited; the state has no control of the mandatory supplementary tiers. Different occupationally-based organizations with employer and employee representatives manage the payment of benefits.

Assessment and Future Challenges

The assessment of the French pension system is rendered difficult by its sheer complexity. If the medium-term fiscal unsustainability has been somehow solved in the last few years, excessive fragmentation and inequality of treatment have been a constant concern for policymakers. Otherwise, the French retirement system is rather generous and covers periods outside of employment reasonably. This will change in the future as replacement rates are bund to decrease, however, social adequacy is not yet perceived to be a politically salient problem.

Figure 1 The Main Pillars in the French Pension System



1st Pillar, universal coverage;
2nd Pillar, occupational schemes;
3rd Pillar, individual programmes.

Annex 1

Key Data about the Pension System in France

Contribution rates – 1st pillar as % of gross wages		
1st tier (basic pension)	**6.55-16.35%**	
2nd tier (supplementary)	**ARRCO**	**AGIRC**
	6-7.5%	**16-20%**

Supplementary schemes	
Contribution rates	**Depending on individual scheme**
Coverage (of employees)	**<10%**
Assets in EUR bln (2007)	**154.0**
Taxation	**Exempt Exempt Taxed**
Investment principles	**Quantitative Restrictions/Prudent Person Principle**

Theoretical replacement rates	**Gross**	**Net**
	1st pillar total	**1st pillar total**
2005	**66.2**	**79.7**
2050	**49.3**	**61.7**

SILC income 2004	**Total**	**Male**	**Female**
Relative income of 65+	**0.899**	**0.930**	**0.881**
Aggregate rep. ratio	**0.663**	**0.723**	**0.601**

Eligibility retirement age of the basic scheme	
Old age	**65**
Seniority	**60 with 40 years of qualifying period**
Early retirement	**Under special conditions at 58**
Deferred retirement	**Unrestricted**

Indexation of basic scheme	**Prices**

Public pension spending (as % of GDP)	**2004**	**2020**	**2050**
	12.8	**13.7**	**14.8**

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Country Report

GERMANY

Current pension system: first assessment of reform outcomes and output

By
Igor Guardiancich

European Social Observatory
www.ose.be

Research Project
"ASSURER UNE PENSION ADÉQUATE DANS UN CONTEXTE EUROPÉEN"
Supported by the
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May 2010

Een onderzoeksproject uitgevoerd door
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GERMANY

The Institutional Architecture

Since the Second World War the German pension system espoused the principles of equivalence (a relatively strict link between contributions and benefits) and income maintenance based on the male breadwinner model. As poverty rates among the elderly were very low, German retirement policy was a success. Fiscal sustainability was not a big concern and contribution rates were periodically increased to match expenditures.
From the late 1980s on, however, and especially after the German reunification, the pension debate shifted onto fiscal aspects of the system and mainly revolved around: i) reductions in the financial burden for the state; ii) maintenance of a stable future contribution rate, i.e. reduction in employers' non-wage labour costs.
Since then, a number of reforms weakened the redistributive elements of German pensions and abandoned the income maintenance principle for stable contribution rates, thereby, paradoxically, bringing pension policy further out of line with an increasingly flexible and precarious labour market. In particular, periods spent outside the labour market (child and elderly care, unemployment, military service, higher education, disability and sickness) are treated very unequally.
Beginning in the early 2000s, various scarcely successful attempts have been made to supplement the shortfalls in public benefits with increased occupational plans and individual savings (2001 Riester and 2004 Rürup reforms). This worked only in unionised sectors under collective agreements. Hence, Germany shifted from a (occupationally fragmented) system that protects individuals from social exclusion to a (sectorally fragmented) system whose outcomes are subject to randomness and which may breed poverty during old age.
Germany has recently changed its law regarding **social assistance**. For people with low earnings, including pensioners, there are means-tested benefits to guarantee a basic income. In 2006, this amounted to EUR 8,172 per year in the western Länder, including average benefits for housing and fuel costs. This was equivalent to 19.3% of average earnings.
The **first (state and mandatory) pillar** is divided into: i) compulsory statutory pension insurance for blue- and white-collar employees (*Arbeiter- und Angestelltenversicherung*); ii) pension scheme for farmers (*Altershilfe för Landwirte*); iii) insurance for civil servants and judges – tax-financed (*Beamtenversorgung*); and iv) several professional schemes.
The Statutory Pension Insurance (*Gesetzliche Rentenversicherung*, GRV) covers all German employees (around 82% of total employment), but only certain categories of self-employed: liberal professions who are members of occupational chambers are covered through occupational provision institutes – funded and contribution-financed (*berufsständige Versorgungswerke*); artists, artisans, publicists are all mandatorily covered. Other categories of self-employed either join the GRV voluntarily.
Public pensions are a contribution-financed, PAYG defined-benefit scheme, which has a contingency reserve (*Nachhaltigkeitsrücklage*) of between a minimum of 0.2 and a maximum of 1.7 of monthly expenditure.
The benefit calculation formula is a canonical point system, which brings the defined-benefit nature of German public pensions very close to a defined contributions system. Pension = APV*PP*PF. APV = Actual Pension Value (its amount differs in the western and eastern Länder), PP = Personal Points, PF = Pension Factor.[1] A Personal Point indicates the

[1] I use standard acronyms, often employed by the World Bank. However, each country tends to call its formula components in different ways.

proportion of an individual's wage relative to the national average wage, and the average takes into account the whole working life.
The Actual Pension Value is valorized/indexed to gross wages, but it also depends on two factors: i) changes of the contribution rates to the statutory pension scheme and to subsidized voluntary occupational and personal pension schemes are taken into account (an increase of contribution rates will reduce the adjustment); ii) sustainability factor, which links the adjustments to changes in the system dependency ratio. Both mean that the whole real contributory base is taken into account when valorizing/indexing point values.
These factors limiting valorization/indexation are meant to keep the contribution rate under check. In 2001, in fact, the increase in the rate was limited to 20% by 2020 and to 22% by 2030.
In 2008/2009 total contributions amount to 19.90% and are equally split between the employer and the employee. The insured person contributes 9.95% of monthly earnings; nothing if earnings are less than EUR 400 a month (mini-jobs, voluntary contributions can be made); a reduced contribution, if monthly earnings are EUR 401-800 (midi-jobs). There is an annual ceiling of EUR 63,600 (in the eastern Länder, EUR 54,000). The insured self-employed also contribute 19.9% of monthly income. The minimum monthly contribution is EUR 79.60 and the maximum is EUR 1,054.70 (EUR 895.50 in the east) or a flat-rate amount of EUR 494.52 (EUR 417.90 in the east). The employer normally pays 9.95% of the monthly payroll and 15% of earnings for mini-jobs under EUR 400. The government finances benefits not related to insurance through 1% of VAT and an eco-tax.
The minimum qualifying period is 5 years. The statutory retirement age will increase stepwise (1 month per year until 2024 and 2 months per year afterwards) between 2012 and 2029 from 65 to 67 for both men and women. Flexible retirement is possible between 63 and 65 (67 from 2029) with 35 years of qualifying period. However, early exit implies permanent benefit decrements amounting to 0.3% per month missing to the statutory retirement age, up to 14.4% maximum. (The problem is that low-skilled and low-income workers are usually forced to exit early and are thus more likely to endure these permanent reductions.) From 2012, an exception will be seniority pensions after 45 years of qualifying period (employment, self-employment, care and childrearing up to age 10 count, but not unemployment periods) and age 65. Deferring the pension after 65 (67) earns a 0.5% increment for each month of additional work. Drawing a standard old age pension and receiving extra income is unrestricted.
The main problem with the system is the differential treatment of periods outside work and atypical work contracts.
Women are fairly well protected (during childrearing, care and in case of divorce – as they split entitlements with the former spouse), as are disabled people. Unemployment, especially long-term, is not. Credits for apprenticeships and higher education have been drastically reduced. Atypical jobs are particularly discriminated: part-time jobs called mini- and midi-jobs are partly voluntarily insured and take up is minimal, false self-employment is on the rise and many simply do not save.
The state pays pension contributions for three years per child to either the employed or non-employed parent (or shared). These years are credited with one pension point per child. There are credits for childrearing up to age 10. These years count toward the number of years needed to qualify for a pension (*Berücksichtigungszeit*). If people work and contribute when their children are under 10, they receive a bonus of up to 0.33 pension points per year (up to 1 point per year total).
As for the unemployed, their pension coverage has deteriorated after the Hartz IV law. Normal unemployment insurance gave entitlements before 2006 to 32 months, now (*Arbeitslosengeld I*, ALG I) not more than 12 (24 if older than 55). When this period is over

(too early for many commentators), an unemployed person becomes a recipient of ALG II. Hartz IV transformed the earnings-related means-tested unemployment assistance scheme into flat-rate means-tested basic security scheme for the unemployed (ALG II). This, since July 2009, gives a EUR 359 basis for contributions (producing an entitlement of less than EUR 5 per month of benefits). Finally, unemployment insurance does not contribute to private savings.
Now only first three years of apprenticeship are valued at 75% of average earnings (before more and irrespective of type of job). Credits for educational years after age 16 have been cut from 12 years (before 1992) to zero (after 2009).
Due to increased female employment, part-time work represents now one third of all employment contracts. Only at very high wages it is suitable for old age. The worst development in part-time is marginal jobs (mini- and midi-jobs). In December 2007, there were 4.9 million people having a mini-job and hence earning up to EUR 400 per month. Less than 3% opted in and paid the difference between employer contributions (15%) and full rate of 19.9%. As for midi-jobs, contributions are reduced for employees, but only 12% paid in the full rate.
The **second (voluntary and privately managed) pillar** consists of occupational funded schemes offered by a variety of sponsors and subsidized through tax rebates. German employers have to offer at least one type of occupational pensions (*Entgeltumwandlung*) and have five different options: they can administer the scheme by themselves (*Direktzusage*), through insurance institutions (*Unterstütyungskasse, Pensionskasse* or *Pensionsfond*), they may take out a direct insurance with an insurance company for their employee (*Direktversicherung*). The Federal Institute for Financial Services (*Bundesanstalt fur Finanzdienstleistungsaufsicht*, BAFin) monitors.
Although Germany is said to be a private pensions 'newcomer', life insurance was widespread. Supplementary pensions were mainly for higher-income male workers in large enterprises and used for two purposes: as a human resource management tool to attract high-skilled workers; as a cheap financing method through the tax-free book reserve method. Lower-income employees had occupational schemes in the public sector (mandatory since 1929) and constructions (the unions pushed for it in 1957).
The slow take up of occupational schemes is attributable to relatively tough regulation. Before 2001 only defined benefit schemes were allowed, and employers had stringent information, administration and tax requirements. Indexation was mandatory, as was (almost) reinsurance against insolvency. Eligibility rules (10 years of contributions and a qualifying period of 35) disadvantaged women.
The 2001 Riester reform changed most of the rules. It gave the right to employees to require employers putting a share of gross earnings (tax- and contribution-free) into occupational schemes. However, due to revenue losses this is phased out in 2009. It allowed defined contribution schemes with at least 0% rate of return. Vesting periods were shortened to help women: 5 years of participation and 30 of qualifying period.
However, the main problem with occupational pensions remains the same: that they expanded only in those sectors where collective agreements are being hammered out with the help of trade unions (and often contributions are not even additional as other fringe benefits are diminished). Hence, socially inclusive retirement has now become much more fragmented than it used to be under pure state provision and depends on sector and firm size.
Favourable arrangements exist in public employment, constructions, food and textiles. In metal, chemistry, hostelry, the unions and employer associations have introduced collective sectoral investment institutions (*Versorgungswerke*) but these have had low impact.
Occupational pensions coverage increased by 10% between December 2001 and June 2004, but it is still limited. In 2004, 60% of employees were covered (one third in the public sector,

46% in the private sector). The size of the firm matters a lot: 21% of employees in very small firms were covered; 39% in firms employing 50-99 workers; 86% in firms with over 1,000 employees. The employer and the employee finance most plans jointly. The trend is away from book reserves to out-of-company plans.
Finally, the **third pillar** consists of voluntary, subsidized individual plans, which were strongly encouraged through the 2001 Riester and 2004 Rürup reforms.
The so-called *Riester-Rente* serves the purpose to encourage low-income workers to additionally save. The government recommends 4% of gross wages invested into these plans (and provides tax subsidies or direct allowances on contributions). There are several conditions, which make Riester less attractive (it was simplified in 2005): guaranteed rate of returns, low charges, consumer information requirements. The accumulated assets do not count towards means-testing.
Everyone covered by public pensions can claim state support from Riester (unemployed receiving ALG I are covered but not the self-employed). Full-time carers and child credits are eligible, so Riester undermines the male breadwinner model. To redistribute to women, unisex benefits were introduced.
For the self-employed there are Rürup plans (tax free to a ceiling and protected against insolvency of the self-employed), but again they are less flexible than insurance arrangements.
Hence, for neither plan was take up spectacular. In 2006 there were only 5.6 million *Riester-Renten* covering 15% of eligible people, of whom many were high-income employees. Still some 15% of self-employed (and verisimilarly solo or false self-employed) do not have any kind of old age provision at all.

