Private and Other Pensions

In most if not all countries with public old-age security systems, additional old-age security schemes have been developed to complement (and in some cases replace) those in the public sphere. Complementary systems typically are related to specific industrial sectors and/or private companies, and are referred to as "occupational pensions," "supplementary pensions," or "private pensions." While these terms are sometimes used interchangeably, they have different meanings and definitions in different cultures (see apRoberts, 1993, for a discussion of terminology regarding complementary retirement pensions).

Occupational pension plans existed prior to public social security in most industrialized nations, but covered only a small fraction of the labor force. Over time, the importance of occupational pensions has increased: employers have used such plans as incentives to attract and retain employees, while workers have sought an enhancement of old-age security beyond that promised by public support mechanisms. Occupational pension schemes are sponsored by employers, usually voluntarily or through collective bargaining. Unlike public pay-as-you-go plans, employer-sponsored plans generally are or strive to be "fully funded," meaning that a plan is designed to accumulate enough assets to cover the present value of future liabilities owed to plan members.

There are many types and variants of private pension plans; one estimate for the United Kingdom suggests the existence of 128,000 different private-sector schemes in 1991 (Daykin, 1994). Plans may be managed by special public bodies or, more commonly, by private firms and insurance companies. A wide variety of funding arrangements exists, as does the extent to which governments regulate and tax private plans. Given the structural variety of occupational pension plans, it is not surprising that benefits also differ greatly from one employer to the next, and that plans are nontransferable from one employment to another (World Bank, 1994).

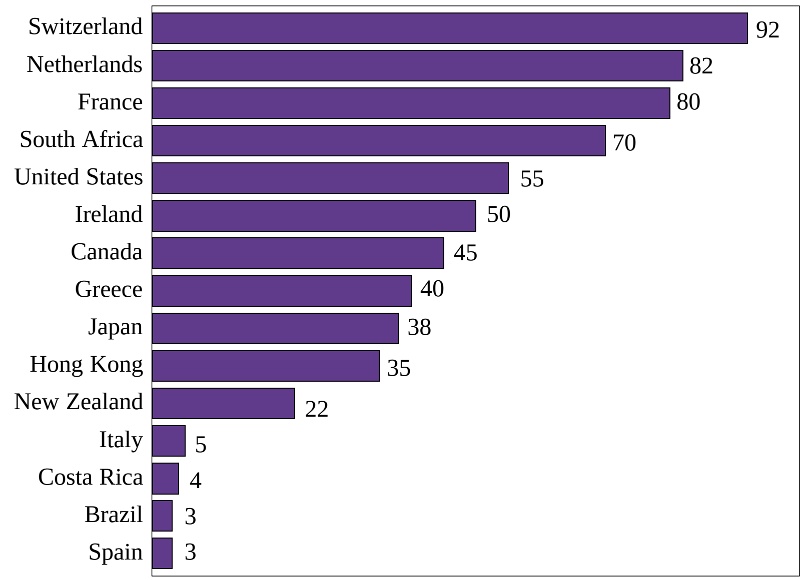
Because government involvement in occupational pension schemes differs greatly across countries, the distinction between public versus private regimes often becomes blurred. Further, the complexity of occupational pensions precludes a precise comparison among countries. Even within a country, it is virtually impossible to calculate a single replacement rate for occupational pensions when in fact the level varies from one sector to another, from one income category to another, and also according to personal characteristics of retirees. International organizations do not regularly collect statistics on complementary pensions, due in large part to such international differences. Because of the difficulty in obtaining crossnational statistics on private and other pensions, this section focuses primarily on a small set of industrialized nations for which reasonably comparative data have been compiled. Given the preceding caveats, the reader is advised that strict comparisons among national statistics may be unwarranted.

