

Pension Reform

*Issues and Prospects for
Non-Financial Defined Contribution (NDC) Schemes*

*Edited by
Robert Holzmann and Edward Palmer*

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Preface

THE PREVIOUS DECADE HAS BEEN A DECADE OF PENSION REFORM throughout the world. In high income countries the driving force has been the threat that current systems will become unaffordable in coming decades, with demographic developments presenting a major risk. In another setting, countries in the process of transition from a command to a market economy are confronted with the challenge of introducing a public pension system that will provide social security in old age but that also supports the fundamentals of a market economy. In the latter sense, it is important to examine carefully the experiences of developed market economies. Even in these countries, the driving force behind reform is demographic change and affordability. In a third setting, middle and lower-middle income countries are faced with the question of what system will best serve the interests of their specific country goals for the future. In all of these settings “NDC”—non-financial defined contribution – pension schemes have been on the agenda in discussions of possible options.

Sweden is one of the handful of countries to have implemented an NDC scheme in the 1990s. The Swedish NDC pension reform has its roots in the work of a Working Group on Pensions that began its work at the end of 1991. After about two years of public discussion of the central ideas of the reform, following the Working Group’s publication of the proposed framework of the reform in 1992, the final proposal was published in February 1994, and passed as legislation by the Parliament in June 1994. After a short political pause, following the election in the fall of 1994, the process of implementation began in 1996. This encompassed rewriting extensive benefit and tax legislation, including difficult transition legislation, as well as developing new information technology, a new annual statement for participants, and a new electronic information systems for participants. The final conceptual bolt was put in place with the construction of a mechanism to assure long-run balance between assets and liabilities, the automatic balancing mechanism. Account statements were sent out for the first time in 1999. Benefits have been paid out according to the new rules since 2001. Now, in 2005, all of the nuts and bolts are in place and the system has been operating over several years.

Additionally, the political consensus behind the Swedish pension reform is as strong today, in 2005, as it was in 1994. From the mid-1990s, NDC came into its own as a concept and was implemented in four countries EU countries. Italy, Latvia, and Poland are the other three. Following these examples, NDC has become a reform option considered by many countries.

It is now safe to say that the reforms in the four original NDC countries in Europe generated considerable interest especially among European neighbors, but also world-wide. The interest generated in Europe is easy to understand since most of Europe has a pay-as-you-go tradition, and NDC constitutes a new way to “organize” a mandatory, universal pay-as-you-go pension system. And, the majority of European countries are discussing reform of their systems in one way or another. What’s more, we now have some experience of NDC schemes implemented during the 1990s. Against this background, it felt particularly relevant for Sweden to host a conference devoted to discussing both the conceptual and institutional aspects of NDC. This would provide an opportunity for Swedish reformers to reflect over the design of the Swedish system in the presence of international pension experts, from both the academic and the policy communities. The goal was even more ambitious, however. The goal was to contribute to creating a synthesis of current knowledge on this new topic. This book is the realization of that goal.

The Swedish National Social Insurance Board was particularly pleased to organize the conference jointly with the World Bank, which served to broaden the discussion to encompass considerations of importance for World Bank client countries. The conference was held during two days in late September 2003 on the island of Sandhamn, one of the outermost islands in the Baltic Sea Archipelago outside Stockholm. The discussion of papers and ideas was spontaneous and challenging, with a whole room of experts from varying affiliations, regions of the world and intellectual “priors.”

My experience is that intellectual reciprocity is a rare outcome of seminars and conferences, and that staying with one’s own hobby-horse is the normal *modus operandi*. This was certainly not the case on Sandhamn, however. Here, experts were not only speakers; they were listeners. Ideas were exchanged and developed in a positive, collegial atmosphere. This gave the feeling of something happening in the room, the feeling that at the end a new and shared understanding had been reached. I believe that all the participants felt that they left the island of Sandhamn with the feeling that they had participated in a conversation that lifted their thoughts to a new level.

Although we didn’t call it NDC in the initial years in Sweden, I have personally been on the NDC journey for well over a decade. From late 1991 to June 1994 I represented the Social Democratic Party in the Government’s Working Group on Pensions, and then became responsible for the reform process as Deputy Minister for Social Insurance, following the election of 1994. In mid-1996, as Director General of the National Social Insurance Board, I became responsible for implementing the reform. Now, in 2005, over a decade after the historical decision of the Swedish Parliament, it is a pleasure for me to help provide a broad readership with the opportunity to share the fruits of the Sandhamn deliberations. And, I’m pleased to note that since the Sandhamn conference in autumn 2003, the contents of this book have developed considerably, not only with improved papers originally presented there, but with several new papers. I believe that this book will provide stimulating reading for pension experts and politicians representing both varied academic and country backgrounds.

Anna Hedborg

Acronyms and Abbreviations

ABM	automatic balancing mechanism
AEI	average earnings index
AF	adjustment factors
ATP	<i>allmänna tilläggspension</i> (earnings-related benefit in Sweden)
CNAV	<i>régime général</i> (basic general scheme in France)
CWB bonds	covered wage bill bonds
DB	defined benefit
DB-PAYG	defined-benefit pay-as-you-go
DC	defined contribution
EP	earnings points
EPC	Economic Policy Committee (European Union)
FDB	financial defined benefit
FDC	financial defined contribution
FEDEA	Fundación de Economía Aplicada (Spain)
FFS	fully funded schemes
FP	<i>folkpension</i> (flat-rate universal benefit in Sweden)
FRD	Demographic Reserve Fund (Poland)
FUS	Social Insurance Fund (Poland)
GRV	<i>Gesetzlich Rentenversicherung</i> (public retirement insurance in Germany)
IC	initial capital
IFM	integration to financial markets
ILO	International Labor Organization
INPS	Istituto Nazionale per la Previdenza Sociale (National Social Security Institute in Italy)
IRA	individual retirement account
IRR	internal rate of return
ISSA	International Social Security Association
IT	information technology
KNH	Kosei-Nenkin-Hoken (principal pension program for private-sector employees in Japan)
LE	life expectancy
LMW	Latvian Ministry of Welfare
MEA	Mannheim Research Institute for the Economics of Aging

MODPENS	Modelo de Pensiones (Spain)
NDB	non-financial defined benefit
NDC	non-financial defined contribution (also, <i>notional defined contribution</i>)
NIPSSR	Japanese National Institute of Population and Social Security Research
INE	Instituto Nacional de Estadística (National Institute of Statistics in Spain)
IRR	internal rate of return
OLG	overlapping generations
PAYG	pay-as-you-go
PDV	present discounted value
PPM	<i>Premiumpensionsmyndighet</i> (Premium Pension Agency, the public clearinghouse for the new FDC scheme in Sweden)
PROST	Pension Reform Options Simulation Toolkit
RPI	retail price index
SSA	U.S. Social Security Administration
TD	turnover duration
TFR	total fertility rate
TSSCI	total social security contributions index
VAT	value-added tax
ZUS	Social Security Insurance Institution (Poland)