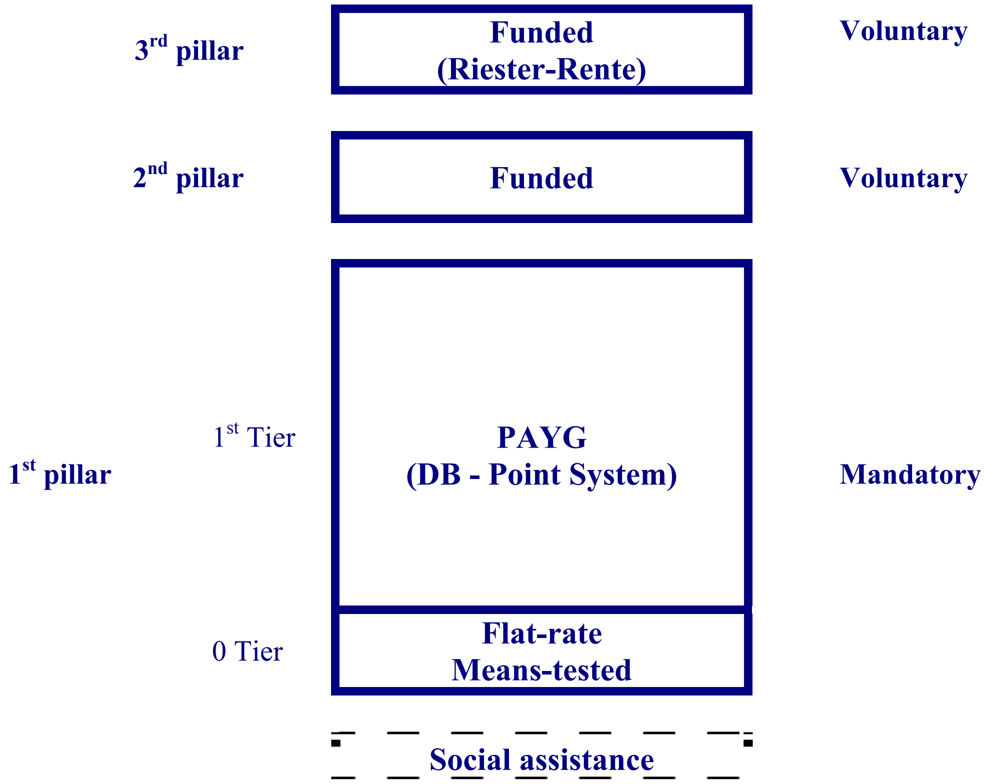
The Administrative Structure

The Federal Ministry for Labour and Social Policy (*Bundesministerium für Arbeit und Soziales*, BMAS) is responsible for legislation. The Federal Insurance Institute (*Bundesversicherungsamt*) supervises the administrative functions of the Federal German Pension Insurance, which is responsible for day-to-day operations and management.
Until 2005, the Statutory Pension Insurance (*Gesetzliche Rentenversicherung*, GRV) had three institutional branches: i) 23 regional insurance funds (*Landesversicherungsanstalten*, LVAs), the federal railway insurance fund (*Bundesbahnversicherungsanstalt*) and the seamen insurance fund (Seekasse) administered all blue-collar workers and insured self-employed; ii) the Federal Insurance Fund for Salaried Employees (*Bundesversicherungsanstalt fur Angestellte*, BfA) administered white-collar workers; and iii) the Federal Insurance Fund for Miners (*Knappscheftliche Rentenversicherung*). These pensions insurance carriers were united into the Federation of German Pension Insurance Institutes (*Verband Deutscher Rentenversicherungstrager*, VDR). Its board was equally split between employers and employees. In 2005 VDR and BfA merged into the DRB and the number of LVAs will be reduced due to regional mergers.
The Federal Institute for Financial Services (*Bundesanstalt fur Finanzdienstleistungsaufsicht*, BAFin) monitors private pension funds and plans under the supervision of the Ministry of Finance.

Assessment and Future Challenges

Even though the German public pillar is still a guarantee against poverty in old age, the equivalence principle on which it is based and the cuts in its redistributive elements imply that it is sliding out of line with an ever more flexible labour market. Hence, as written in the introduction, Germany shifted from an occupationally fragmented system that largely protects individuals from social exclusion to a sectorally fragmented system whose outcomes are subject to randomness and which may breed poverty during old age. According to experts it has now the option to follow two different developmental paths: either continue with a voluntaristic approach, as in the United Kingdom and relegate its elderly poor to social assistance, or espouse the universalism of a Dutch or Danish public scheme and mandate additional private savings to low-income workers and atypical job holders.

Figure 1 The Main Pillars in the German Pension System



1st Pillar, universal coverage (certain categories of self-employed are excluded);
2nd Pillar, occupational schemes;
3rd Pillar, individual programmes.

Annex 1

Key Data about the Pension System in Germany

Contribution rates – 1st pillar		
Dependent employment	**Self-employment**	**Atypical (mini-jobs)**
9.95% employees	19.9%	4.9% employee (voluntary)
9.95% employers		15% employer

Supplementary schemes	
Contribution rates	Dependent on individual scheme
Coverage (of employees)	60%
Assets in EUR bln (2007)	428.7
Taxation	Exempt Exempt Taxed or Taxed Exempt Exempt
Investment principles	Quantitative Restrictions/Prudent Person Principle

Theoretical replacement rates	Gross			Net
	1st pillar	2nd pillar	Total	Total
2005	43%	0%	43%	63%
2050	34%	15%	48%	67%

SILC income 2004	Total	Male	Female
Relative income of 65+	0.92	0.93	0.90
Aggregate rep. ratio	0.45	0.44	0.48

Eligibility retirement age	
Old age	65 (rising to 67 by 2029, 1 month per year until 2024 and 2 months per year afterwards)
Seniority	45 years and 65 years of age after 2012
Early retirement	Flexible between 63-67 with maluses
Deferred retirement	Unlimited (6% bonus each year)

Indexation	Gross wages with self-equilibrating factors

Public pension spending (as % of GDP)	2004	2020	2050
	11.4	11.0	13.1

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Country Report

HUNGARY

Current pension system:
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HUNGARY

The Institutional Architecture

Even though the pension system that Hungary inherited from socialism did not generate excessive deficits, mainly due to insufficient, *ad hoc* indexation (spending peaked at 10.4% of GDP in 1994 and then fell to 7.3% by 1997), its complexity made prominent scholars quip: *"The prime inadequacy of the existing system was its design. It embodied an almost impenetrable mix of social assistance* […] *and social insurance* […]. *Pensioners had little idea why their pensions were exactly what they were or how they related to their previous contributions"*. Hence, Hungary was among the first in Central, Eastern and Southeastern Europe to introduce a multipillar system (in 1997). However, extreme political budget cycles, which accompanied a decade of implementation, render a fresh overhaul necessary.

Hungary has a universal **social assistance** scheme to ensure a minimum level of income for the elderly. To be eligible, applicants have to be 62 and able to demonstrate that their total income falls below 80% of the minimum old age pension (95% for couples). The allowance is means-tested and tax-financed, i.e. the budget tops up the difference to the minimum threshold. In 2003, the allowance was paid to less than seven thousand individuals.

The **first (mandatory) pillar** is divided into two tiers: i) the first tier is public, earnings-related, financed through social contributions on a pay-as-you-go basis; ii) the second tier is private, earnings-related, financed through social contributions and is fully funded. Old-age pension contributions have been changing constantly. Long-term decreases were reversed in 2008. Contributions amount to 33.5% of the gross wage and are split between employers (24.0%) and employees (9.5%). Of the latter part, 8.0% is devoted to the private tier. There is a contribution ceiling for employee contributions, which is set annually by the Government and amounted in 2007 to circa eight times the minimum wage.

Eligibility rules (retirement age) for a *first tier*, public pension are: age 62 for both women and men with 20 years of qualifying period. (15 years under strict conditions). Early retirement age increases by 2013 to 60 for both men and women and the vesting period from 33 to 37 for all (there are many other early retirement venues though). There are bonuses and decrements. Bonuses amount to a 0.5% monthly increase (since 2004) if the person is 62 with at least 20 years of qualifying period. Decrements are calculated on time missing until 62: 1 - 365 days, the reduction is 0.1%; 366 - 730 days, the reduction is 0.2%; 731 - 1095 days, the reduction is 0.3% for each 30-day period, that is 7.2% maximum.

The 1997 reform led to a reduction of pension entitlements through a completely redesigned assessment base, defined-benefit formula and less generous indexation. Since 1998, the assessment base is based on average valorised wages earned since 1988. The degressive benefit formula is bound to become linear in 2013 and differentiated between those participating to the funded tier and those staying in the public tier only. The latter earn an accrual rate of 1.65% per year of service and the former 1.22%, thereby losing some 25% of public benefits. These, of course, receive as well an annuity from the funded pillar, however, the Guarantee Fund that was established to guarantee an adequate level of returns was abolished in 2002 and never reintroduced. Finally, indexation became effectively Swiss (mixed price-wage) in 2004. Again, Hungarian policymakers distorted this measure by introducing *ad* hoc benefit hikes, a 13th pension, levelled benefits across cohorts in 2005 etc. Reversals to these budget-consuming measures happened in 2008, when employee contributions are excluded form the assessment base of the newly retired, thereby decreasing pension benefits by 8% circa.

The establishment of the *second tier* was even more convoluted.

The market is rather consolidated and consists of 19 mandatory pension funds. These insured almost 3 million members (71% of the economically active) and collected HUF 1,766 billion (6.8% of GDP) by mid-2009. The operational structure of these pension funds is a uniquely inefficient feature of the Hungarian pension system. The funds are mutual associations where the members are co-owners, which disguises for-profit organisations into a non-profit governance structure. Employer associations, banks and insurance companies, sponsor the funds. Big financial holdings (the Big Six) dominate the market. The irrational decentralised contribution collection, introduced in 1998, was finally shed in mid-2006 and delegated to the Tax Office. Payment of annuities is inadequate as well: life expectancy tables are unisex, thereby leading to adverse selection problems, and indexation is Swiss, making forecasting impossible for these funds. Finally, all these flaws led to spectacular losses during the global financial meltdown: all the contributions of 2008 and 13% of all assets were wiped out. Ameliorating the general picture, a few novelties were recently introduced. Since 2009, the funds are required to offer a selectable portfolio system, consisting of three different portfolios – conservative, balanced and dynamic – with varying risk profiles. The assignment of members depends on the remaining time until retirement. Participants are able to choose among portfolios, however, the dynamic portfolio is restricted to younger workers. Moreover, to diminish operational costs, the *Hungarian Financial Supervisory Authority* (HFSA) capped asset management and front-end operational fees.

The **second and third (private and voluntary) pillars** consist of individual or occupational savings in Voluntary Mutual Benefit Pension Funds. Despite a total exemption of employer contributions and a generous tax credit, these schemes never really took off. The market remained fragmented, participation stagnated, contributions were low and mainly paid by employers. By mid-2009, less than one third of the 250 funds licensed in the mid-90s operated on the market. Concentration is high, as the 15 largest companies attracted more than 80% of the 1.365 million members (one third of the labour force, declining) and HUF 749 billion assets. If participants are relatively numerous, the per-capita contributions are modest. Being the precursors of the mandatory pillar, voluntary funds display identical problems with respect to performance, operating costs and return volatility. Due to deficit concerns, tax exemptions and credits have recently been limited. Since 2008, employers can contribute only up to half the minimum wage. These ceilings will probably discourage further participation. Recently a ‘second’ third pillar was added in order to increase long-term, domestic private investment in the Budapest Stock Exchange. These saving schemes have no portfolio limits and allocation is based on individual choice. Similarly to the third pillar, members receive a tax credit and capital gains are exempted from taxes. Yearly front-end fees and asset management costs are capped. Notwithstanding, initial membership fell short of expectations. By the end of 2006, instead of the projected 70,000, only ten thousand new members opted for the scheme.

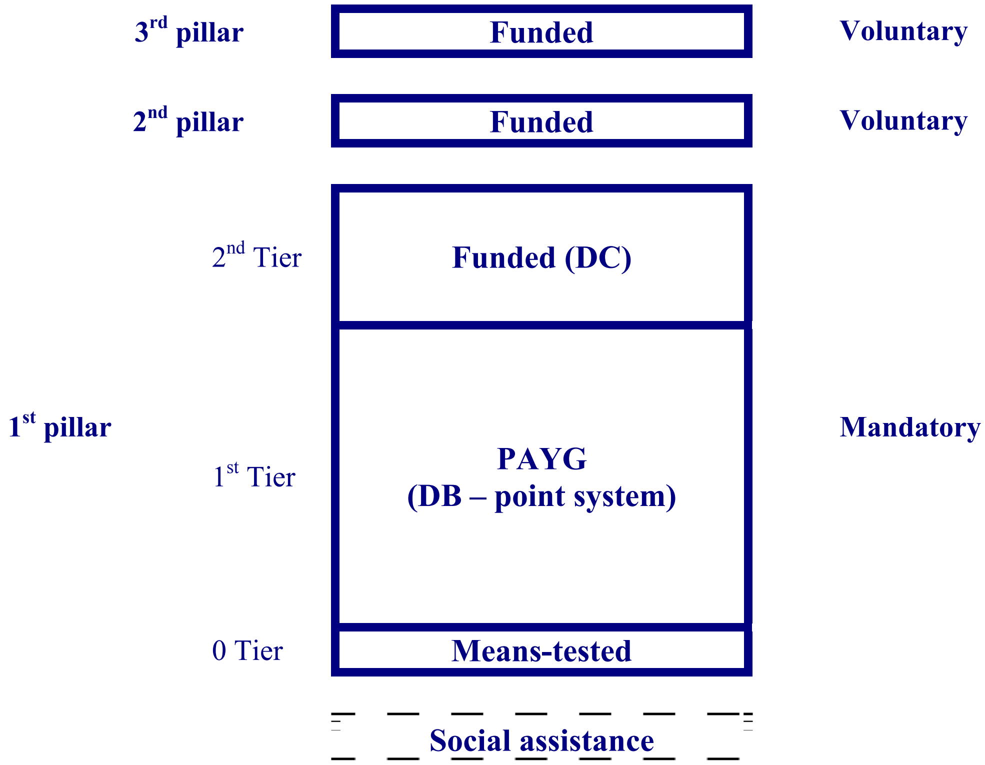
The Administrative Structure

The *Central Administration of National Pension Insurance* (CANPI) manages Hungarian public pensions. The *Ministry of Social Affairs and Labour* is responsible for policy-making and legislation. The *Hungarian Financial Supervisory Authority* (HFSA) regulates the funded mandatory tier and the *Ministry of Finance* legislates in the field. The *Tax Office* collects social security contributions for both the public and private tiers (since mid-2006).

Assessment and Future Challenges

The Hungarian pension system is one of the most troubled in the region, as it has three main flaws: i) an amateurish reform of public PAYG pensions instilled them with several design flaws (some authors attribute this to excessive fatigue after passing second, funded tier legislation); ii) the governments that followed the 1997 reform, introduced so many amendments that the future fiscal balance of the pension system has rapidly deteriorated to pre-reform levels; iii) the funded tier has governance problems that may be addressed only through a thorough systemic reform, i.e. by de-mutualising the current funds. Probably no piecemeal reform steps are enough to restore the Hungarian pension system's sustainability. The linearization of the benefit formula in 2013 may be conducive to delayed labour market exit (94% of employees retire before the statutory age), however, a renewed structural overhaul may be a much wiser solution.