Occupational pensions cover roughly one-third of workers in developed countries

Occupational pension plans cover about one-third of the labor force in OECD countries but far less in most developing countries and transitional economies, where employer-sponsored schemes tend to cover only public-sector workers. Most occupational plans are employer-specific, but in some nations (e.g., Denmark, the Netherlands) plans are organized on an industry-wide basis, with compulsory participation a result of collective bargaining. Switzerland requires all employers to provide pension benefits for employees.

Company-based pension programs in the developing world are found most frequently in former British colonies and in countries with large multinational subsidiaries. Most such programs are subject to less regulation and lower funding requirements than their counterparts in industrialized countries, although both Indonesia and South Africa have developed comprehensive and well-regulated private pension systems. Coverage of private sector workers is increasing in a number of other large developing nations such as Brazil, India, and Mexico (World Bank, 1994).

Figure 5.1
Percent of Labor Force Covered by Occupational Pension: Circa Late 1980's



Note: Coverage in Switzerland, the Netherlands and France is compulsory for many workers; coverage in other nations shown is voluntary.

Source: World Bank, 1994

Occupational pension coverage related to national social security policy

Chapter 4 mentioned ways in which public retirement scheme features may vary according to national income security goals. The prevalence and regulation of private retirement schemes also is related to national policy, because private benefits often complement public benefits. In nations where public pensions are directly linked to lifetime earnings (e.g., in Belgium, Canada, Germany, and the United States), occupational pension schemes are voluntary. In countries where public retirement benefits are mainly in the form of lump-sum payments (e.g., in Denmark, France and Switzerland), governments tend to make occupational pensions mandatory and to link benefits to employees' earnings (OECD, 1988c). Private benefits usually represent a smaller portion of the total compensation mix in countries that provide relatively generous state benefits (Knight, 1992).

Private pension plans in most countries are largely or fully funded, with employer and employee contributions set aside. Some nations use a combination of funded and pay-as-you-go features, depending on the occupations involved. Private pension distributions are subject to income tax in all developed countries except New Zealand, although effective tax rates are usually low relative to those of workers.

Table 5.1

Occupational Pension Scheme Features in 19 Developed Countries: Early 1990's

Country	Nature	Normal Benefit Type	Primary Financing Type
Belgium	Voluntary	Linked to salary	Funded
Canada	Voluntary	Mixed[1]	Funded
Denmark	Compulsory	Lump sum	Funded
Finland	Compulsory	Linked to salary	Mixed[2]
France	Compulsory	Linked to salary	Mixed[2]
Germany	Voluntary	Mixed[1]	Book reserve
Greece	Voluntary	Linked to salary	P-A-Y-G
Ireland	Voluntary	Linked to salary	Mixed[2]
Italy	Voluntary	Linked to salary	Mixed[2]
Luxembourg	Voluntary	Linked to salary	Book reserve
Netherlands	Voluntary	Linked to salary	Funded
New Zealand	Voluntary	Mixed[1]	Funded
Norway	Voluntary	Linked to salary	Funded
Portugal	Voluntary	Linked to salary	Funded
Spain	Voluntary	Mixed[1]	Funded
Sweden	Voluntary	Linked to salary	Funded
Switzerland	Compulsory	Linked to salary	Funded
United Kingdom	Voluntary	Linked to salary	Funded
United States	Voluntary	Linked to salary	Funded

Note:
[1]Mixture of lump-sum and salary-linked provisions.
[2]Mixture of fully-funded and pay-as-you-go features.

Source: Aarts, Burkhauser and de Jong, 1992, cited in Quinn and Burkhauser, 1994

Number of contributors to private pension plans generally on the rise

Table 5.2 shows the increase in private pension plan contributors (active participants) that has occurred in most developed countries. More than 42 million workers in the United States alone were involved in some form of private pension plan in 1988. While the number of active private plan participants in the U.S. is much higher than in other countries, coverage relative to its private-sector workforce is lower than in Switzerland and France, which have mandatory plans for some industries. The U.S. private pension system is acknowledged to be the most regulated voluntary system in the world. Despite efforts to strengthen and expand its coverage, the share of participating private-sector workers rose only modestly between 1970 and 1988 (Dailey and Turner, 1992). The percentage of full-time private workers in U.S. company pension plans reached a high of 50 percent in 1979, and then fluctuated between 46 percent and 50 percent during the period 1980 to 1993 (U.S. National Research Council, 1995).

