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Commentary

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Social Security and Pension Trends: Five Country Case Studies

The American Association of Retired Persons (AARP) Public Policy Institute has commissioned five country-specific case studies of Social Security and Pension topics and trends. The five countries selected for these studies are Australia, Canada, Chile, Sweden and the United Kingdom. These case studies have been published with the respective titles of: *(1)Old-Age Income Security: Australia Tries a Different Way (2)Financing the Canada and Quebec Pension Plans (3)An Update on Chile's Experience with Partial Privatization and Individual Accounts (4)Sweden's Move to Defined Contribution Pensions and (5)Voluntary Carve Outs for Social Security Reform: Lessons from the United Kingdom.* Together these five case studies serve to provide potential guidance to policymakers in other countries as they seek to address the challenges presented by demographic change including aging populations, increasing longevity, declining birth rates and other economic and social trends that impact the financing, solvency and sustainability of Social Security systems.

From the experience in Australia, AARP notes that the Superannuation Guarantee is a mandatory pension system that requires employers to make contributions for employees based on earnings. However, there is concern as to whether the 9% contribution rate for the Superannuation Guarantee will produce adequate income in retirement, particularly for women due to their longer life expectancies, shorter work histories and lower earnings. Australia provides a basic means-tested age pension to benefit the elderly poor that has to some extent created a disincentive for personal saving and investment. According to the AARP study, the combination of a means-tested basic age pension and a Superannuation Guarantee with mandatory contributions has created huge complexities and perverse labor force and financial behavior patterns.

From the experience in Canada, AARP notes that the Canada Pension Plan (CPP) may invest its assets in the securities markets through the CPP Investment Board. This Board began investment operations in 1999; its mandate is to invest in the best interests of contributors and beneficiaries and to maximize long-term investment returns without undue risk of loss. The CPP Investment Board is an independent entity operating at arm's length from the federal and provincial governments. As of September 30, 2007 the total portfolio under management amounted to C$121.3 billion comprising public equities (56.5%), private equities (8.1%), bonds and money market securities (24.9%), real estate (5.1%), inflation-linked bonds (3.3%) and infrastructure investments (2.1%). The latest CPP actuarial report includes a statement that better-than-anticipated experience, especially regarding investment performance over the period 2004-2006, has put downward pressure on the required steady-state contribution rate over the CPP's 75-year projection period.

From the experience in Chile, AARP notes that Chile became the first nation to shift from a pay-as-you-go defined benefit social insurance model to a funded defined contribution model and that many other Latin American countries implemented reforms based on the Chilean model. However, in the Chilean economy, many workers are employed part time, seasonally, or on short-term contracts, and many work in the informal sector. As a result, many workers, particularly women and others with low wages, are unable to accumulate enough funds to provide an adequate pension. Women are particularly disadvantaged, as only 30 percent of women who have contributed to the system qualify for a pension above a minimum level; the average pension for retired women is about 60 percent of that for retired men.

From the experience in Sweden, AARP notes that under a reformed system workers contribute 16 percent of earnings to a notional defined contribution account that the government controls. In addition workers contribute 2.5 percent of earnings that is invested in individual accounts. The 16 percent is credited into a notional defined contribution account to which is added notional interest. The purpose of the account is to determine the corresponding benefit payable at retirement and to provide a link between contributions and benefits. The system remains pay-as-you-go; the notional accounts are not backed by separate individual assets. In order to keep the system stable in terms of the relationship between contributions and benefits, it is necessary to introduce an automatic balancing mechanism that, in effect, operates by adjustments to the benefit indexing system that will likely reduce the real value of future retirement incomes in relation to pre-retirement income.

From the experience in the United Kingdom, the AARP notes that the UK introduced voluntary carve-out accounts where workers were given the opportunity to voluntarily divert part of their social security payroll taxes into an individual account in exchange for which future social security benefits were reduced. However the experience was unsatisfactory since the accounts carried high administrative fees, paid no interest for eighteen months as posting of contributions to accounts lagged collections and were deemed to credit interest at too low a rate resulting in one-half million people abandoning their individual accounts and returning to the regular social security system.

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