The Main Pillars in the Hungarian Pension System



1st Pillar, universal coverage (0 tier tax-financed, 1st tier public, 2nd tier private);
2nd Pillar, occupational schemes;
3rd Pillar, individual programmes.

Annex 1

Key Data about the Pension System in Hungary

Contribution rates	
Total (1st pillar)	**33.5%**
1st tier	**24.0% (employer)** **9.5% (employee)**
2nd tier	**8.0% (employee)**

Supplementary schemes	
Contribution rates	**Variable, depending on scheme**
Coverage (of employees)	**circa 31%**
Assets in EUR bln (2009)	**2.72**
Taxation	**Exempt Exempt Exempt**
Investment principles	**Quantitative Restrictions**

Theoretical replacement rates	**Gross**			**Net**
	1st pillar	**2nd pillar**	**Total**	**Total**
2005	**65.8%**	**0.0%**	**65.8%**	**101.9%**
2050	**58.5%**	**18.7%**	**77.2%**	**98.1%**

SILC income 2004	**Total**	**Male**	**Female**
Relative income of 65+	**1.009**	**1.071**	**0.971**
Aggregate rep. ratio	**0.611**	**0.600**	**0.638**

Eligibility – retirement age	**62 for both women and men with 20 years of qualifying period (15 years under strict conditions)**
Early retirement	**60 for both women and men and with 37 years of qualifying period**
Deferred retirement	**No provisions**

Indexation	**mixed prices and wages**

Public pension spending (as % of GDP)	**2004**	**2020**	**2050**
	10.4%	**12.6%**	**20.3%**

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Country Report

ITALY

Current pension system: first assessment of reform outcomes and output

By
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European Social Observatory
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ITALY

The Institutional Architecture

Since the early 1990s, the Italian pension system comes close to what may be labelled 'permanent reform'. The traditional, Bismarckian PAYG system, which was completed in 1969 (all funded elements were suppressed) witnessed five reforms in less than two decades: 1992-1993 Amato reform, 1995 Dini reform, 1997 Prodi reform, 2003-2004 Maroni-Tremonti reform and 2006-2007 reform under the Prodi II government. The extremely fragmented, inequitable and fiscally unsustainable system (the first pillar is divided in 50 schemes) has been fundamentally modified in order to: i) render it financially sustainable; ii) increase horizontal equity; iii) tighten eligibility rules; iv) strengthen the contribution-benefit link; iv) diversify risk by introducing a multipillar architecture; v) spur private savings through supplementary schemes. Notwithstanding all the efforts, the first pillar has design flaws, fiscal sustainability is not assured, the coverage of supplementary pensions is patchy, certain categories are inadequately protected. (The fact sheet will relate to rules entered into force in July 2009.)

The **first (state and mandatory) pillar** includes two tiers. The zero tier, introduced in 1995, is basically a social pension (having some Beveridgean features), which ensures a minimum level of income for the elderly. The social check (*assegno sociale*) is granted to any resident in Italy older than 65 who does not have a sufficient contributory record to be entitled to a public pension. The benefit is means-tested and the income threshold for individuals in 2009 is equal to EUR 5,317.65 per year. The *assegno sociale* amounts to EUR 409.05 per month for 13 months.

The first tier covers all employed people, it is earnings-related, financed through social contributions on a pay-as-you-go basis. It covers old-age, disability and survivorship risks. The 1995 Dini reform fundamentally changed the calculation formula by introducing a Notional Defined Contribution system for new labour market entrants (and pro rata for workers with less than 18 years of contributions). This supplanted the extremely favourable defined-benefit calculation formulae for old-age pensions (for public employees based on last-year calculations before parametric changes in 1992-1993) and also so-called seniority pensions, which allowed some categories of public employees to retire after contributing for as few as 20 years. The system is still PAYG, but contributions flow into virtual individual accounts, which are the indexed to the 5-year average of GDP growth. At retirement, the accrued amount is converted through a coefficient related to age – revised every 10 years – into an annuity, which is then indexed to the Consumer Price Index. The are differences between paid and imputed contribution rates. These vary by occupational sector: 32.7% for private employees (8.91% for employees and 23.81% for employers), 32.95% for public employees (8.75% employees and 24.20% employers). Both are imputed 33% on their accounts. The self-employed pay 19% and earn 20%. The contribution rate for *parasubordinati* (particular categories of employees having atypical fixed-term contracts) vary and the difference between the real and virtual contributions are even greater. Eligibility for old-age pensions is a minimum contribution period of 5 years and age 60/65 for women/men in the private sector and 65/65 in the public sector, due to the ECJ sanction against Italy (on discrimination grounds) in November 2008. Women have the right to continue working until 65. All can retire later, but the conversion coefficients stay the same, which is a big disincentive. Eligibility conditions or seniority pensions (abolished for new workers) are being tightened and are a sum between age and contribution years (minimum 35), i.e. 95/96 in 2009 for employees and self-employed, 96/97 in 2010-2012 and 97/98 since 2013.

There are, however, serious flaws in the NDC self-equilibrating mechanisms, implying that neither macro stability nor micro incentives are guaranteed. In particular, the effective and imputed contribution rates create disequilibria, the self-equilibrating mechanisms have not been specified, indexation to GDP growth is problematic, the contribution rates for disability and survivor pensions are not separated.

Finally communication on the new retirement rules was always insufficient. The NDC formula will substantially decrease replacement rates and the purchasing power (with respect to wages) of continuing pensions will decline with price indexation. Both will lead to poverty in old age if people do not contribute longer and have supplementary pensions. An additional problem are the seniority rules ingrained in Italian salary structures. These discourage the employment of elderly workers, hence, neither the effective retirement age nor the contribution period will fall in line with the new expectations. Finally, holders of atypical contracts (*parasubrdinati*) are the least protected of all: their imputed contribution rate is too low and they do not get pension credits for unemployment periods.

The **second pillar** consist of supplementary occupational schemes that can take one of two forms: closed occupational pension funds (managed by social partners) and open pension funds in case of collective affiliation (managed by financial institutions). The former plans had 2,048 million members as of June 2009, the latter 806 thousand. They accumulated together assets worth almost EUR 21.5 billion. Supplementary funds use defined contribution formulae for dependent workers and also defined benefits for self-employed. There are tax incentives for participants. The schemes are Exempt-Taxed-Taxed and contributions are deductible up to 12% of total income, or to maximum EUR 5,164.57. The retirement age as well as contributory requirements are the same as in the first pillar. In addition, as part of the second pillar there is a severance pay, the *Trattamento di Fine Rapporto* (TFR), which is financed by 6.91% of contributions on gross wages. The accrual rate is 1.5% per year plus 75% of the inflation rate. After various reforms, the TFR is through a silent-consent formula being transferred to private schemes and used as an institutional gate to spur supplementary pension provision. This was not appreciated by employers, which used the TFR as a cheap source of internal financing.

The problems in the second are related to the labour market structure. Mainly employees in private medium and large enterprises are insured and they decided to transfer the TFR to supplementary schemes. Small enterprises, the self-employed and the public sector are almost totally excluded. Additionally, atypical workers have too meagre salaries to participate and they do not have the right to the TFR. Hence, the occupational, private component of the Italian pension system reflects an increasingly two-tiered labour market and will, through the lack of coverage, favour poverty in old age.

Finally, the **third pillar** consists of voluntary, supplementary pension schemes, the so-called *Piano Individuale Pensionistico* (PIP), as well as open funds for individual affiliation. Both are managed by financial institutions. The TFR can be voluntarily transferred and the tax advantages as well as eligibility conditions are similar to the second pillar. They are mainly defined contributions. In June 2009, there were 777 thousand PIPs, which accumulated EUR 2.75 billion in assets.

Information needs

The information needs of participants were in Italy handled with very poorly. The government(s) has not undertaken any extensive effort to explain the functioning of NDC and only recently have individuals been receiving a statement of their contributory account presenting their future pension entitlements. There is some lack of clarity about the way the system works. No official document has explained the working of the new system, the formula underlying the conversion coefficients has not been officially published, and the methodology envisaged for the revision of the coefficients has not been specified. Hence, the lack of discussion and explanation did not significantly change the microeconomic incentive structure.

The Administrative Structure

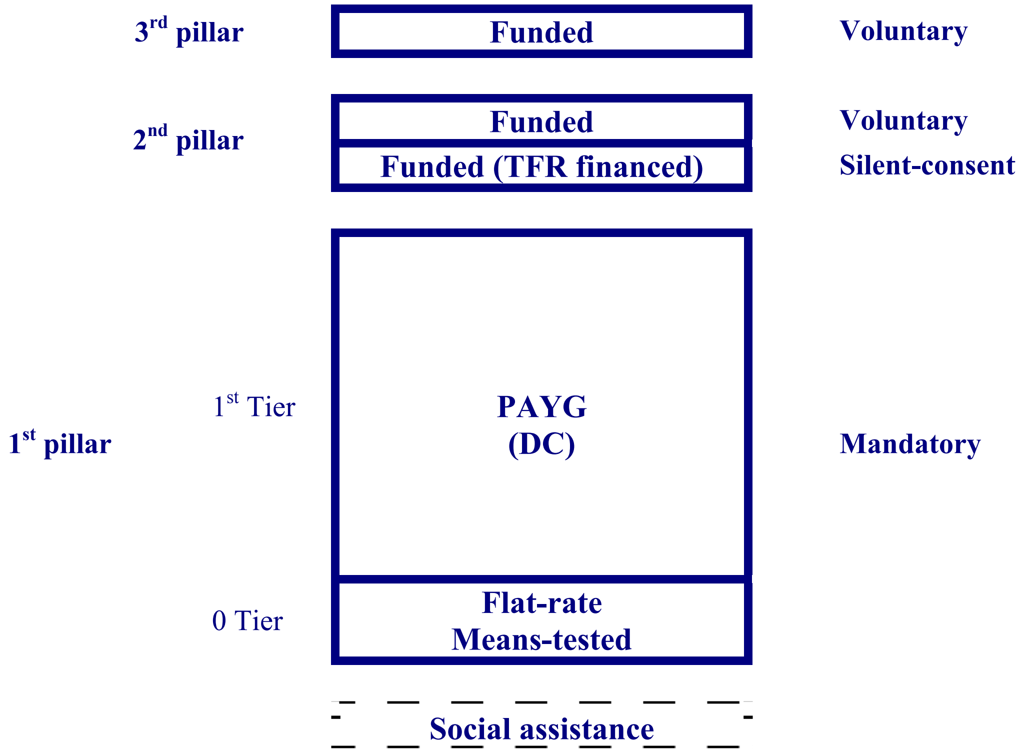
The Ministry for Labour, Health and Social Policies is responsible for legislation. The administration of public pension schemes is particularly fragmented, but most of the schemes are administered by the social security institution for the private sector (*Istituto Nazionale per la Previdenza Sociale*, INPS). This is divided into 4 major pension schemes (which are slowly being harmonized): employees – *Fondo Pensioni Lavoratori Dipendenti* (FPLD), farmers – *Gestione coltivatori diretti, mezzadri e coloni,* artisans *Gestione degli artigiani,* merchants – *Gestione degli esercenti attività commerciali*. INPS accounts for two thirds of public spending and covers the majority of private employees and the self-employed. Public employees are covered by a different institution, the national body for the public sector (*Istituto Nazionale di Previdenza per i Dipendenti dell'Amministrazione Pubblica, INPDAP*). There are various special schemes for small occupational groups. As for the management, the pension fund board appointed by the government and social partners' representatives have a role of supervision, *de facto* participating in their administration in all these institutions.

Assessment and Future Challenges

Even though the continuous reform increase the financial stability of the system, strengthened the incentives to retire later and rendered all schemes more homogeneous, there are several problems that need to be tackled. There are still negative fiscal prospects for Italian public pensions, especially due to the very slow phasing in of the new system. This should be accelerated. The differential retirement age between men and women should be equalized. The design flaws of the NDC formula should be fixed.

Finally, in order to lessen the possibility of poverty in old age, the coverage and development of supplementary pensions should be drastically increased. The introduction of the NDC system will reduce average replacement rates. While this will have a minor impact to employees in a Standard Employment relationship, the effects for workers holding atypical contracts will be detrimental. Pension credits and more homogeneity in treating various working categories should be a priority.

Figure 1 The Main Pillars in the Italian Pension System



1st Pillar, universal coverage (0 tier tax-financed, 1st tier public and contribution-financed);
2nd Pillar, occupational schemes;
3rd Pillar, individual programmes.