Table 5.2

Active Participants in Private Pension Plans and as a Percentage of Private-Sector Labor Force: 1970-89

Numbers of participants in thousands

Year	Australia	Canada	France	Japan	Netherlands	Switzerland	United Kingdom	United States
1970	-	1,552	10,583	5,905	1,592	1,102	7,125	26,100
1975	-	2,046	15,183	9,424	1,729	1,207	6,000	30,738
1980	-	2,505	16,502	11,200	2,109	1,311	6,025	35,939
1981	-	-	16,494	11,810	2,106	1,365	-	36,912
1982	-	2,682	16,414	12,440	2,063	1,434	-	37,481
1983	-	-	16,407	12,830	2,059	1,518	5,800	38,971
1984	-	2,536	15,823	13,430	2,083	1,543	-	39,713
1985	1,014	-	15,509	14,030	2,137	-	-	40,444
1986	1,160	2,582	15,324	14,620	2,205	-	-	41,209
1987	1,261	-	15,429	15,150	2,232	2,331	5,800	41,784
1988	1,572	2,673	15,730	15,850	2,292	-	-	42,300
1989	1,742	2,754	16,000	16,720	2,423	-	-	-

Participants as a percentage of private-sector labor force

Year	Australia	Canada	France	Japan	Netherlands	Switzerland	United Kingdom	United States
1970	-	26	80	20	50	46	38	42
1975	-	28	100	29	49	51	32	44
1980	-	29	100	31	59	56	31	45
1981	-	-	100	32	58	57	-	45
1982	-	30	100	33	56	61	-	45
1983	-	-	100	33	56	65	30	45
1984	-	28	100	34	57	66	-	46
1985	20	-	100	35	59	-	-	46
1986	22	27	100	36	59	-	-	46
1987	23	-	100	37	61	92	29	46
1988	28	28	100	38	62	-	-	46
1989	30	29	100	39	66	-	-	-

Notes: "–" Data not available

Some figures are as interpolated in the source.

Private-sector labor force includes wage-earners and salaried employees plus the unemployed. Part-time employees are included to the extent they appear in national labor force statistics. Self-employed persons, unpaid workers, and all government (and related agency) workers are excluded.

Information for Japan is for funded pension plans only. See source for additional country-specific details.

Source: Dailey and Turner, 1992

Number of beneficiaries growing faster than contributors

Although numbers of private pension beneficiaries are much smaller than corresponding numbers of contributors, the former have been growing at a faster rate since 1970 in many developed countries. The ratio of private pension beneficiaries to all persons aged 65 and over is roughly 1 to 3 in most countries in table 5.3, with a notably high level in France and a relatively low level in Japan. Australia's level is especially low given that its private system is a recent creation with as yet few beneficiaries.

Table 5.3

Persons Receiving a Retirement Pension From a Private Plan and as a Percentage of All Persons Aged 65 and Over: 1970-89

Persons receiving a private pension, in thousands

Year	Australia	Canada	France	Japan	Netherlands	Switzerland	United Kingdom	United States
1970	-	-	-	-	292	127	1,025	3,230
1975	-	-	2,324	-	364	167	1,100	4,600
1980	-	-	3,455	551	449	208	1,350	6,030
1981	-	610	3,569	616	467	218	-	6,370
1982	-	640	3,660	687	483	225	-	6,750
1983	-	671	3,741	766	497	237	1,800	7,160
1984	-	700	3,932	850	515	244	-	7,600
1985	25	752	4,242	943	535	-	-	8,000
1986	22	828	4,575	1,031	559	-	-	8,500
1987	-	904	4,764	1,142	581	274	-	-
1988	-	981	4,953	1,239	578	-	-	-
1989	-	-	5,047	1,342	590	-	-	9,000

