

Social security for all: Trade union policies

**Labour Education 2006/4
No. 145**

Contents

Editorial	V
<i>Social security for all – A human right must become reality,</i> by Guy Ryder	1
<i>The current pension debate for trade unionists: A brief canvass of the issues,</i> by Bob Baldwin	9
<i>Social security for all: Investing in global social and economic development,</i> by Michael Cichon	21
<i>Challenges of old-age security reform in developing and transition countries: A trade union perspective,</i> by Peter Bakvis	37
<i>Addressing the bases of insecurity of the Philippine social security system,</i> by Melisa R. Serrano	43
<i>The role of trade unions in reforming social security and pensions in Ghana,</i> by David Kwabla Dorkenoo	53
<i>SEWA's health insurance programme,</i> by Mittal Shah and Tara Sinha	61
<i>New challenges for social protection in the European Union,</i> by Maria Jepsen and Janine Leschke	69
<i>Pension reform in Austria and the role of trade unions,</i> by Eva Belabed	83
<i>Reforming the Romanian state pension system and the role of trade unions,</i> by Petru Sorin Dandea	93
<i>Pension reform and trade unions in the Slovak Republic,</i> by Mária Svoreňová	99
<i>Trade union role in the Slovenian pension system,</i> by Metka Roksanđić	109

Editorial

This issue of *Labour Education* focuses on unions and their role in developing social security policies, particularly protecting and reforming national pension systems. Included are several country studies by union activists which describe the reforms, challenges and union campaigns surrounding pension systems in their countries. The context for these country studies and the other articles in this issue is the joint ILO, European Commission and Government of Portugal World Conference “Social protection and inclusion: Converging efforts from a global perspective”, held in Lisbon in October 2006.

The conference was part of the ILO's current campaign globally to implement universal social protection. An article by the ILO's Social Security Department reflects the analysis provided to the world conference: that the public provision of pensions is an effective and affordable method of alleviating poverty.

The country studies in this issue were presented at a workshop of the Global Union Research Network (GURN) which followed the world conference. The GURN (www.gurn.info) is a platform for trade unionists and researchers dealing with the challenges of globalization from a labour perspective. It is a cooperative project of the International Trade Union Confederation (ITUC), the Trade Union Advisory Committee to the OECD (TUAC), the Global Union Federations (GUFs), the ILO's International Institute for Labour Studies (IILS) and the ILO's Bureau for Workers' Activities (ACTRAV).

Most of the articles in this edition of *Labour Education* focus on age pensions and the issues surrounding their reform, in both the developing and industrialized world. The industrialized world usually operates a complementary scheme of an income replacement, contributory¹ pension system underpinned by some form of safety net of pension support for those without a qualifying history of employment or pension contributions. In contrast, for most in the developing world age pensions are, or would be if they existed, simply a form of essential poverty alleviation. In practice, however, age pensions are rare in many developing countries except for civil service workers.

Over the past decades paid employment has been growing in most industrialized countries, but an increasing number of workers are not engaged in a long-term employment relationship. In the industrialized world there is a declining proportion of workers in standard forms of employment, and associated with this there is a trend of more workers not being covered by contributory pensions and other social insurances. With women disproportionately represented in precarious employment, there are serious gender implications in this trend.

In the developing world the wide spread of informality in the labour market is a major obstacle for extending the coverage of social security through payroll contributions. Many articles in this edition discuss the impact of demographics on the financial sustainability of their country's pension schemes, but so too is the size of precarious and informal employment having its impact. Extending social security is impossible by merely increasing the tax burden of the formal sector: precarious and informal employment undermines the potential of contributory pension schemes as mechanisms of universal social protection.