Annex 1

Key Data about the Pension System in Italy

Contribution rates	Private employees	Public employees
Total (1st pillar)	32.70%	32.95%
Employees	8.91%	8.75%
Employers	23.81%	24.20%

Supplementary schemes	
Contribution rates	6.91% in case of TFR, plus minor contributions by employees and employers
Coverage (of employees)	13%
Assets in EUR bln (2007)	57.77
Taxation	Exempt Taxed Taxed
Investment principles	Quantitative restrictions and Prudent Person Principle

Theoretical replacement rates	Gross			Net
	1st pillar	2nd pillar	Total	Total
2005	78.9	0.0	78.9	87.8
2050	64.1	15.5	79.7	92.0

SILC income 2004	Total	Male	Female
Relative income of 65+	0.844	0.871	0.835
Aggregate rep. ratio	0.583	0.639	0.492

Eligibility retirement age	
Old age	60 for women and 65 for men in the private sector 65 for both women and men in the public sector
Seniority	Sum between age and contribution years (minimum 35), i.e. 95/96 in 2009 for employees and self-employed, 96/97 in 2010-2012 and 97/98 since 2013

Indexation	Prices

Public pension spending (as % of GDP)	2004	2020	2050
	14.2	14.0	14.7

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THE NETHERLANDS

The Institutional Architecture

The protection offered by the Dutch pension system against the risks of poverty and social exclusion in old age is one of the most encompassing in the world. The system underwent since the 1980s incremental but steady modernization and, at the same time, maintained its dual Beveridgean-Bismarckian character: a basic universal scheme based on residence, the *Algemene Ouderdoms Wet* (AOW), topped up by quasi-mandatory pre-funded privately-managed occupational schemes. With the help of external constraints (EU equal treatment law and the 1990 Barber judgement by the ECJ) the Dutch government eliminated the breadwinner bias in the system; and through subsequent legislation it expanded its coverage to less privileged working categories (part-time, fixed-term and other atypical jobs). However, gaps in coverage persist and despite being Dutch pensions among the most efficient in the world, the system underwent since the 1990s three reform trends: i) individualization of occupational pensions; ii) lifelong labour market participation through the abolishment of pre-retirement arrangements; iii) implicit privatization of the public tier due to incomplete indexation and increases in the pensionable age (as lower benefits will have to be supplanted via other savings arrangements).
The **first (state and mandatory) pillar** has a single tier. The AOW is a PAYG basic pension covering all residents from the age of 65 (during 2009 it was raised to 66 by 2020 and 67 by 2025). Early retirement is disallowed, as is deferral. It is, however, possible to combine pensions and work.
Whereas until the mid-1990s the AOW was self-balancing (expenditures and revenues had to match), now it can run deficits and is financed through three different channels. Individual income-related contributions apply for all taxable income up to EUR 31,122 as of 2008. The current contribution rate is 17.9% (and the maximum is set at 18.25%). The rest constitutes income dedicated to occupational pensions. Deficits are covered by general taxation. In 1998 a Reserve Fund was established, which should finance any AOW shortfalls after 2020 (the projected amount of assets in the Fund, accumulated through annual government deposits will be is EUR 126 billion).
The benefit is flat rate and is conditional on the number of years of residence in the country (between 15 and 65). The full AOW is earned after 50 years, each missing year entails a deduction of 2%. People who live alone are entitled to an AOW pension based on 70% of the net minimum wage (EUR 1,048.09 gross in January 2009, slightly less than 30% of gross wages). People who are married or living with a partner are both entitled to a pension based on 50% of the net minimum wage (EUR 730.64 gross in January 2009). There is a supplementary allowance for partners under 65 topping up the AOW pension, amounting to circa 30% of the minimum net wage (this should be discontinued after 2015). There is a holiday allowance and a small government top-up. The AOW is taxed unless one is entitled to a (generous) tax credit.
The AOW is indexed alongside the net minimum wage, which is uprated biannually. Hence, there is a small discrepancy between gross wage growth and the AOW, which is slowly eroding its replacement rate with respect to earnings. The Indexing Conditions Suspension Act permits Parliament to suspend indexation if the ratio of inactive to active persons of employable age falls below 82.6:100. Since 1996 the AOW has been fully indexed.
The AOW hence is an insurance against poverty for the majority of the Dutch population. However, partial AOW benefits, when not coupled with a second pillar pension represent a threat to social inclusion during old age. Partial AOW benefits are on the rise due to increased immigrants working in the Netherlands and residents working abroad. In December 2008, 464

thousand people did not receive full AOW, i.e. 17% of the total. This is a threefold increase in two decades. As for Dutch people abroad, these are in abetter position than immigrants, as they can insure themselves with the Social Insurance Bank (*Sociale Verzekeringsbank*, SVB) when working outside Netherlands. Almost 34 thousand people over 65 claimed income support, which is roughly 70% of those that are actually eligible. Local-level governments provide such social assistance.

The **second pillar** consists of quasi-mandatory supplementary occupational schemes. They are regulated by the Pension Savings Act (*Pensioen en Sparfondsen Wet, PSF*). The Law on Mandatory Participation in Sectoral Pension Funds (*Wet Betreffende de Verplichte Deelneming in een Bedrijfspensioenfonds*) permits the Ministry of Social Affairs to require an entire sector to participate in the same pension fund once the social partners set up one pension arrangement in that sector. Hence, some 91% of wage earners are covered by occupational schemes.

By the end of 2008 there were 567 pension funds in the Netherlands, divided among three types: sectoral pension funds (*Bedrijftakspensioenfonds,* BPF), company pension funds (*Ondernemingpensioenfonds*, OPF) and pension funds for the self-employed. By Q3 of 2009 they collected assets worth almost 126% of projected 2009 GDP.

There is no statutory requirement for entry ages for occupational plans, but any discrimination against women has been abolished. More than half of all schemes do not have an entry age, the rest between ages 16 and 25. Retirement happens at 65 and can be either coupled with work or extended. In 2005, the tax-favoured status of separate early retirement programmes (*Vervroegde Uittreding*, VUT) and which led to pre-pension benefits between ages 60 and 65 was abolished to stimulate labour-market participation of older workers.

As for the benefit formulae, of the 567 funds, 76.5% offer defined benefit schemes (of these, 14.5% final salary schemes and 56.4% average salary schemes), 7.1% defined contributions schemes and 13.1% mixed schemes. Most final salary schemes have an accrual rate of 1.75% for each year of service, implying a replacement rate of 70% after a complete 40-year career. In most average-salary schemes the accrual rate varies from 1.75% up to 2.2% per year of service.

Second pillar contributions are set in collective wage agreements, and are typically shared between employers and employees. Employers usually pay a higher share: in 1998, employers paid 6.7% of their wage bill into second pillar schemes, while employees paid 2.3% of their wages. Due to the financial crises the figures are now much higher, easily totaling 15% of taxable income. Due to tight coupling between the AOW and occupational pensions, contributions to the second pillar are paid only on the salary above a level called the franchise. However, this level has been slowly decoupled from the AOW to increase the coverage and magnitude of occupational pensions.

Valorization and indexation are not legally required and not predetermined, but rather subject to tripartite negotiations. With respect to valorization, for approximately 75% of the participants in average wage schemes, past earnings are valorized in line with growth of average earnings while for 8% the rate of inflation is used. The problem of insufficient indexation for non-active members (those who have changed jobs and whose assets remained in the former employer's scheme) has been eliminated by legally enforcing the full portability of pension rights.

Until recently most schemes were using wage indexing but in the wake of the two financial crises (2001-2002 and 2008-2009) had to cancel or freeze it. In 2008, 70.9% of total funds did adopt a predetermined standard of indexation, which is, however, conditional upon the pension funds' performance. The rules differ substantially and range from overall wage movements (11.8%) to overall price movements (33.9%) passing through a series of nuances.

As mentioned in the introduction, the main problem of the otherwise very encompassing

Dutch second pillar are persisting 'white gaps', which happen for self-employed, people working in informal sectors, in non-covered sectors and, until recently, to those working part-time. Additionally, the system treats social risks differently: unemployment, childcare and early retirement lead to cuts in pension entitlements; disability and divorce to hikes. All of these are being only slowly tackled.

As for the gaps in coverage, the part-time problem (affecting most women, as the Netherlands is the only OECD country where there are more women working part-time than full-time) has been very effectively solved by a pro-rata reduction of the franchise for occupational schemes, which means that most people working part-time will obtain an occupational pension. For the self-employed, who are not automatically covered, their contributions can be reinvested in the firm (tax-free up to a ceiling) and then converted into an annuity; however, it is very unlikely that this may happen at a larger scale.

With regards to the differential treatment of social risks, unemployment, childcare as well as early exit (now abolished) did not give any right to accrue assets in occupational pensions. Disability does. Voluntary insurance during childcare is permitted. There is usually redistribution towards women, if they divorce. In fact, the pensions accrued during marriage are split between the couple and divorced women continue receiving benefits even if they remarry.

Finally, the **third pillar** consists of voluntary, supplementary pension schemes, which enjoy high tax subsidies in those cases when the combined value of the AOW and occupational schemes' benefits do not guarantee a final replacement rate of 70%. Most 'white gaps' are partially compensated with tax exemptions for additional savings. Ultimately, there is a life-course savings arrangement exists due to abolition of pre-retirement rules. Unfortunately, most authors question whether voluntary savings are enough to cover the (small) gaps of the Dutch occupational pensions and lower benefit levels that will be brought by the massive switch to average salary schemes from final ones.

Information needs

Communication is taken rather seriously in the Netherlands. The SVB sends an annual statement every January or February, which shows the total amount of the AOW pension that one received during the past year, as well as any deductions made for tax and national insurance contributions. Together with the annual statement, the beneficiary receives a statement of the monthly pension for January (pension statement) and SVB's magazine. Additionally, the insured can view their annual statement online during the first week of January.

As for the occupational funds, a major issue was to increase their transparency in the wake of the two financial crises. First, each fund has to provide members with an annual statement on assets, investment strategy, accrual rates. Second, the regulator's solvency rules toughened substantially. Funding requirements are stringent (there is a the solvency test and minimum funding test) and pension funds, which are underfunded have to produce very clear short- and long-term recovery plans to the Dutch Central Bank.

The Administrative Structure

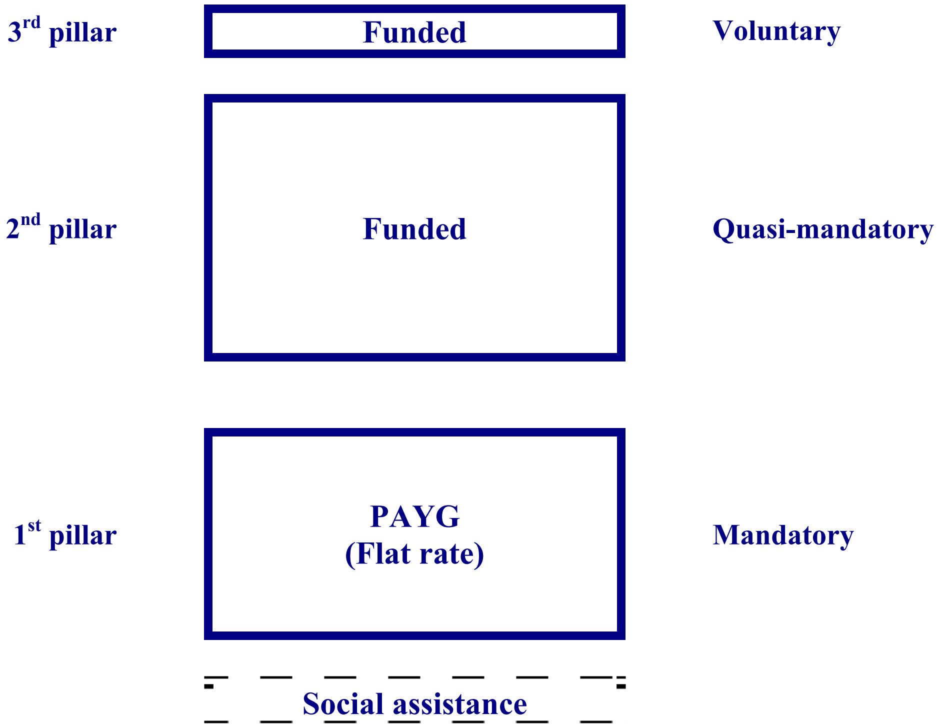
The social safety net for citizens consists of a social assistance programme called social minimum. This social assistance programme is managed by municipal agencies. The AOW is administered by the Social Insurance Bank (*Sociale Verzekeringsbank*, SVB), a state bureaucratic structure that leaves little room to corporatist bodies.

As for occupational schemes, until 2004, the Pension and Insurance Authority (*Pensioen en Verzekeringskamer*, PVK) was the supervisory body charged with oversight. In 2004 the PVK merged with the Dutch Central Bank (*De Nederlandsche Bank*, DNB) and is now called the Pension Chamber (*Pensioenkamer*). Details of pension plans are negotiated in collective agreements, while the Ministry for Social Affairs defines the general framework for operations and governance.

Assessment and Future Challenges

The Dutch pension system, which combines Beveridgean and Bismarckian features, is very suitable to guarantee social adequacy for most of the resident population. However, the system should prepare for future challenges, not least increasing costs in both the first and second pillars (through tax exemptions).
Looking at the system's social adequacy, incomplete residency is a problem: the increasing number of immigrants gets only partial AOW benefits and could hence be socially excluded. With respect to the occupational pensions, coverage and protection should improve. Irregular work histories imply that people may not accrue rights, e.g. during care, unemployment, childrearing etc. Labour mobility can be a source of trouble for final salary schemes, as new employers do not cover the whole back service and this deficit is not automatically supplanted by tax deductions. There are 'white gaps', which are only partially compensated with tax exemptions for additional savings. The self-employed are not covered by second pillar arrangements and the tax deductions they enjoy are not devoid of problems.

Figure 1 The Main Pillars in the Dutch Pension System



1st Pillar, universal coverage (residence-based);
2nd Pillar, occupational schemes;
3rd Pillar, individual programmes.

Annex 1

Key Data about the Pension System in the Netherlands

Contribution rates	2009	Max
Total (1st pillar)	17.9%	18.25%

Supplementary schemes	
Contribution rates	Shared between the employer and employee, they vary across and within schemes
Coverage (of employees)	91%
Assets in EUR bln (2009)	722
Taxation	Exempt Exempt Taxed
Investment principles	Prudent Person Principle

Theoretical replacement rates	Gross			Net
	1st pillar	2nd pillar	Total	Total
2005	29.6%	41.1%	70.6%	92.0%
2050	29.6%	39.3%	68.9%	90.1%

SILC income 2004	Total	Male	Female
Relative income of 65+	0.879	0.882	0.879
Aggregate rep. ratio	0.426	0.475	0.517

Eligibility retirement age	
Old age	65 (66 in 2020 and 67 in 2025)
Early retirement	Disallowed
Deferred retirement	Disallowed (but pensions can be combined with work)

Indexation	Minimum net wage

Public pension spending (as % of GDP)	2004	2020	2050
	12.4	14.8	20.0

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POLAND

The Institutional Architecture

The inefficient, extremely fragmented (250 working categories enjoyed varying early retirement rules during the 1990s) and fiscally unsustainable old age pension system that Poland inherited from socialism was systemically overhauled in 1998.[1] A multi-pillar structure consisting of a multi-tiered first pillar (combining a state-run PAYG Notional Defined Contribution first tier and a privately-managed fully-funded second tier) and still rather underdeveloped occupational and individual savings schemes substituted the old single pillar state-run system. Despite being the 'Security through Diversity' package at the forefront of pension innovation, it contained two major flaws: not only the reform reinforced the male breadwinner model, which did not disappear from Poland even during socialist times, but also the flexibilization and short-termism of Polish employment clashes with the new system, which instead encourages workers to yearn for stable, long-term contractual relationships. Hence, Polish retirement rules put vulnerable citizens at risk of social exclusion due to: low levels of actuarially strict mandatory provision, insufficient protection of women outside marriage and the underdevelopment of supplementary insurance.