Private pension recipients as a percent of all persons aged 65+

Year	Australia	Canada	France	Japan	Netherlands	Switzerland	United Kingdom	United States
1970	-	-	-	-	22	18	14	16
1975	-	-	33	-	25	21	14	20
1980	-	-	46	5	28	24	16	23
1981	-	26	49	6	28	25	-	24
1982	-	26	51	6	29	25	-	25
1983	-	27	53	7	30	27	21	27
1984	-	27	57	7	30	27	-	27
1985	2	28	63	8	31	-	-	28
1986	1	30	67	8	32	-	-	29
1987	-	32	69	9	32	30	27	-
1988	-	33	70	9	31	-	-	-
1989	-	-	71	9	32	-	-	29

Notes: "–" Data not available

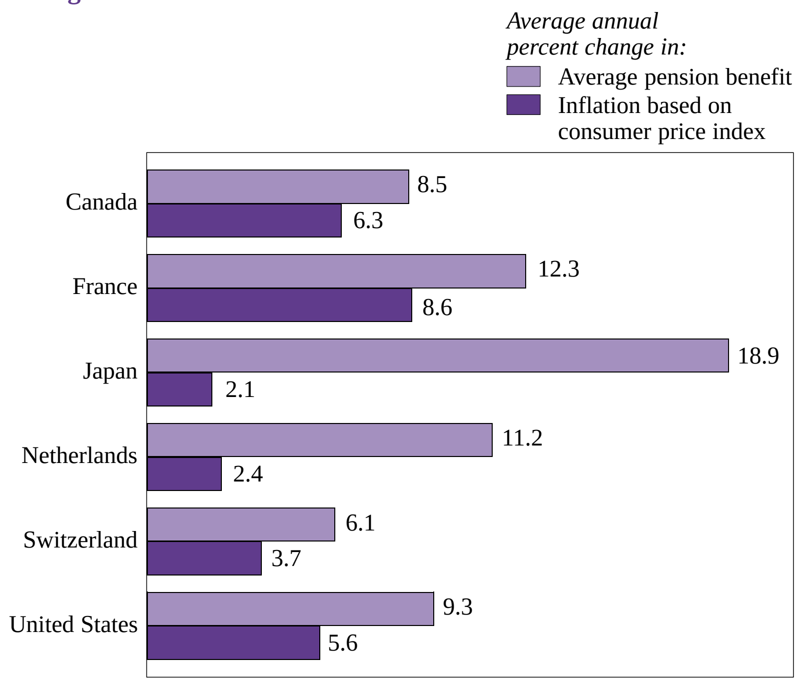
Data for Canada include government-worker retirees.

Source: Dailey and Turner, 1992

Growth of private pension benefits outpaced inflation in the 1980's

Accurate estimates of average annual private pension benefits are difficult to obtain. The data in figure 5.2, compiled by Dailey and Turner (1992), are based for the most part on national statistics on total benefit amounts paid to all retirees divided by the total number of retired beneficiaries, excluding survivors and disability pensioners. For each of the six countries, the increase in average pension benefits was significantly greater than the change in the national consumer price index during the 1980's.