Having their origins in pension schemes for certain professional groups, these schemes have evolved to now cover the entire workforce. Today some proponents of universal social pension schemes argue that comparatively generous employment-based pension schemes which benefit a select proportion in the workforce exist at the expense of a more egalitarian distribution of pension benefits to all in the community. It is further argued that unions protect their members' entitlements to the detriment of the community at large. However asking for burden sharing between the very poor and the poor is most likely to be neither a viable nor a fair solution. The provision of social security to all is a responsibility of the whole society. Singling out the pension provisions of one group of the population as a funding source for a universal pension is a very arbitrary approach to identifying the required financial resources. Progressive taxation of the entire wealth in a nation is a much fairer and transparent approach to provide resources to fight poverty through universal basic social security.

Social solidarity does ask that persons with higher incomes in society finance a larger part of the social benefits of another group. The experience in the industrialized world is that a combination of contributory pensions and a universal tax financed safety net pension is a viable combination of solidarity and individual responsibility to protect against old-age poverty and to move towards income security in older age. Trade unions are often pursuing in parallel the twin objectives of extending social security coverage and securing decent living standards for retirees. However, with changing patterns of work, pension schemes need to be restructured to provide protection for a more heterogeneous workforce.

International conventions and standards, particularly the ILO's Declaration of Philadelphia, the Universal Declaration of Human Rights and the Social Security (Minimum Standards) Convention 1952 (No. 102), establish the right of all to social security and express the responsibility of national governments and the international community to guarantee that right in practice. Unions have been and are agents for social change towards greater equity through their ability to mobilize working people and bring pressure upon government to afford citizens their human right to social security. Today unions face the challenge of how to continue to pressure government and employers in an environment where free market reforms have increased in social inequality and shifted economic risk to the individual worker.

It is difficult to defend and promote pension systems based on standard employment relationships and intergenerational solidarity if a growing number of younger workers are in precarious employment with little hope of earning sufficient pension entitlements themselves. There is a

need for unions to organize and represent workers in non-standard employment and to ensure that they are not excluded from social security. This raises the question of the policies pursued by trade unions. In the longer term social security for all is clearly a desirable outcome for trade unions as representative organizations, because it shifts the balance of power in the labour market in favour of workers. But in the shorter term the special interest of trade union members might in some cases conflict with these wider social policy needs.

Unions are and have been most successful as agents for social equity and equal opportunity. This role came about through combining advocacy on behalf of their immediate members' interests with the needs of working people as a whole. The pressure that unions can bring to bear on governments in the pursuit of the basic human right of universal social security is a measure of the extent to which unions can mobilize all the potential beneficiaries of that right. With a significant proportion of the world's workforce being in the informal economy, the challenge is how unions can better represent and mobilize informal workers.

We live in societies where the term "working people" now represents a broader spectrum of self-employed workers, piece workers, independent contractors and "consultants", as well as employees. And employees are themselves engaged in a variety of traditional and non-standard employment types. All of these people are subject to selling their labour in the "labour" market, all would benefit from the solidarity of collective action and representation, and all have a right to social security.

Sufficient funding is a key problem of ensuring that social security becomes a human right in reality. However, calculations by the ILO have shown that most countries can afford basic social security for all. It is often not a question of resources per se, but of efficient, fair and economically sound mechanisms of resource collection. This requires a constant debate in society about the best forms of financing and providing social security. The answers change over time as societies themselves change. If and where contributory systems are failing to ensure universality then an examination of national tax systems may provide solutions. This is particularly true when there is now increasing evidence that contributory social insurance deters workers and employers from formally declaring their activities. Funding mechanisms which incorporate the informal economy, such as "user pays" systems, licence fees, wealth or consumption taxes, could be explored and debated by unions.

Guy Ryder, General Secretary of the International Trade Union Confederation, makes the case in support of social security. In the face of some of the ideological and economic forces driving globalization, and despite the international standards which underpin social security as a human right, it remains necessary to argue and explain the multifarious benefits of social security. He notes its many facets: it is a human right; it protects people from fear and insecurity; is an instrument to strengthen gender equality; is a pillar of democracy; creates fairer labour markets and increases flexibility; contributes to development; and benefits the wider public good.