Poverty alleviation is in Poland served by providing **social assistance benefits** to households whose income falls under a certain threshold (PLN 567.08 in 2009). This non-contributory scheme is unrelated to the age of the recipient, as is not the social pension, which is payable to all adults that had been recognised as completely incapable of work due to impairment of body functions. In 2008, 240.5 thousand persons received it.

The **first (state and mandatory) pillar** includes three tiers. The *zero* tier is a guaranteed minimum pension, which is being paid to persons who reached the statutory pensionable age and have accumulated at least 20/25 contributory years for women/men. The guarantee is means-tested and is hence triggered if the total pension falls below a certain threshold. The difference is topped up from the state budget. In 2009, minimum guaranteed benefits amounted o PLN 675.10, which equalled to 46% of the average old-age pension or 53% of the minimum salary.

The new *first* and *second* tiers started paying out pensions since January 2009. Two old-age pension systems have been operating in Poland since 1999. The old, defined-benefit pension scheme applies to people older than 50 on the date of entry into force of the reform, the new one to those younger. These are subdivided into two groups: i) people below 30, compulsorily insured in both the public and private schemes; ii) people aged 30 to 50, who chose whether to adhere to the Notional Defined Contribution scheme only or to both. The latter obtained a moratorium of ten years to retire early, if they did not pick the funded pillar and if they fulfilled all requirements under old rules before 2009. Women retiring during 2009-2013, who did not join private schemes, were instead offered a smooth transition between the two systems, consisting of a mixed old-age pension partly under old and partly under new rules.

The first and second tiers are financed through individual contributions (19.52% of gross wages) that are equally split between the employer and employee (9.76% each). Participation in the second, funded tier implies that of the employee's contribution, 7.30% is diverted to the Open Pension Funds. The ceiling to contributions and pensionable earnings is set at 2.5 times average earnings projected for a given year in the state budget law, i.e. PLN 95,790 in 2009.

The *first* tier is PAYG, state-run and adopts a Notional Defined Contribution formula. Hence,

[1] This country fact-sheet does not deal with the Agricultural Social Insurance Fund (*Kasa Rolniczego Ubezpieczenia Społecznego*, KRUS), an unreformed and highly problematic institution covering the pensions of farmers.

12.22% of contributions flow into individual notional accounts.
The notional capital's accrual rate (valorization) is 100% of the real wage bill growth (75% before 2004), thereby bringing the system's finances in line with both productivity and labour force participation growth. At retirement, the notional assets are converted into annuities using unisex life expectancy tables provided by the Central Statistical Office (*Główny Urząd Statystyczny*, GUS).
Since 2008, indexation is carried out once a year, on 1 March. The indexation rate is mixed: 80% of price inflation in the preceding calendar year, increased by at least 20% of real growth of average monthly earning. Indexation of pensions above the minimum level is negotiated with the Tripartite Committee.
In order to stabilise the contribution rate when baby-boomers retire or other demographic fluctuations happen, the government established a Demographic Reserve Fund.
Early retirement was abolished under the new arrangements. However, special working categories have been included into a bridging pensions system (starting in 2009). Circa 270 thousand people working in special conditions will receive a bridging pension up to five years before retirement age (hence at 55/60 for women/men with 20/25 years of contributions and 15 year at least working under special conditions). This benefit will be financed from the state budget. Deferred retirement is allowed without limits for both tiers. Work during retirement is possible, but if work income is above 70% of the average wage, pensions are reduced; they are suspended if it exceeds 130% (in 2008, the two limits were, respectively PLN 24,216.90 and PLN 45,345.60).
Despite the technical prowess of the first tier, this contains severe distributional inequities. 'Security through Diversity' draws an overoptimistic picture of the adequacy of the multipillar system for future retirees. Following the authors' assumptions, the new schemes are less generous for shorter accumulation periods, yet more than proportionally reward postponed retirement. The second pillar contributes towards entry benefits roughly as much as the first one due to higher returns.
These projections are unreliable. Subsequent evaluations reject the assumptions as excessively confident, given the economic slowdown in 1998-2004 and the fact that people enjoying long uninterrupted careers are increasingly rare. In particular, even high-income employees should buy supplementary private insurance in order to achieve acceptable income maintenance levels. However, only a tiny fraction is voluntarily insured.
The new system is particularly ill suited for atypical workers and women. Increased flexibility and abuse in the Polish labour market clashes with a pension system that encourages workers to yearn for stable contractual relationships. Atypical forms of employment guarantee lower protection standards than permanent employment. Part-time employment does not yield adequate income levels; fixed-term contracts increase the likelihood of unemployment spells. Civil law agreements are unlawful if they are stipulated with own-account workers, who are in reality fake self-employed and so have lower contribution bases (declared income with a lower limit of 60% of the average wage – in practice, almost all self-employed declare this minimum).
Women have cumulative disadvantages. The male breadwinner model has been considerably strengthened as state infrastructure for elderly- and child-care collapsed. Marriage is encouraged to improve insurance against old age. Finally, the lower statutory retirement age, coupled with similarly shorter accumulation, decreases the replacement rate by almost 30%.
The ongoing discussion on the introduction of redistributive elements yielded some tangible results. In 2004-2005, wage valorisation was introduced and full assessment bases started to be used for older pensions. Since 2009, childrearing women have their bases calculated on minimum wages and not on the much lower social allowance. These measures signal the attentiveness of Polish policymakers, yet they are clearly insufficient.

The *second* tier has a shared private-state management; it is fully funded and invested on the market. Compulsory affiliation means that the majority of younger workers are now covered, i.e. over 14 million by mid-2009. The 14 existing Open Pension Funds (*Otwarty Fundusz Emerytalny*, OFE) accumulated since 1999 assets worth PLN 152.7 billion. The year 2008 marked the worst performance in their decade of existence, a staggering -14.15% nominal rate of return. Otherwise, yields were fairly positive but swinging widely – since 2000 the average annual nominal rate of return was 8.76% and the real one 5.13%.
The Law on Annuities, adopted by the Parliament after 10 years of debate at the beginning of 2009, states that assets are converted into the single annuity using unisex life tables at retirement age (not before 65). Women, who retire before that year will receive payments based on programmed withdrawal until 65. Annuities will be increased by 90% of returns from reserves. At the minimum annuities are price-indexed and based on unisex life-tables, thereby again redistributing towards women.
The funded tier has some problems that should be overcome at once. First, there are Draconian investment limits (5% maximum in foreign assets), which limit risk diversification. Second, there are minimum return guarantees that breed herding behaviour. Third, the funds failed to self-regulate and hence, the Financial Supervision Authority (KNF) had to cap them, thereby emasculating cost competition. Fourth, despite a costly and long information campaign an increasing number of new labour market entrants fail to choose a fund and are therefore automatically assigned.
In addition to the mandatory pillar, policymakers introduced occupational and individual pension plans in 1999 and 2004. Employee Pension Funds (*Pracowniczy Fundusz Emerytalny*, PFE), Employee Pension Programs (*Pracowniczy Program Emerytalny*, PPE) and Personal Pension Accounts (*Indywidualne Konto Emerytalne*, IKE) constitute the **second** and **third pillars**. These are both fully funded and privately managed. Regrettably, their role in private pension provision is still marginal, in particular because high contribution rates for mandatory pensions and the existence of OFEs crowd out individual and occupational schemes for all but the most well off employees.
There were only five PFEs (genuine occupational pension plans) in Poland in late 2009, covering 59 thousand insured. By December 2008, just 1% of registered enterprises offered 1,079 PPEs. Less than 3% of total employees participated, i.e. 325 thousand workers. Two reasons account for the scarce popularity of these plans. First, Polish employers did not adopt any mechanisms to prevent poaching, especially due to high unemployment. Second, tax incentives are insufficient. In April 2004, PPEs were simplified, liberalising contributions, unblocking investment and widening tax exemptions, but the effects were limited.
IKEs represent a complement to PPEs. The government grossly overestimated the number of opt-ins, expected to reach 3.5 millions in a few years. By June 2009 there were 833 thousand insured (some 5% of total employees) with assets worth PLN 1.8 million, which means that the downward trend in the number of members that started in 2007 is continuing. The reasons for the scarce appeal are again inadequate tax incentives, penalties for early withdrawal and high overall social security contributions.

Information needs

Starting from 2006, ZUS has been obliged to provide all insured persons (born after 31 December 1948) with annual information about contributions recorded on their individual accounts, amount of initial capital after indexation and about the hypothetical old-age pension amount. In addition to regular statements sent to KNF, each OFE sends to its members a written annual statement about the funds accumulated on the member's account, dates of premiums paid in that period and transfer payments, as well as on translation of those premiums and transfer payments into accounting units, and about the results of fund's investment activity.

The Administrative Structure

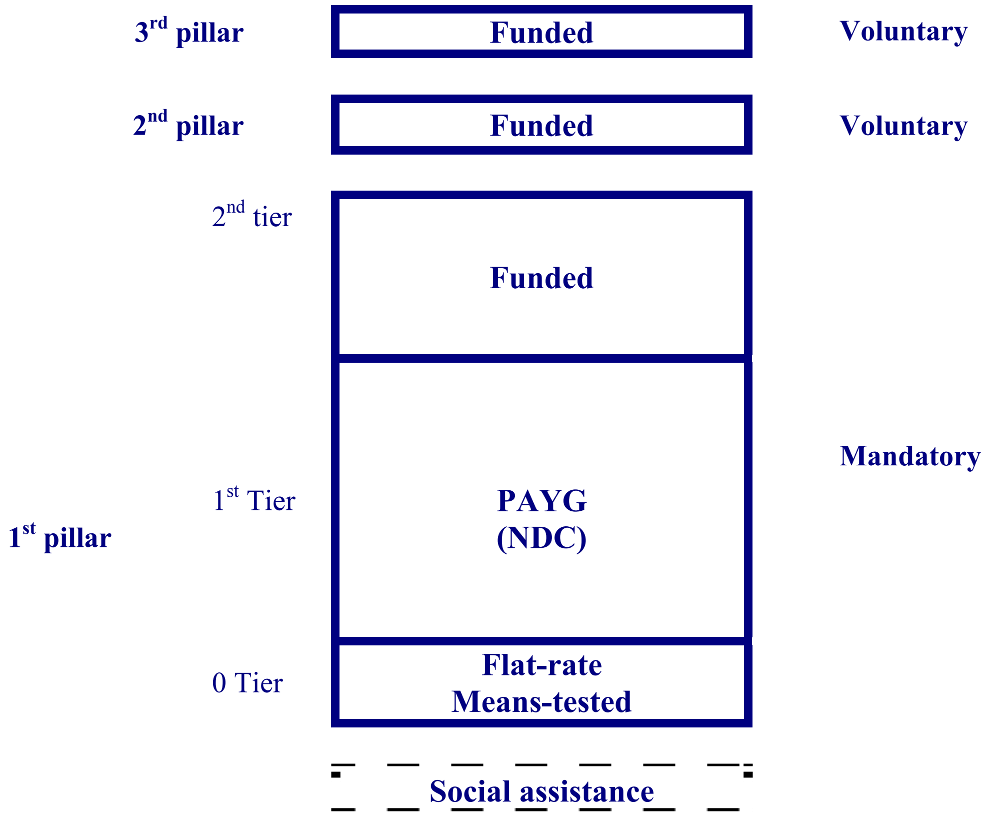
The Polish pension system is under the responsibility of the Ministry of Labour and Social Policy for employees, the Ministry of Agriculture and Rural Development for farmers, and by the Ministries of Defence and of Internal Affairs for soldiers and policemen. The Social Insurance Institution (*Zakład Ubezpieczeń Społecznych*, ZUS) administers pensions for workers but not for farmers. The ZUS covers old-age pensions, disability and survivors pensions, sickness and work accidents. These are financed through the four sub-funds of the Social Insurance Fund (*Fundusz Ubezpieczeń Społecznych*, FUS). Farmers are instead covered by the Agricultural Social Insurance Fund (*Kasa Rolniczego Ubezpieczenia Społecznego*, KRUS). Social partners have a minor direct responsibility in managing the system being part of the supervisory boards within each institution.

Open Pension Funds' management is shared among public and private institutions. Asset management and investment is supervised by the Polish Financial Supervision Authority (*Komisja Nadzoru Finansowego*, KNF). A Pension Fund Society (*Powszechne Towarzystwo Emerytalne*, PTE), a separate legal entity, manages each pension fund. Yet, private pension contributions are collected and allocated by ZUS, which acts as a clearinghouse.

Assessment and Future Challenges

The Polish pension reform of 1999 modernized the fiscally and intellectually broke socialist pension system, rendering it fiscally sustainable and basically self-balancing, at the expense, however, of future social adequacy and poverty alleviation targets. Atypical working categories have to be in all respects better protected (perhaps with a Beveridgean basic pension) and women need to work more, in less precarious positions and have greater access to childrearing facilities. The combined gaps in service and income replacement policies, pose them at great risk of income exclusion in old age. Adding to these, there are governance problems with mandatory funded schemes and supplementary pensions are insufficiently developed.

Figure 1 The Main Pillars in the Polish Pension System



1st Pillar, universal coverage (0 tier tax-financed, 1st tier public and contribution-financed, 2nd tier state-regulated and privately managed, contribution-financed);
2nd Pillar, occupational schemes;
3rd Pillar, individual programmes.