Figure 5.2
Change in Private Pension Benefits vs. Inflation: 1980 to 1989



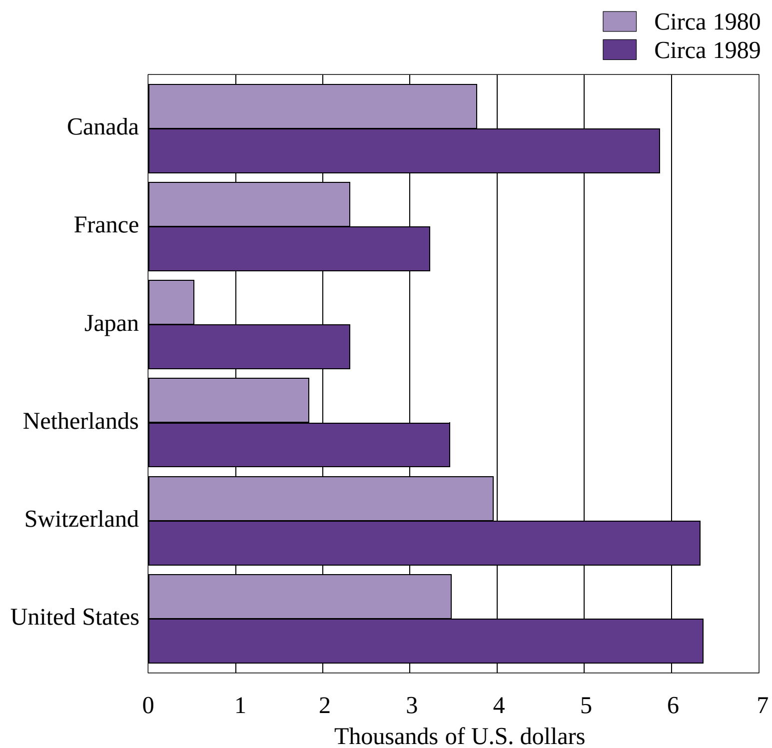
Note: Change in pension benefits based on national currency per year. Time period for Canada covers 1981-88; for Switzerland 1980-87.

Source: Dailey and Turner, 1992; World Bank, 1992

U.S. and Swiss private pension benefits comparatively high

The U.S. Department of Labor has developed time series of average annual retirement pension payments in several developed countries (Dailey and Turner, 1992). The most recent comparative data show average private pension retirement benefits in the United States to be about US$ 6,400 in 1989, and in Switzerland about US$ 6,300 in 1987. Canadian data shown here include former government employees, and thus are somewhat overstated relative to other national figures. The Japanese data, on the other hand, are understated because they exclude lump-sum retirement benefits.

Figure 5.3
Average Annual Private Retirement Pension: Circa 1980 and 1989



Note: Data for Canada include pension plans for government employees.

Amounts are based on national currencies converted to U.S. dollars using average exchange rates for the earlier and later years. Change during the period will, in part, reflect change in exchange rates.

Source: Dailey and Turner, 1992

Employers make majority of private pension fund contributions

Annual contributions to private pension plans may fluctuate from year to year, but the overall trend during the 1980's was one of steady increase. Employees make less than half of all contributions to private pension plans in the 9 countries in figure 5.4. Employer contribution shares range from 58 percent in Switzerland to virtually 100 percent in Japan. However, in the 4 countries for which there are time series data (Canada, the Netherlands, Switzerland, and the United Kingdom), the employee's share of total contributions rose gradually during the 1980's. A similar trend is likely in the United States, given the growing popularity of tax-deferred 401(k) plans that usually require employee participation (Dailey and Turner, 1991).