In her article, Melisa Serrano of the University of Philippines School of Labor and Industrial Relations, describes the efforts of the Philippine Social Security System to increase the participation of informal economy

workers, employers and the self-employed. She highlights the importance of making contribution mechanisms physically accessible, even to the extent of ensuring that Overseas Filipino Workers are able to contribute towards their pensions. The experience of the Philippines is that increased accessibility, coupled with an emphasis on reducing contribution avoidance by employers, has created the capacity for higher benefits.

David Kwabla Dorkenoo of the Ghana Trades Union Congress outlines the pension reform process currently underway in his country, which will see a three-pillar system introduced. The history to these changes lay in dissatisfaction with the functioning and benefits under the various contributory pension systems. However, this article highlights the gap between contributory systems and universal systems. Ghana has a formal economy of only 10 per cent of the working population, representing 90 per cent of people without access to pensions. The Ghana Trades Union Congress is making attempts to broaden its representation within the informal economy by creating Labour Enterprise Trust. Union members contribute to a trust which is then used to create employment projects and insurance schemes, thus expanding formal employment and expanding the ability of unions to represent people from the informal economy.

The focus of the article by Mittal Shah and Tara Sinha of the Self-employed Women's Association (SEWA), India, is on SEWA's health insurance scheme for self-employed workers in the informal economy. With around 90,000 women insured, with a further 80,000 other family members also covered, it represents a significant system of social protection. In 1972 SEWA started organizing self-employed women for their economic rights, and now boasts 796,000 members from the informal economy. The association established banking services for its members before it expanded into health services, noting the risk to financial security from ill-health. In the boxed section at the end of their article, Mittal Shah and Tara Sinha describe the current campaign for national social security legislation launched by SEWA and other unions representing informal economy workers. This is a clear example of the potential for unions to mobilize these workers in the pursuit of human rights.

Petru Sorin Dandea, Vice-president of the Romanian National Trade Union Confederation, Cartel Alfa, sets out in his article the difficulties faced in transforming the communist-era state pension system to deal with the post-communist environment. The main problem was that the pension system became a de facto unemployment benefits scheme, with workers allowed to retire early in order to deal with the high rates of unemployment in the early 1990s. During the 1990s beneficiary numbers rose nearly 100 per cent while contributor numbers nearly halved. Again, along with unemployment (or early retirement) the growth of the informal economy contributed to the drop in contributors and consequent fiscal imbalance. Following reforms to deal with the lack of sustainability of the scheme, the Romanian pension system, based on social insurance contributions from employers and employees, still faces a dependency ratio of about 1. Petru Sorin Dandea notes the estimates that there are 2 million people [out of a workforce of 9.3 million (Ed.)] who do not contribute to the scheme.

The two articles by Mária Svoreňová of the Trade Unions Confederation of the Slovak Republic and Metka Roksandić of the Association of

Free Trade Unions of Slovenia both detail the pressures upon pension systems in European transition countries. Both systems were inherited from the communist era and provided universal coverage. However, the pension systems in the two countries faced budgetary pressure during the transitional phase of the 1990s. The established systems of social dialogue gave unions in both countries a strong voice in dealing with these reforms, and unions were the main social actors in campaigning for better protections in the reform process.

Eva Belabed, of the Chamber of Labour, Upper Austria, articulates many of the economic pressures and social trends impacting on European pension systems, mostly due to globalization, noting that "...we find ourselves in a process which aims at reversing the historical consensus in many European countries about the participation of all in the decisions and the wealth of society". Demographic change and the consequent threat to the sustainability of pension schemes are often the catalysts for reforming pensions. However, as Eva Belabed discusses, the reforms often go beyond the necessity to address demographics and sustainability and venture into ideological-driven reforms. The obvious example of this is the privatization of pensions, motivated by the desire to benefit the markets and business. Other examples are the introduction of individual pension accounts and non-defined benefit schemes, that drive the intergenerational solidarity which has underpinned European pension schemes for decades. But the individualism inherent in these models has a deeper worrying consequence, as touched on by the citation above. Workers are divorced from control of their assets as they are shifted into privatized schemes which leave them, individually and collectively, with a mere commercial relationship with their retirement assets and no political influence.