Annex 1

Key Data about the Pension System in Poland

Contribution rates	Employer	Employee
Total (1st pillar)	9.76%	9.76%
1st tier	9.76%	2.46%
2nd tier	-	7.30%

Supplementary schemes	PPEs, PFEs
Contribution rates	Variable, depending on scheme
Coverage (of employees)	3%
Assets in EUR bln (2007)	na
Taxation	Taxed Exempt Exempt
Investment principles	Quantitative Restrictions

Theoretical replacement rates	Gross 1st pillar total	Net 1st pillar total
2005	63.2	77.7
2050	35.7	43.9

SILC income 2004	Total	Male	Female
Relative income of 65+	1.089	1.204	1.022
Aggregate rep. ratio	0.585	0.658	0.573

Eligibility retirement age	
Old age	60/65 for women and men
Early retirement	55/60 for those eligible to bridging pensions
Deferred retirement	No limit

Indexation	
Guarantee pension	80% prices and 20% wages
Income pension	Prices

Public pension spending (as % of GDP)	2004	2020	2050
	13.9	9.8	9.3

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Country Report

SLOVENIA

Current pension system: first assessment of reform outcomes and output

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SLOVENIA

The Institutional Architecture

The Slovenian pension system underwent two reforms during the 1990s. The 1992 package is described by Stanovnik (2002: 26) as *"too little, too late"*, as the system continued to be used as buffer for labour market redundancies. The public retirement scheme started to generate high deficits after 1996, when the employer contribution rate was slashed almost by half. The second package, the *Pension and Disability Insurance Act*, was approved in 1999. The present pension system is based on three main pillars. Social insurance programmes are combined with social assistance provisions providing the basic safety net for people in need.

The **first (public and mandatory) pillar** is represented by earnings-related programmes, financed through social contributions and related to employment. The zero tier is a *state pension*, which has a markedly universalistic character. It was introduced in 1999 and is unique in the region. It represents a safeguard for those unprotected categories that fall out of general pension systems. To be eligible, the person has to be 65, be a resident of Slovenia and must have resided in a Member State for 30 years when aged 15-65. It is means-tested (income both as flow and stock). The state pension is equal to one third of the current minimum pension assessment base, thereby granting in 2009 a replacement rate of 18.3% to the average net wage. The first tier is financed on a pay-as-you-go basis, through contributions paid by employees (15.5% of gross wages), employers (8.85% of gross wages, before 1996 it was 15.5%), self-employed (total), and through generous state compensatory contributions (compared to other Central, Eastern and Southeastern European countries). Eligibility rules (retirement age) in the public pillar are very complex and flexible, in principle. Once the transition period is over (in 2022), the requirements to be eligible for a public pension are: age 63/65 for women/men with 15 years of insurance period; age 61/63 for women/men with 20 years of pension qualifying period; age 58 with 38/40 years of pension qualifying period for women/men. Under Yugoslavia the latter two represented the full pension qualifying period, for which there was no age criterion to retire. The 1999 reform led to a reduction of pension entitlements through a longer assessment base (best 18 consecutive years, instead of 10) and lower accrual rates (38% and 35% of the assessment base for women/men for the first 15 years and 1.5% for each additional one). This means that a full qualifying period earned benefits equal to 85% of the pension assessment base before 1999 and 72.5% after. There are bonuses and decrements. Bonuses are of two kinds: if the qualifying period is longer than the full one before reaching statutory retirement age, then each additional year is worth more towards the base (up to 3.6% in total); if the age of retirement is higher than the full one, then each month increases the whole pension benefit by a percentage (up to 7.2%). Decrements are of one type only. If an insured retires before the full pensionable age and has accumulated less than the full qualifying period, then his benefits are permanently cut by a variable amount (up to 18%). Indexation is in principle to wages (very complex), and it adapts continuing pensions to stricter eligibility conditions for new pensioner cohorts (a so-called transgenerational equity element). In particular, the combination of the two led to a reduction in net replacement rates, which declined from 89.2% in 1990 to 67.1% of the average wage in 2008 (for old-age pensions).

The **second (private, voluntary or mandatory) pillar** is now either voluntary for private sector employees, mandatory for particular working categories and, since 2004, mandatory for public sector ones. Occupational pension schemes (open- and close-ended) were separated from individual ones (third pillar) in 2001. Different providers are allowed to offer private pension plans: mutual pension funds, pension companies, insurance companies and the public pension fund facility *Kapitalska družba*. These entities are subject to different laws, they are

supervised and licensed by different agencies, they have a different legal status, they evaluate assets differently. As a consequence, neither their products nor their status are comparable, thereby disrupting the level playing field. The Ministry of Labour, Family and Social Affairs approves the schemes. Mutual pension funds are regulated by the *Securities Market Agency*, while for pension and insurance companies the regulator is the *Insurance Supervision Agency*. *Kapitalska družba* is 100% state-owned and enjoys a privileged status. It currently manages four pension funds: i) the Capital Mutual Pension Fund – open-end voluntary supplementary pension insurance fund, which exists since the early 1990s but never took off; ii) the Closed Mutual Pension Fund for Civil Servants – closed supplementary pension insurance fund for civil servants; iii) the Compulsory Supplementary Pension Insurance Fund of the Republic of Slovenia – compulsory supplementary pension insurance fund covering certain jobs (unhealthy or risky) for whom employers are obliged to pay further contributions as compensation for foregone early-retirement; iv) First Pension Fund of the Republic of Slovenia – close-end fund for those who exchanged pension coupons for insurance policy points (as a result of privatization imbalances). All supplementary schemes are Exempt Exempt Taxed. Occupational pensions are prioritised, as deductions first apply to employer contributions and later, up to the ceiling of 24% of total mandatory pension insurance contributions and 5.844% of the gross wage, to the employee. The Closed Mutual Pension Fund for Civil Servants has the greatest tax advantages and covered 187 thousand members in December 2008. This boosted the overall coverage rate of occupational schemes (some 50% of the working population), which reflects a two-tiered labour market. In December 2007, the 12 providers accumulated assets worth 11.3% of Slovenian GDP.
The **third tier is private and voluntary,** consists of individual savings in pension and life insurance vehicles. Premiums paid to this third tier are subject to tax relief, lower than in occupational schemes. Hence, the third pillar faces considerable obstacles for development.

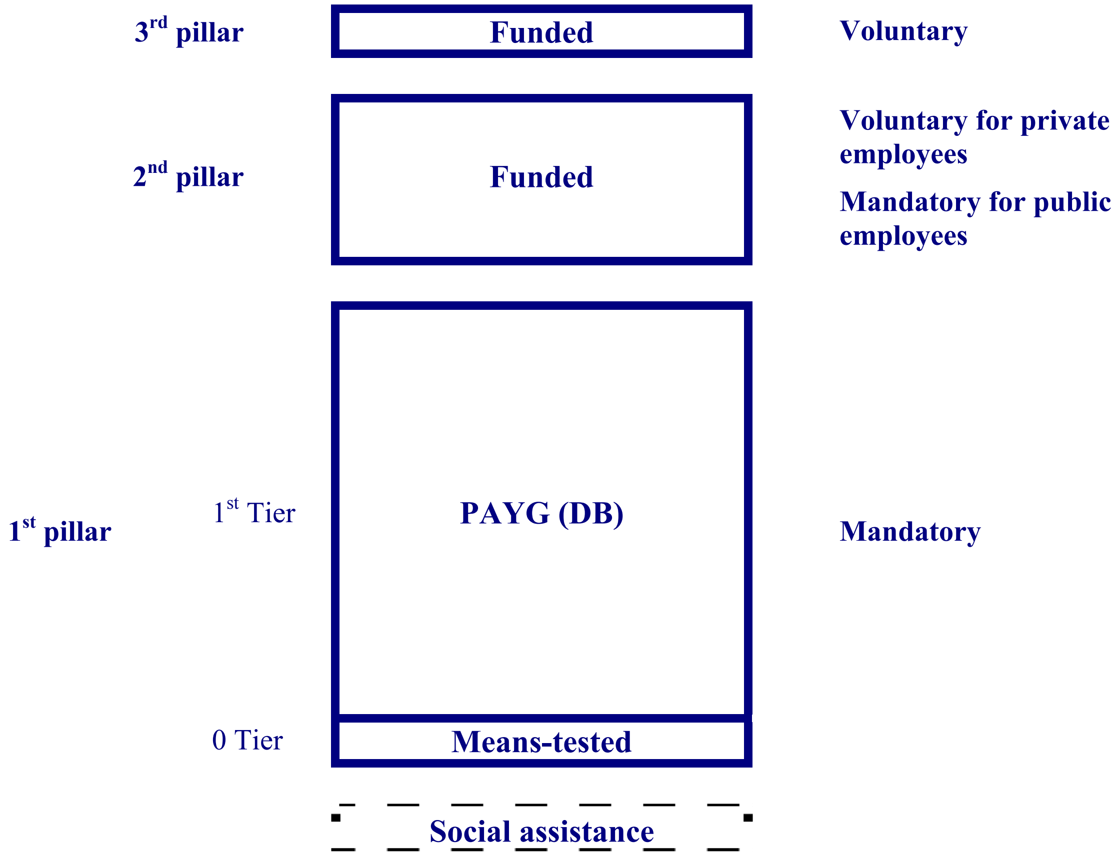
The Administrative Structure

The *Institute for Pension and Invalidity Insurance* (ZPIZ) is an autonomous public finance agency, a monolithic institution that is almost entirely responsible for running the Slovenian public retirement system. It is a tripartite institution, on whose boards sit representatives of the government and the social partners. The *Tax Administration* (DURS) collects social security contributions. The *Ministry of Labour, Family, and Social Affairs* is responsible for policy-making and legislation.

Assessment and Future Challenges

Despite its generosity, two main challenges befall the Slovenian pension system. First, the 1992 and 1999 pension reforms stabilised expenditures only in the medium term. If the starting point is relatively favourable, i.e. 11.0% of GDP in 2004 against 11.9% in EU-25, pension expenditures are bound to rise to 19.3% of GDP by 2050 in a no-reform scenario. Solutions to the problem are to create strong disincentives for early exit and encourage longer labour market participation by using a combination of: penalties, quicker transition to higher retirement ages and Active Labour Market Policies (ALMPs). Second, coverage in occupational and individual supplementary schemes is insufficient. Less than 60% of the active population is insured, showing the typical problems of two-tiered labour markets, as for example in the United Kingdom or Italy. Premia are paltry, amounting to circa 3.6% of the average gross salary in 2007. Most alarming is that even this is too high for labour-intensive industries.

The Main Pillars in the Slovenian Pension System



1st Pillar, universal coverage;
2nd Pillar, occupational schemes;
3rd Pillar, individual programmes.

Annex 1

Key Data about the Pension System in Slovenia

Contribution rates	
Total	**24.35%**
1st pillar	**8.85% (employers)** **15.5% (employees)**

Supplementary schemes	
Contribution rates	**tax-exempt up to 5.844% of gross wages**
Coverage (of employees)	**56% in 2005**
Assets in EUR bln (2007)	**1.05**
Taxation	**Exempt Exempt Taxed**
Investment principles	**Quantitative Restrictions/Prudent Person Principle**

Theoretical replacement rates	**Gross**	**Net**
	1st pillar total	**1st pillar total**
2005	**64%**	**82%**
2050	**39%**	**60%**

SILC income 2005	**Total**	**Male**	**Female**
Relative income of 65+	**0.865**	**0.943**	**0.804**
Aggregate rep. ratio	**0.424**	**0.515**	**0.376**

Eligibility retirement age	**63/65 for women/men with 15 years of insurance period** **61/63 for women/men with 20 years of pension qualifying period** **58 with 38/40 years of pension qualifying period for women/men**
Early retirement	**Special provisions only for particular working categories**
Deferred retirement	**No upper limits**

Indexation	**To wage growth (with a transgenerational equity element)**

Public pension spending (as % of GDP)	**2004**	**2020**	**2050**
	11.0%	**12.4%**	**19.3%**

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SWEDEN

The Institutional Architecture

The old Swedish pension system combined both Beveridgean features – in the form of a universal tax-financed flat-rate basic pension (*folkpension*) and pension supplements – and a Bismarckian insurance system – the earnings-related contribution-financed defined-benefit *allmän tilläggspension* (ATP) – that guaranteed very generous and encompassing protection against old age risk. The ATP system entered serious fiscal difficulties from the 1980s, when a 10-year long reform effort started. This led to one of the most radical pension overhauls in OECD countries. The new system is multipillar, whose first pillar combines a minimum flat-rate guarantee pension (*garantipension*), a Notional Defined Contribution earnings-related pension, the income pension (*inkomstpension*) and a private fully-funded premium pension (*premiereservsystem*). Quasi-mandatory occupational pensions top up the schemes above.
The reform was only possible due to the existence of National Pension Funds (*AP-Fonden*), so-called 'buffer funds', which invested the ATP surpluses during the years, thereby reaching the effective capacity to cover 5 consecutive years worth of benefits.
The reform achieved three important goals: i) it stabilized the long-term financial prospects of the Swedish public pension system; ii) it introduced wage-related indexation, thereby stopping the erosion of the ATP benefit ceilings; iii) by calculating the assessment base over an individual's life-time, it eliminated the perverse redistribution of the best-year formula.
The **first (state and mandatory) pillar** includes three tiers. The zero tier, the guarantee pension supplanted in 2003 the old basic pension and related supplements. It is universal, tax-financed, flat rate and indexed to prices. Eligibility is based on residence (40 years) and age (for people over 65). It is either meant as a source of income for people who do not qualify for public pension or as a supplement for low-income pensioners. Means-testing applies for income earned through the income pension, premium pension, supplementary pension (*tilläggspension*), widow's pension (*änkepension*); but not through by income form capital, occupational pensions (*tjänstepension*) or private pension insurance. In 2009, the full guarantee pension amounted to SEK 6,777 per month for a married persona and SEK 7,597 for a single one. The income ceilings were SEK 10,959 per month for a single person (around a quarter of gross average earnings) and SEK 9,713 per month for a married one. For those who do not meet this requirement (usually immigrants), there is a special maintenance allowance; low-income pensioners are also eligible for the pensioners housing supplement (BTP) that covers 93% of housing costs up to SEK 5,000 per month for a single pensioner.
The first tier is the income pension (ATP), a very sophisticated Notional Defined Contribution system introduced in 1998 for the cohorts born after 1954 (a mixed system applies for those born between 1938 and 1953) and which implies taking into account lifetime income. It is financed through a total contribution rate of 18.5% of the pensionable pay, i.e. the gross wage minus the 7% employee contribution for pension insurance. Of these, 16% flow into ATP and 2.5% to the funded premium pension. Hence the actual contribution rate on gross wages is 17.21% in total, 14.88% to ATP and 2.33% to the premium pension. Contributions are paid up to a ceiling (111% of the gross wage in 2006), employers pay a tax equal to their contributions above that ceiling and this flows into the general budget. The state (sometimes together with the claimant) covers the contributions for inactive periods during childrearing, military service, higher education, sickness and unemployment.
The individual accounts are valorized according to per capita wage growth - an 'income index' (*inkomstindex*) based on changes in average pension-carrying income for wage-earners aged 16-64 (hence the divergence with total wage growth, e.g. as in the case of a declining workforce, may create fiscal imbalances). The retirement age is flexible and one can retire at