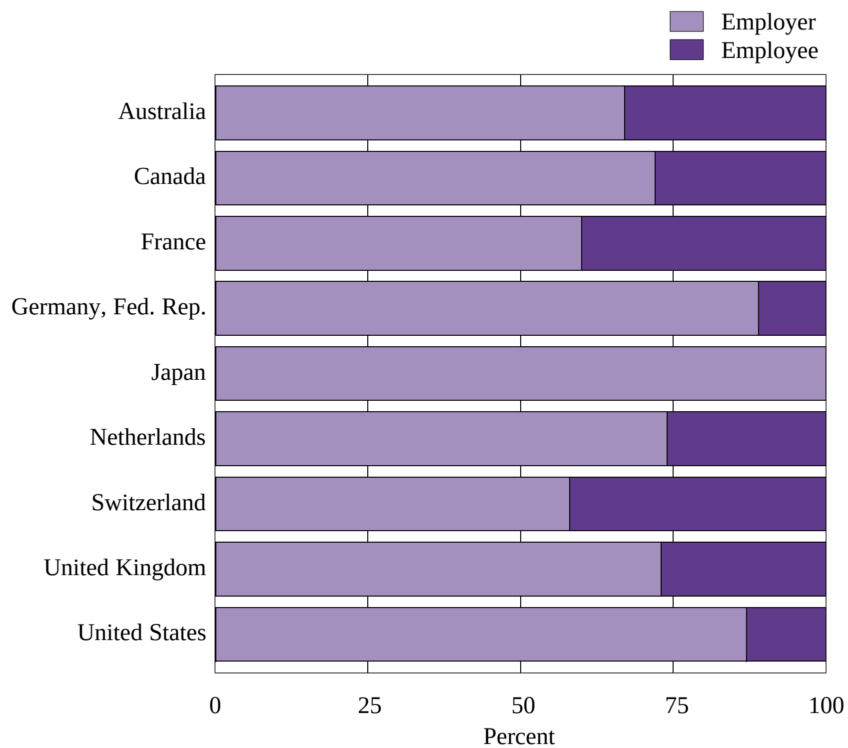
Table 5.4
Total Contributions to Private Pension Plans: 1980 and Circa 1988

(Millions of current U.S. dollars)

Country	1980	Circa 1988
Canada	3,118	3,837
France	12,047	18,018
Germany, Fed. Rep.	2,663	3,747
Japan	N/A	10,741
Netherlands	3,759	3,468
Switzerland	4,074	6,239
United Kingdom	12,580	14,831
United States	66,157	87,900

Source: Dailey and Turner, 1992

Figure 5.4
Employer and Employee Share of Contributions to Private Pension Plans: Circa 1988



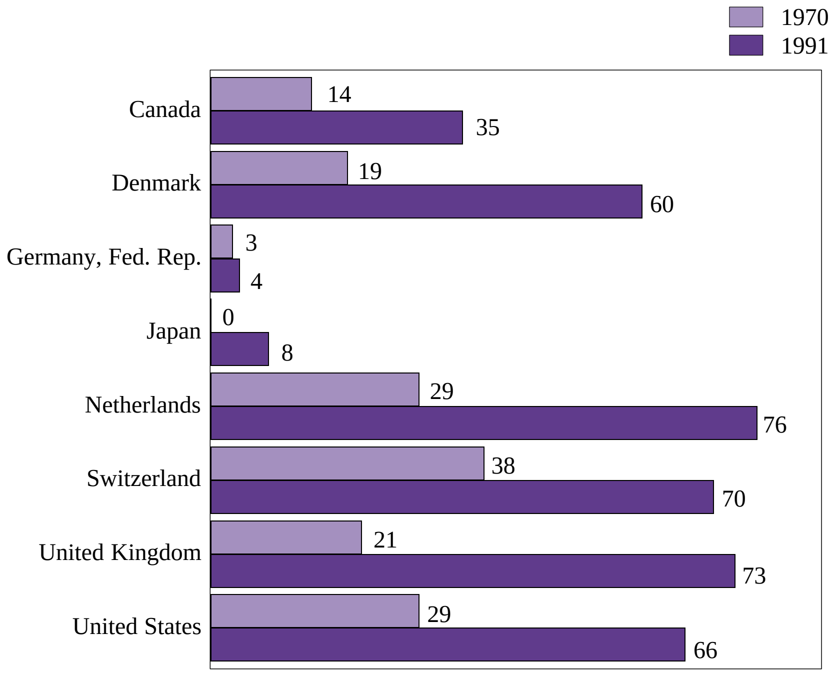
Note: Data for United States refer to 1981.

Source: Dailey and Turner, 1991

Occupational pensions a major source of long-term capital

Data for 8 OECD countries compiled by the World Bank (1994) demonstrate the growth in private pension assets during the 1970's and 1980's. Including estimates of assets managed by insurance firms, total fund assets in 1991 were equivalent to two-thirds or more of national GDP in the United States, the Netherlands, Switzerland, and the United Kingdom. Most occupational-plan funds have been invested in private sector assets, are internationally diversified, and have earned higher returns than publicly-managed funds (Davis, 1992; 1994).