The impact of globalization is noted as influencing a convergence of social protection spending within the European Union. In their article, Maria Jepsen and Janine Leschke of the European Trade Union Institute for Research, Education and Health and Safety, discuss the catch-up in per capita GDP spending by the newer EU members, while the more established economies have moderated their spending, partly due to increased economic competition within Europe. However, they note that there remains a commitment within the EU to the welfare model. At the same time "solidarity" as the basis of the welfare model appears to be changing. Rather than the emphasis being on solidarity between groups in society, Maria Jepsen and Janine Leschke discuss the concept of "competitive solidarity", where the collective welfare of Europe is based on the "joint competitive and productive success" of Europe.

Bob Baldwin of the Trade Union Advisory Committee to the OECD, and Peter Bakvis, Director, ITUC/Global Unions – Washington Office, have produced articles which canvass a broad spectrum of issues surrounding pension policy and the debates that engage unions. Bob Baldwin gives an overview of the differing models being employed around the world, their limitations and advantages, and posits this within the central trade union concern about "whether they can provide adequate incomes to the largest possible number of people". Peter Bakvis frames his response to the ILO discussion paper mentioned at the outset of this editorial, a shorter version of which is contained in this publication. In

noting the ILO has taken “head-on” the World Bank’s three-pillar model, he analyses the role the World Bank’s ideological adventure has had in undermining the capacity of national governments and workers to retain control over pension policy, and how this continues despite the Bank’s own analysis of the shortcomings, in practice, of the three-pillar model.

Jim Baker
Director
ILO Bureau for Workers’ Activities

Note

¹ The term “contributory” refers to the range of pension systems which are funded through work-related contributions, generally from both the employer and employee, including pay-as-you-go, social insurance, privatized capital funded, etc., and for which benefits are dependent on a history of employment and/or contributions, as distinct from schemes funded from budgetary sources and tax income.

Special thanks go to Tim Wallace who edited and coordinated preparation for this issue of *Labour Education*.

Social security for all – A human right must become reality

This article discusses the ethical imperative and economic case for social security, the challenges facing the extension of social protection coverage, and the policies the trade union movement sees as necessary to move towards social security for all as a core element for decent work and decent lives. It notes that social policies are a question of political will and are only sustainable if they are based on a stable consensus.

Guy Ryder
General Secretary
International Trade Union Confederation (ITUC)

“There is enough for everybody’s need,
but not enough for everybody’s greed.”

MAHATMA GANDHI

Humans have developed the capacity to produce goods and services to such a degree that no one need endure hunger or malnutrition. The barriers to achieving this objective are institutional and political.

Equality before the law is not enough to address the inequalities and injustice in today’s world. The French writer Anatole France captured the limitation of this classical liberal concept in a single sentence: “The law, in its majestic equality, forbids rich and poor alike to sleep under bridges, beg in the streets or steal bread.”

People start unequal in life: billions are born into poverty while others grow up in more privileged families. Many have little access to formal education, some are handicapped and not everyone has the same ability to learn and work. Some are also suffering from chronic illness – but others are lucky and rarely need any medical treatment. Some inherit property; others are advantaged by being exceptionally intelligent, good-looking or athletic. In most countries it makes a difference if you are a man or a woman. Making people – despite their very different starting conditions and

abilities – compete on equal terms leads to very unequal outcomes that do not meet any criteria of social justice.

Survival of the fittest is the law of the market. What is called “competitive creative destruction” generates success and hardship simultaneously where the winner takes all. This is deeply polarizing and does not meet the common understanding of justice, in particular if the different starting conditions are taken into account. Unlimited market competition forces around 1.3 billion people,¹ including more than 200 million children,² to work for wages below the poverty line.

In light of the above concerns, this article discusses the ethical imperative and economic case for social security, the challenges facing the extension of social protection coverage, and the policies the trade union movement sees as necessary to move towards social security for all as a core element for decent work and decent lives.