any time after 61, however, collective agreements and employers' attitude hinder employment after 67.
The annuity is calculated with respect to an individual's age and is based on gender-neutral mortality tables (hence there is redistribution to women). The rate of return imputed to the annuity is 1.6% and then adjusted for deviations with respect to wage growth (this provides somewhat higher initial annuities and smoothens out the pension prospects).
Due to the deficiencies in valorization, there is also a balancing mechanism. If assets (the buffer fund plus the estimated value of assets in the form of contribution revenues) fall below liabilities (accrued notional pension capital and capital value of outgoing pensions), then indexation of pensions in payment and returns credited to notional accounts are reduced by the ratio of assets to liabilities. In 2008, the ratio fell for the first time under unity, to 0.9672, thereby triggering the mechanism. If the ratio, instead, exceeds 1.1, the built up reserves may be redistributed to the participants.
The second tier, is the fully-funded premium pension, financed by the remaining 2.5% of total contributions. Contributions are collected by the National Tax Board and managed by the Premium Pension Authority (PPM, *Premiepensionsmyndigheten*). This acts as a clearinghouse, managing individual contributions and disbursing annuities. This severs any direct contact between the pension funds and its individual members. New members choose between circa 800 funds, including a public default fund, the Premium Savings Fund, (*Premiesparfonden*) for those who do not make an active fund choice. Annuities are either fixed with a minimum rate of return of 3% or variable. After death, assets are not inheritable and are transferred to the birth cohort. At the end of August, the total market value of investments in the PPM was SEK 283 billion (EUR 28 billion), of which the default fund holds the largest share with a market value of SEK 74.53 billion. Notwithstanding the large information campaign in the early 2000s, only 10-15% of new labour market entrants make an active choice and do not end up insured in the default fund.
The **second pillar** consists of supplementary quasi-mandatory occupational funded schemes. These are based on collective agreements and cover a staggering 90% of employees. The contribution level is usually between 2 and 5% of wages. The plans are either defined-contribution or a defined-benefit. The four main plans are meant for: white-collar workers (*industrins och handlens tilläggspens ion*), blue-collar workers (STP), central government (*statlig tjänstepension*) and local government (*communal tjänstepension*). Some of these schemes allow for retirement as early as at age 55, but frequently beneficiaries start claiming them at age 65.
Finally, the **third pillar** consists of voluntary, supplementary pension schemes, is a voluntary accumulation for old age to pension funds or insurance companies. Its growth is favoured by tax incentives.

Information needs

Just before launching the new system of individual accounts, the Swedish government launched a 3-year information campaign aimed at prospective participants. The media and the web were extensively used. Members received first annual account statement for the pension scheme, the 'orange envelope', together with a brochure explaining the system. Such campaign is crucial to increase financial literacy and individual responsibility. Each orange envelope contains the projections for the first pillar benefits (both the NDC and individual accounts) if the person retires at 61, 65 and 67. The PPM also sends an annual statement on returns and investment in the premium pension.

The Administrative Structure

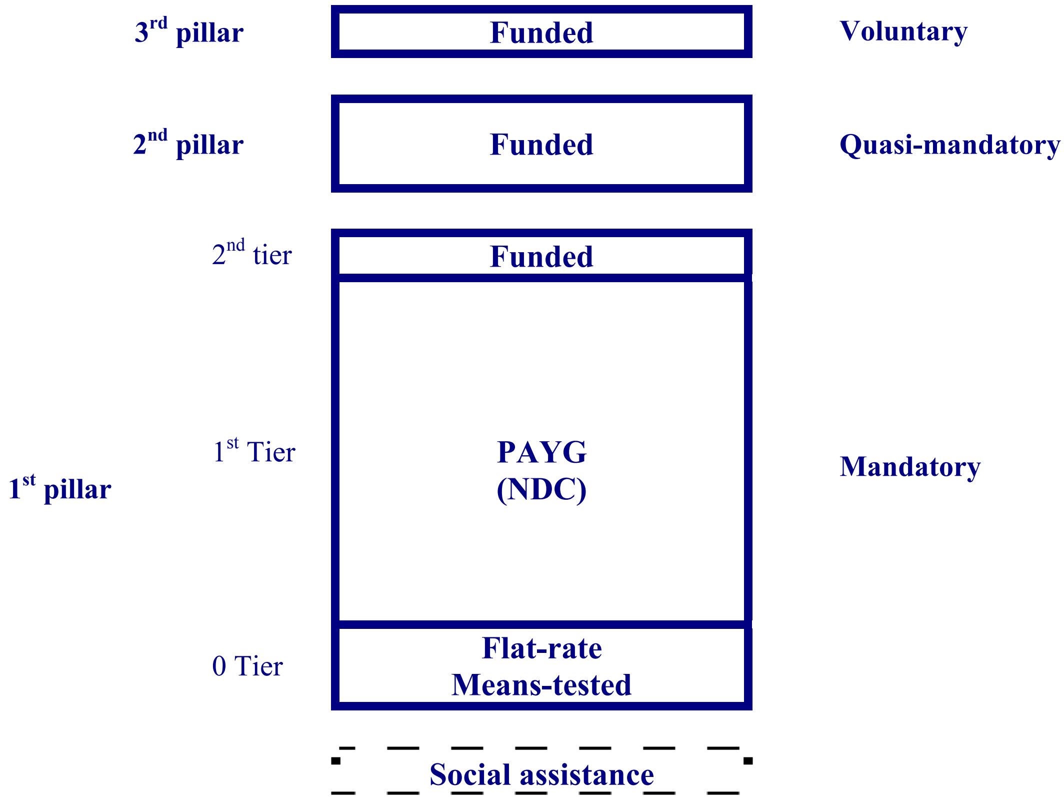
The public pension system is under the responsibility of the Ministry of Social Security and Labour. The National Insurance Board (*Försäkringskassan*) administers the guarantee pension and the income pension. The Premium Pension Authority (PPM) manages the individual accounts and annuities in the premium pension. Private managers administer the funds. All non-insurance based items have been moved to the state budget (contributions for years outside the labour market, the guarantee, disability and survivor pensions). The National Tax Board collects contributions for income-related schemes.

Assessment and Future Challenges

The Swedish system is often considered as one of the most stable and reliable in the world. The introduction of the NDC system will on average decrease replacement rates, but this should not determine any more risks for the elderly, due to high coverage (of occupational pensions as well), extensive pension credits, means-tested benefits and very high labour participation rates.

There are, however, two sets of recommendations that can be given. The first set relates to ways to improve the existing system. The major problem is one of awareness. Information campaigns should be a constant component of one's adult life. In fact, even the financially literate Swedish population fails to understand the underpinning mechanisms of the NDC system and the importance of making an active choice when selecting a pension fund. The second set is instead aimed at would-be reformers who aim to replicate the Swedish system abroad. Sweden had a number of favourable circumstances (broad cross-parliamentarian consensus, 10 years of debate, wealthy AP Funds and a very active labour force) that rendered such radical reform feasible. Not many countries around the globe enjoy such advantages nowadays.

Figure 1 The Main Pillars in the Swedish Pension System



1st Pillar, universal coverage (0 tier tax-financed, 1st tier public and contribution-financed, 2nd tier state-regulated and privately managed, contribution-financed);
2nd Pillar, occupational schemes;
3rd Pillar, individual programmes.

Annex 1

Key Data about the Pension System in Sweden

Contribution rates	
Total (1st pillar)	**18.5%**
1st tier	**16%**
2nd tier	**2.5%**

Supplementary schemes	
Contribution rates	**3-5%**
Coverage (of employees)	**90%**
Assets in EUR bln (2007)	**165.00**
Taxation	**Exempt Taxed Taxed**
Investment principles	**Quantitative restrictions**

Theoretical replacement rates	**Gross**			**Net**
	1st pillar	**2nd pillar**	**Total**	**Total**
2005	**53.0**	**14.7**	**67.7**	**71.4**
2050	**40.4**	**15.4**	**55.8**	**56.7**

SILC income 2004	**Total**	**Male**	**Female**
Relative income of 65+	**0.797**	**0.865**	**0.754**
Aggregate rep. ratio	**0.581**	**0.605**	**0.543**

Eligibility retirement age	
Old age	**Flexible retirement from 61 for both women and men**
Early retirement	**Allowed in some occupational schemes**
Deferred retirement	**No upper limit**

Indexation	
Guarantee pension	**Prices**
Income pension	**Per capita wage growth**

Public pension spending (as % of GDP)	**2004**	**2020**	**2050**
	12.9	**12.8**	**13.9**

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Country Report

United Kingdom

Current pension system:
first assessment of reform outcomes and output

By
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European Social Observatory
www.ose.be

Research Project
"ASSURER UNE PENSION ADÉQUATE DANS UN CONTEXTE EUROPÉEN"
Supported by the
Belgian Federal Public Service Social Security

May 2010

Een onderzoeksproject uitgevoerd door
het Observatoire social européen (OSE)
in opdracht van
de Directie-generaal Sociaal Beleid
van de Federale Overheidsdienst Sociale Zekerheid.

Un projet de recherches de
l'Observatoire social européen (OSE)
à la demande de
la Direction générale Politique sociale
du Service public fédéral Sécurité sociale

UNITED KINGDOM

The Institutional Architecture

The British pension system embodies two features that are peculiar for the European pension panorama: i) its institutional complexity is unmatched and is the result of continuous reform layering; ii) it did not undergo a golden age of benefit expansion and a silver age of retrenchment but was (and still will be) characterized by insufficient protection of the most disadvantaged social groups. This is a direct continuation of Titmuss's 'two nations in retirement', a problem that appeared already in the 1950s, adding insult to injury with regards to the country's Beveridgean aspirations.

In fact, the social inadequacy of retirement in the UK has never been a secret and the failure of the market to protect against the risk of poverty in old age has been openly acknowledged. Hence, the British multi-pillar system has witnessed a number of structural improvements under the New Labour in the last decade.

The first, public pillar has become flat rate and more generous, thereby constituting a social safety net with redistributive features. The second and third pillars – constituted mainly by private occupational and individual savings schemes, as people contract out of state-managed arrangements – have been re-regulated (following the Maxwell and other scandals), rendered less voluntaristic (by the introduction of auto-enrolment mechanisms) and less dependent on contributory records (contracting out is now restricted to defined benefit schemes).

Although the New Labour clearly distanced itself from the neo-liberalism preached by previous, Conservative governments, the problem of the so-called 'under-pensioned' has been mitigated but not solved. Low-income workers, atypical jobs and women still accumulate disadvantages that jeopardize their income status during old age.

The **first (state and mandatory) pillar** consists of the *Basic State Pension (BSP)*, introduced already in 1946. It is a PAYG, flat rate scheme, whose benefits are very meagre, leading to social exclusion in old age. The full BSP for 2009-2010 is GBP 95.25 a week and for couples GBP 152.30 a week. In order to stop the slow reduction of BSP's replacement rate, its indexation has shifted from prices to earnings.

BSP (and the State Second Pension, S2P) is financed by National Insurance Contributions (NICs), which are compulsorily paid on income above the Primary Earnings Threshold (ET), which amounts to GBP 5,715 in 2009-2010. Employees pay Class 1 NICs and self-employed Class 2 and Class 4 NICs. Voluntary insurance is possible for low income employees, non-employed and self-employed persons with low profits (Class 3 NICs – flat rate of GBP 12.05 per week). Class 1 NICs are paid by employers in full – 12.8% of gross payroll above the ET. Employees pay a contribution rate of 11% for earnings between the ET and the Upper Earnings Limit (UEL), that is GBP 43,875 in 2009-2010, and 1% above that. If one earns an amount below the Primary Earnings Threshold and above the National Insurance Lower Earnings Limit (LEL), i.e. GBP 4,940 for 2009-2010, these contributions are being credited to you. Class 2 NICs are paid by self-employed at a flat rate of GBP 2.40 a week and Class 4 NICs are calculated as a percentage of annual taxable profits – 8% between GBP 5,715 (ET) and GBP 43,875 (UEL), and 1% above that.