Figure 5.5
Private Pension Fund Assets as a Percent of GDP: 1970 and 1991



Note: Includes estimated assets managed by life insurance firms. Excludes book reserves in Germany and Japan.

Source: World Bank, 1994

Taxes on private pensions

Tax policy vis-a-vis private pensions has become an integral part of macroeconomic planning in countries with extensive occupational pension programs. Private pensions represent a large segment of private sector savings flows, and pension funds are major suppliers of capital to industry (Dilnot, 1994). Governments may manipulate tax rates both for individuals and companies to the extent that they wish to boost savings rates and non-public pension program participation. In 1980, Japan reduced tax incentives for firms to keep large book reserves, and instead encouraged companies to fund worker pensions. As a result, the proportion of Japanese workers covered by private funded schemes rose 7 percent in 8 years.

Table 5.5 is a simplified account of general tax policy regarding private pensions in 18 countries. Given the variety of private pension schemes in these nations, there is a surprising degree of similarity in tax treatment. Most countries levy little or no tax on contributions (under a certain limit), and prefer to collect revenues when pension disbursements are made. The major exceptions to this tendency are Australia and New Zealand. More often than not, income generated by pension contributions goes untaxed until it is taken as a benefit; the Danish system taxes investment income only insofar as it exceeds a given real rate of return (Johnson, 1992).

Table 5.5
Taxation of Private Pensions in Industrialized Countries: Circa 1993

	Tax on:		
Country	Contribution	Fund Income	Benefits
Australia	Mixed	Yes	Mixed
Belgium	Mixed	Yes	Yes
Canada	No	No	Yes
Denmark	No	Mixed	Yes
France	No	n/a	Yes
Germany	Mixed	No	Yes
Greece	No	No	Yes
Ireland	No	No	Yes
Italy	Mixed	No	Yes
Japan	Mixed	Yes	Yes
Luxembourg	Mixed	No	Yes
Netherlands	No	No	Yes
New Zealand	Yes	Yes	No
Portugal	Mixed	No	Yes
Spain	Mixed	No	Yes
Sweden	No	Yes	Yes
United Kingdom	No	No	Yes
United States	Mixed	No	Yes

n/a - not applicable.

Source: Johnson, 1992; Dilnot, 1994

Provident funds paramount in some developing countries

A provident fund is a form of compulsory defined-contribution program wherein regular contributions are withheld from employee wages and invested for later repayment. Payouts typically are in the form of a lump sum upon retirement, but may also be made earlier in times of special need. Except in some Latin American countries, employers match or exceed the employee contribution. Although provident funds can cover private-sector workers, they are managed publicly.

Malaysia, in 1951, was the first nation to establish a wide-scale provident fund. By the mid-1990's more than 20 nations had developed such schemes. None of these countries had a public pay-as-you-go system at the time its provident fund was established (World Bank, 1994). Where provident-fund coverage is extensive, such funds may in effect be the public pension system.

The performance of provident funds globally has been erratic. In some East Asian countries (notably Singapore, which has the world's largest provident fund), funds have earned positive investment returns. In other nations, inflation and poor economic growth have lessened the value of fund contributions; in Sri Lanka, for example, the real annual rate of return for the Provident Fund often has been negative (ILO, 1993). Such performance has led several countries to abandon provident schemes in favor of defined-benefit pension plans.