The first priority must be to put an end to poverty. Solidarity and adequate taxation at local, national and international levels can mobilize the necessary

resources to meet the basic needs of all people. Efficient social protection systems can ensure that those who cannot work themselves out of poverty are not left behind. Universal access to food, water, health, shelter and education is key for development; a basic income floor is needed to ensure a bottom line against poverty.

Social justice requires basic social services, reduction of inequalities of opportunities, a basic income floor for everyone and special care for those who are disadvantaged by disabilities or social conditions. In many industrialized countries today the discussions focus on adapting and modernizing the welfare state. These are complicated and controversial processes for trade unions also. However, in this article I want to focus on a more fundamental issue: how to extend social security to those who have hardly any or no social security at all. Nearly 60 years ago, in a much poorer world, the principle for universal social security was already laid out in the Universal Declaration of Human Rights:³

Everyone, as a member of society, has the right to social security and is entitled to realization, through national effort and international co-operation and in accordance with the organization and resources of each State, of the economic, social and cultural rights indispensable for his dignity and the free development of his personality.

All modern societies in one way or the other recognize the need for basic social protection. Only a few marginal, but sometimes vocal, ultra-liberals are questioning this. Social security is, indeed, recognized as a right enshrined in the most important human rights instruments. It is not charity for the poor, but a right, a claim that citizens can make against the State. Following the bitter experience of the world economic crisis and the horror of the Second World War, the ILO's Declaration of Philadelphia in 1944 proclaimed:⁴

All human beings, irrespective of race, creed or sex, have the right to pursue both their material well-being and their spiritual develop-

ment in conditions of freedom and dignity, of economic security and equal opportunity;

All national and international policies and measures, in particular those of an economic and financial character, should be judged in this light and accepted only in so far as they may be held to promote and not to hinder the achievement of this fundamental objective.

This moral consensus has not yet materialized in practice and too many people are suffering from poverty and insecurity. They lack adequate health care, access to education, child benefits and basic income security. Too many governments seem to be unable or unwilling to collect sufficient taxes or to spend the money prudently to fulfil their minimum obligations towards their citizens. It is often the lack of democracy that allows governments to ignore the poor, and it is brutal poverty that deprives people of the ability to make their voice heard.

Maybe one reason is that the costs of social security appear directly in public budgets while the benefits are much more difficult to trace. How much growth does a dollar invested in health, education or safe working conditions generate? How do we value an increase in life expectancy?

However, trade unions have no illusions that the lack of social security is merely a lack of knowledge or enlightenment. Social security is a contested terrain. In many instances trade unions and workers had to fight hard for social protection despite the fact that it has been essential for development. There is hardly any social reform that has not been opposed by vested interests. Entrepreneurs, landowners and other members of the economic elite were not and, often are not, prepared to share more fairly the wealth and income that has been created or to concede their economic power, which is stronger when workers are living under the permanent threat of unemployment, poverty and insecurity.

Social policies are a question of political will. The level of development is an important factor, but even more important is the balance of power in a society. In all societies and at all levels of development there are diverging views about how much

social security is necessary, desirable and affordable. Critics of redistributive policies argue that these policies aim at equal outcomes despite unequal efforts and tax hard-working people to support welfare thefts. But except for some ultra-egalitarian radicals no one is suggesting equality of outcomes and, whatever may be the problems of today's world, they certainly do not include too much equality.

Social policies are only sustainable if they are based on a stable consensus. A serious discussion about social security for all should not waste time on the positions of ultra-libertarian or ultra-egalitarian ideologues. An informed debate should begin with identification of general considerations and basic principles. I suggest the following.

Social security: Identifying key characteristics

A human right

To deny people access to health and education, to force people to work for less than a living wage, to accept constant malnutrition and deprivation: these are all violations of the universal principles of human dignity and respect. It is the obligation of any State to provide these minimal social rights to its citizens. Where States fail to meet their obligations, this failure and its consequences become a responsibility also for the international community. Human rights are universal and it is immoral to ignore poverty just because it occurs beyond national borders.