To qualify for the Basic State Pension (BSP), people need to: i) contribute; ii) have been treated as having contributed; iii) have credits for 90% of their potential working lives. That means that to be entitled to a full BSP, women/men have to contribute for 39/44 years. State pension age, currently 60/65 for women/men, will be equalized (65 for both) between 2010 and 2020. There are no early retirement provisions. Deferred retirement has been further encouraged in 2005: any time restrictions were removed and each year of deferral increases the state pension by 10.4%. After one year of deferral a lump sum can be claimed as well: the

foregone state pension with a guaranteed accrual rate of 2% above the Bank of England base rate.
As a result of the Pensions Act 2007, state pension age increases to 66 during 2024-2028, to 67 during 2034-2036 and 68 during 2044-2046.Otherwise the BSP is proportionally reduced, to a minimum of 25%. The Pension Act 2007 reduces the number of years of contributions or credits required for a full BSP to 30 for all (from 2010). Reduced state pensions will be available already with one year's contribution or credits for people reaching state pension age. This reform is helpful for all people who do not have long contributory records, women in particular. In fact, it is projected that whereas currently only one sixth of women are entitled to a full BSP (as opposed to 90% of men), this proportion should increase to 75% in 2010 and to 90% by 2025.
The BSP is clearly not enough to be socially included (the full rate for individuals is equal to just 19.5% of the 2009 gross median weekly salary in the UK). Hence, the state now tops up low pensionable incomes by granting the Pension Credit, introduced in 2003. This includes two components: the Guarantee Credit and the Savings Credit.
The Guarantee Credit is income-related and independent of NICs. It is a tax-free weekly benefit for people over 60 with low earnings. This eligibility age will increase in line with the women's state pension age. The Guarantee Credit is the continuation of the Minimum Income Guarantee, which tops up weekly income to GBP 130 for individuals and to GBP 198.45 for couples.
The Savings Credit is an extra amount for people aged 65 or over, who have made modest provision for their retirement. It can be drawn together with the Guarantee Credit. The Savings Credit amounts up to GBP 20.40 a week for individuals and GBP 27.03 a week for couples. Eligibility for Savings Credit is rather complex, but it is still available for incomes up to GBP 181 a week for individuals and GBP 266 for couples.
Both the amounts of the Guarantee and Savings Credits may be more in case of disability, caring responsibilities or certain housing costs, such as mortgage interest payments.
The **second and third pillars** consist of supplementary state- or privately-run pensions. The pillars are again extremely complex and allow for various options. The default scheme is the State Second Pension (S2P). However, one can contract out of the S2P by choosing either

i) traditional, lightly regulated private plans
   a. second pillar company (occupational) schemes
      i. contracted-out occupational pension schemes – Contracted-out Salary-related Schemes (COSRS), Contracted-out Money-Purchase Schemes (COMPS), Contracted-out Mixed Benefit Schemes (COMBS), Contracted-out Hybrid Schemes (COHS)
      ii. voluntary occupational contracted-in schemes – Construction Industry Scaffolders Record Scheme (CISRS), Contracted In Money Purchase Schemes
      iii. third pillar personal schemes – Personal Pensions Scheme (PPS), Appropriate Personal Pension Schemes (APPS), Group Personal Pension Scheme (GPPS)

ii) newly established, heavily regulated private-public schemes
   a. Stakeholder Pension Schemes since 2001
   b. Personal Accounts (PA) since 2008.

Given the intricacy of the two pillars, the fact sheet will analyze the S2P and briefly mention the shortcomings of traditional contracted-out occupational and personal plans. Greater attention will be devoted to Stakeholder Pensions and Personal Accounts.
The *State Second Pension (S2P)* was introduced in 2002 and substituted the State Earnings-Related Pension Scheme (SERPS). S2P covers most employees but not the self-employed.

Contributions and credits for the S2P cumulate now for various categories that were previously discriminated by the SERPS, due to their excessively low incomes.

Employees earning at or above the annual LEL (GBP 4,940 in 2009-2010) up to the Low Earnings Threshold (LET), i.e. GBP 13,900 for the tax year 2009-2010, are treated as if they had earnings equal to the LET for State Second Pension purposes. However, the protection of periods outside employment varies greatly. Both the BSP and S2P provide protection for various types of care: for children under six and receiving Child Benefits; for ill or disabled persons and getting Home Responsibilities Protection (HRP); for those entitled to Carer's Allowance. In all these cases S2P accumulates as if the carer earned the LET. As of 2010, according to Pensions Act 2007, HRP is being replaced with National Insurance credits. For the S2P, years caring for a child under 12 are credited at the LET.

Likewise, disability is also fairly treated and provides contributions to S2P if one is entitled to long-term Incapacity Benefit, contributory Employment and Support Allowance, protected Severe Disablement Allowance or Income Support.

Unemployment is not protected this well: contributions are credited to the BSP only and not to the S2P. Being inactive or working in the informal economy does not give you any rights and may relegate you to social assistance.

As for S2P benefits, under current rules, these build up at different rates depending on one's income. The way the State Second Pension is calculated will be simpler from 2010-2011. Instead of using three bands of earnings, the top two earnings bands will be merged. S2P will gradually become flat rate, worth around GBP 1.60 a week, for each qualifying year. People earning above the LET are entitled to an extra earnings-related payment. By 2030 this will be phased out. Provided that the S2P flat benefit does not increase, this means that the combined BSP and S2P benefits will again socially exclude their recipients.

Contracting out of SERPS was traditionally connected to the role private financial institutions played in the UK. Contracting out guaranteed various rebates on NICs, under the conditions that private benefits be at least equal to those guaranteed by the public scheme. This was not a particularly difficult condition since the Conservatives started retrenching public benefits back in 1986.

However, two decades later, the market clearly proved incapable to warrant social inclusion to the least protected social groups – low-income workers, employees in small firms, the self-employed and atypical contract holders. Voluntary, additional savings proved to be and entirely inadequate solution for low-income workers as the incompatibility between means-tested benefits and the propensity to save was far too evident.

Hence, due to a number of market failures – excessive complexity, high fees, patchy and sector-biased coverage, mis-selling, vulnerability to financial crises and a massive shift from defined benefit to defined contribution schemes – contracting out has changed in two ways: i) new plans have been added, which combine simplified rules and lower costs (Stakeholder Pensions in 2001 and Personal Accounts in 2008); ii) the Pensions Act 2004 introduced tougher solvency rules and the Pension Protection Fund to safeguard against the sponsor's insolvency and underfunding; ii) the Pensions Act 2007 ends (the date is still undefined) contracting out on a money-purchase (defined contribution) basis and allows only for contracted out salary-related (defined benefit) schemes.

The main problem with occupational plans is their variability and low coverage. Circa 47% of employees are members of an occupational pension scheme and 19% have personal plans. Since plans overlap, overall coverage of voluntary private pensions is 59%. The size of the firm matters mostly: 71% of workers in small firms were not covered in 2003, 56% in medium and 40% in large enterprises. Public sector was far more encompassing: 83% of male and 81% of female employees were covered in 2003. Being coverage entirely voluntary for the self-employed, these are of course the least covered group - only 43%/35% of self-employed men/women contributed to a private scheme in 2003. In general, women working part-time are the most discriminated. Hence, Stakeholder Pensions and Personal Accounts were introduced to cover low-income groups and atypical employment contracts.

As for the calculation formulae, in the public sector there are only defined benefit schemes, but in the private sectors money-purchase and hybrid schemes were steadily gaining ground, thereby shifting all the risk onto the employee. For new labour market entrants, defined contribution schemes are becoming the norm, hence, the New Labour decided to stop this by allowing contracting out only to defined benefit plans.

As mentioned a number of times, to reduce the negative effects of voluntarism, the Welfare Reform and Pensions Act 1999 introduced Stakeholder Pensions and the Pensions Act 2008 introduced *Personal Accounts (PA)*.

Stakeholder Pensions were meant especially to cover low-income employees. They are money-purchase personal schemes with limited charges, which allow members to vary contributions. They are managed by insurance companies and have a link with employers, since all firms but the smallest (below 5 employees) have to grant access. However, since employers do not have to mandatorily contribute, the take up rate is very low among the targeted group of working poor.

Personal Accounts seem more promising. They are multi-employer occupational schemes. Via the auto-enrolment of workers through their employer, most problems related to the limited access to company funds should be resolved. The total contribution rate will be 8% (slightly less than the 9% average for defined-contribution occupational schemes): 4% for employees (with an income floor and ceiling), 3% for employers and 1% tax relief.

To keep costs low, a clearinghouse, inspired to the Swedish Premium Pension, which collect contributions for Personal Accounts, keep the records and match schemes and workers. Management and administration of the plans remains private. Failure to select a fund will result in the enrolment into a ‘default fund’ with low investment risk.

Personal Accounts should be beneficial for employees and employers. Among underprotected employees, four groups shall gain from Personal Accounts: i) the 2 million workers who have employer contributions lower than 3%; ii) 9 million employees not covered by occupational schemes will be auto-enrolled; iii) circa 3.5 million employees not eligible for auto-enrolment may choose Personal Accounts voluntarily; iv) people under 22 may opt in and receive the 3% employer contribution. However, auto-enrolment falls short of quasi-mandatory or mandatory participation. People earning less than the LEL are not eligible. Roughly 3 million self-employed and 9 million economically inactive cannot be auto-enrolled and are not eligible for employer contribution. They can choose to voluntarily opt in into Personal Accounts as an alternative form of saving.

However, given the poor record of voluntary savings inclination, it is questionable whether huge numbers will actually start saving. Hence, the problem of patchy second pillar coverage has been mitigated but definitely not solved.

Information needs

In addition to brochures, annual statements etc, prospective British pensioners have a capillary access to information and data about their pensions. The most reliable source is Directgov (http://www.direct.gov.uk/en/index.htm), which includes all fundamental information on pensions as well as benefit calculators.

The Administrative Structure

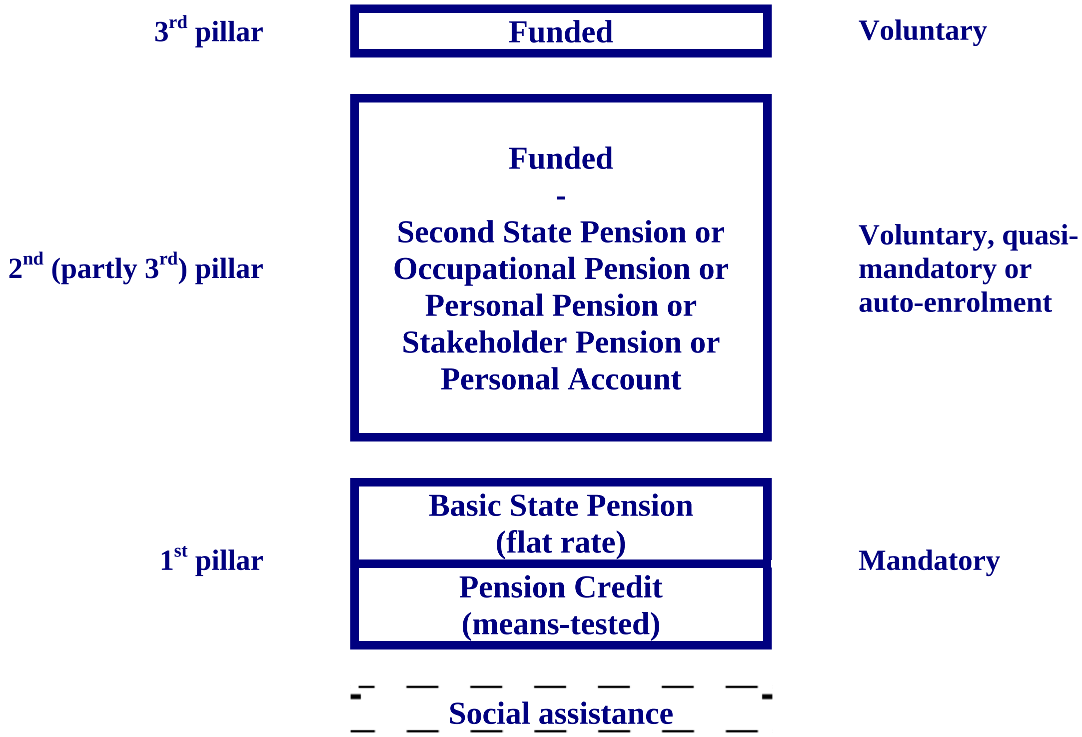
The pension system is under the responsibility of the Ministry of Social Security and Labour. Inland Revenue collects social security contributions via regional and local National

Insurance Contributions Offices. The management of accounts and the payment of public pension benefits (BSP, Pension Credit, S2P) are administered by the Pension Service, part of the Department of Work and Pensions (renamed in 2002), through the National Insurance Fund. Social partners do not participate to the administration of public provisions.
Private schemes, by contrast, can be administered by different private actors: employers, financial services companies and various organizations. Since 1995 reform at least two employee representatives have to sit on the board of trustees (up to 1/3 of the board). The governing body of these organizations is the National Association of Pension Funds (NAPF). The Pension Regulator (renamed in 2005) monitors the occupational pension sector.
The Financial Services Authority (FSA), the statutory regulator for financial services since 2001 monitors personal pension schemes.

Assessment and Future Challenges

As stated in the introduction, the British pension system is excessively complex as well as discriminatory against certain working categories (low-income employees, the self-employed, atypical job holders and workers in smaller firms) and social groups (women, unemployed, those employed in the informal sector). The main reason for the lack of social inclusiveness is the imperfect interaction between the ungenerous public pension system (BSP, Pension Credit and S2P) and contracted out occupational and personal schemes (more generous, but costly and hence leading to patchy coverage). Continuous amendments to the system have mitigated but not eliminated the problems of high risk of poverty in old age. A more radical move, such as mimicking the Dutch or Danish solutions, and the introduction of a sound and generous Beveridgean social safety net could solve the impasse.

Figure 1 The Main Pillars in the British Pension System



1st Pillar, universal;
2nd Pillar, occupational schemes;
3rd Pillar, individual programmes.

Annex 1

Key Data about the Pension System in Britain

Contribution rates			
Class 1	Class 2	Class 3	Class 4
Employer: 12.8% above the ET	Self-employed: GBP 2.40 a week	Voluntary: GBP 12.05 a week	Self-employed: 8% on profits between ET-UEL 1% above UEL
Employee: 11% between ET-UEL 1% above UEL			

Supplementary schemes	
Contribution rates	9% on average in occupational contracted out schemes
Coverage (of employees)	59% total (47% occupational plans, 19% personal plans)
Assets in EUR bln (2007)	1,490.00
Taxation	Exempt Exempt Taxed
Investment principles	Prudent Person Principle

Theoretical replacement rates	Gross			Net
	1st pillar	2nd pillar	Total	Total
2005	17%	50%	66%	82%
2050	19%	50%	69%	85%

SILC income 2005	Total	Male	Female
Relative income of 65+	0.720	0.738	0.713
Aggregate rep. ratio	-	-	-

Eligibility retirement age	
State pension age	60/65 for women/men, equalized to 65 by 2020, increased to 68 by 2046
Early retirement	No
Deferred retirement	Unlimited

Indexation	
BSP and Pension Credit	Earnings
S2P	Prices

Public pension spending (as % of GDP)	2005	2020	2050
	6.6%	-	8.6%

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