Table 5.6
Payroll Tax Rates for Provident Fund Schemes: 1991

Country	Employees	Employer
Africa		
The Gambia	5	10
Ghana	5	12.5
Kenya	5	5
Nigeria	6	6
Swaziland	5	5
Tanzania	10	10
Uganda	5	10
Zambia	5	5
Asia		
Fiji	7	7
India	10	10
Indonesia	1	2
Kiribati	5	5
Malaysia	9	11
Nepal	10	10
Singapore	7-30	10
Solomon Islands	5	7.5
Sri Lanka	8	12
Western Samoa	5	5
Latin America		
Argentina (1994)	11	0
Chile	13	0
Colombia (1994)	2.9	8.6
Peru (1993)	13.3	0

Note: New plans began in 1994 in Argentina and Colombia, and in 1993 in Peru.

Source: World Bank, 1994

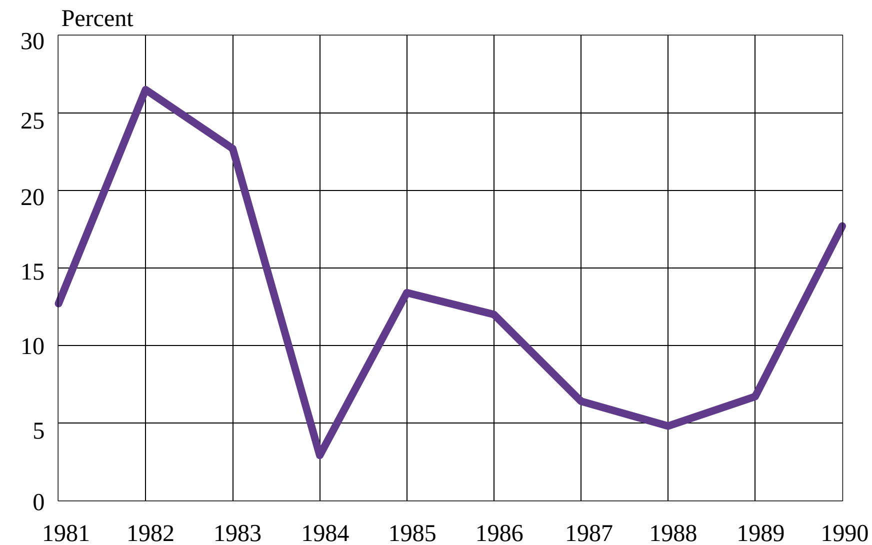
Chile has become the developing-country model for pension privatization

Chile first enacted a public pension scheme in 1911, and expanded its program over time following the European social insurance model financed on a pay-as-you-go basis. Between 1960 and 1980, the ratio of pensioners to contributing workers increased from 9 per 100 to 45 per 100, due to rapidly changing demographics and increasing tax evasion on the part of employees and employers (Williamson, 1992). These changes, occurring in the context of a stagnant economy, resulted in a situation where the pension system was no longer able to meet current obligations. Faced with an increasingly bleak future scenario, the Chilean government in 1980 abandoned its public system in favor of a compulsory savings plan administered by private sector companies.

Since 1981, all wage and salary earners are required to contribute 10 percent of their earnings to a privately-administered retirement fund (additional payroll deductions are made for life insurance and fund expenses). Workers themselves select from many competing investment companies, are free to switch their accounts, and have several options for withdrawal and annuities upon retirement. To reduce mismanagement risks, the government assumes a major supervisory and regulatory role (Schulz, 1993).

By most accounts, the Chilean experiment to date has been a success, with real annual returns on contributions averaging in excess of 12 percent during the 1980's. Observers have pointed out several drawbacks to the new system, such as high administrative costs, workers' loss of freedom vis-a-vis one-tenth of their earnings, and the fact that eventual income replacement rates are not guaranteed, i.e., are reliant on investment earnings that may suffer in times of economic stagnation (Gillion and Bonilla, 1992). Nevertheless, many countries in Latin America (as well as some in Eastern Europe and Africa) have adopted or are seriously considering aspects of the Chilean system (Harteneck and Carey, 1994).

Figure 5.6
Average Real Rate of Return for Private-Sector Pension Funds in Chile: 1981 to 1990



Source: Gillion and Bonilla, 1992