A protection from fear and insecurity

Millions of people in the world live in insecurity, dependency and fear of unemployment, sickness, work accidents and old age. Social security is a crucial instrument to equip people with the basic protection and capabilities that allow them to plan their lives, to make choices and take risks. It is impossible to overestimate the increase in

quality of life if medical treatment is available, children go to school instead of work and old people retire in decency.

An instrument to strengthen gender equality

A modern approach to social security offers an important instrument to empower women by overcoming traditional patriarchal structures of families and societies. Social services and cash transfers can be designed in a way that strengthens individual independence. Child benefits for school attendance benefit girls in particular. Pre-natal health services protect women and child care provision is crucial to enable women to re-enter the labour market. Pension credits for periods of raising children reduce female old age poverty. A basic non-contributory pension is an important safeguard against the transmission of labour market inequalities into social security provisions.

A pillar of democracy

Meaningful democracy requires citizens who enjoy genuine freedom – based on legal, political, religious and economic independence. Very few people have sufficient private property to enjoy financial security in case of sickness, unemployment, injuries and old age. In this respect the common availability of social security provisions is the functional equivalent to sufficient private property. Social security provisions strengthen the independence of people. It affords them choices. It provides workers and their families with the basic security that is a precondition to be fully capable of exerting citizen rights.

A mechanism to create fairer labour markets and increased flexibility

The balance of power in a labour market is inherently unequal. Social protection limits the power of employers to abuse or exploit

workers. People whose basic social rights are secured are more able to demand respect at the workplace. They are less likely to endure abuse, dangerous working conditions and miserable pay. Social security takes labour partly out of competition and rewards employers that innovate and invest in people. It is a key instrument to reduce unfair competition and avoid a race to the bottom. Trade unions support the idea that innovations and productivity gains are rewarded with higher profits, but we see no value in higher profits that are gained by hazardous working conditions, exploitation of children or denial of decent wages.

A vital tool for development

Social security is an investment in people. There is ample evidence³ that countries can grow in equity. The argument of welfare critics of an inevitable trade-off between growth and equity is empirically wrong and it does not become true through constant repetition. Social security is not only compatible with growth; it is in many instances a vital tool for development. It pays to invest in public health, education, health and safety at the workplace and maternity protection. A healthy and educated workforce is the precondition for productive employment. We also know that pensions and social transfers function as automatic stabilizers and reduce demand volatility. Social stability is an asset that makes countries attractive for long-term investment.

A producer of public goods

Social security contributes to social peace which benefits everybody, not just transfer recipients. The way to public security and lasting social peace is through fairness, equal opportunities and social protection and not through more police and prisons. What is the value of economic growth if it is invested in barbed wire, security guards, walls and fences? If the social fabric of a society breaks down and poverty

and desperation feed crime, individuals are forced to buy security privately. Even wealthier middle classes lose quality of life as they retreat in “golden cages” to protect themselves against the excluded majority.

A basic package of protection including health care, primary education and a basic income floor are not seriously disputed. It is rather a question of how to achieve these modest objectives. In the public debate a number of challenges for internationally applicable social standards are discussed. Diversity of countries and local conditions, participation of the people in the design and implementation of social security systems, and the tax-raising ability of nation states in a competitive global open economy are key issues in this respect.

Universality and diversity

Trade union policies are based on an inclusive concept of solidarity and advocate universal social policies to improve working and living conditions for all workers and the population at large. Historically trade unions have often pioneered social security provisions through collective bargaining that have subsequently been universalized through legislation. Extension of social security requires a broad cross-society alliance in order to create the necessary political support. It improves the bargaining position of workers in the labour market and is a stepping stone for many informal economy workers to get some basic social rights.

Although social security is a universal human right there is a huge diversity in possibilities for achieving this objective. The overarching and universal principles need to include respect for the dignity and autonomy of citizens in need, solidarity in sharing the costs of social security, promoting equality of opportunities and ensuring that those who are protected participate in the development and execution of social security policies. Societies constantly change and social security systems have to adapt continuously to maintain their protective function. There is no one social

security model that could serve as a stable reference point over time. Social security systems are products of specific historical processes and local conditions. There is bitter experience of grand design schemes that were ridiculed by government or by market failure. In any country there are traditional, cooperative, state and market elements of social security. Each of these elements needs to be judged not on the basis of its organizational form but on its merit to contribute to the overall objective of extending social security to those in need.

Getting the design right

Social policies must address the needs of the people in a way that supports the dignity and autonomy of the individual and enables people as much as possible to develop their own capabilities and to strengthen their independence. A system needs to provide universal basic social services and a basic income floor, but it should be designed in a way that helps to develop income opportunities where possible. Incentives that result in a dependency culture or abuse are not desirable. We are not talking about people resting in a social safety net, but a right for everybody to walk with dignity and respect on a basic social floor.

In any case, the extent of welfare abuse is in most cases highly exaggerated. It is difficult to see how the universal access to health care or the provision of a basic income in the form of child benefits or basic old-age pensions can set wrong behavioural incentives. Child benefits, in particular when linked to school attendance, can in the right circumstances help reduce child labour. Pensions are not addressing the active labour force. Social security systems need to be designed in a way that motivates and enables people to seek and find decent employment. But it needs to be stressed: employment that does not generate a living wage is not decent employment. A legal minimum wage is an important instrument to provide a basic income floor. However, this will not be sufficient in countries where many workers are

engaged in subsistence activities largely outside the formal economy.

In such a situation, public work schemes will be needed that offer socially meaningful employment at the legal minimum wage. This will give people the possibility to earn at least the minimum wage instead of being forced to accept the worst forms of exploitation or being without any income at all. This is an approach currently being developed on a large scale in India.

Such an approach needs to be complemented with infrastructure development and a wide range of active labour market policies to create more and better jobs, and with social assistance or other cash transfers where other forms of support have failed.

Extension of social security faces not only the challenge to meet the basic and urgent needs of people but also to develop efficient and effective organizational and administrative structures. In the last decades there has been an ideological battle to privatize social security systems. However, the results have at best been mixed and often driven by ideology rather than reason. Instead of continuing these ideological battles I would like to reiterate the pragmatic position of the trade union movement. The first and foremost function of social policies is the efficient delivery of universal social services and adequate social transfers at low costs, in systems leading to universal coverage and based on responsible management and public accountability. In this regard, the much heralded Chilean privatized pension scheme has just seen its Waterloo – insurance companies got rich yet real pension rates and coverage are low and the burden on the State as provider of last resort remains high. It was an expensive but sobering experience and we should learn from this, as it shows that miraculous schemes that simultaneously offer high profits for insurance companies, create dynamic capital markets, increase the level of investment and provide attractive pensions at low costs only exist in flawed economic textbooks and not in the real world.

Pure market solutions can provide for (limited) risk pooling, but not for redistribution. Without redistribution coverage of

the poor will not be possible. It is an illusion to believe that without a strong role of the State either as provider or as regulator universal social security is possible.

Public accountability and participation of the protected

While technical expertise is important to build viable social security systems this should not lead to the illusion that the wisdom of experts alone is the best way to design and implement social security systems. Systems will not work if they are not based on the values, tradition and convictions and participatory learning processes of the people. The often cumbersome, conflictual and contradictory process of public debate is indispensable in creating the consensus that viable solutions require.

Workers have again and again had to bear the costs of poorly administered or badly protected public or private social security schemes. Schemes using particularly high shares of their contributions for administrative costs are likely to have governance deficiencies. This is not only bad governance but unethical enrichment. The money in social security schemes is workers' money. It is deducted from their salaries or paid via taxes. The use of these resources and the administration of these funds must be transparent and under constant public scrutiny. Those who pay as workers as well as those who receive benefits must have a say in the governance of these resources. Resources must be available to enable worker representatives to receive the technical training and the access to expertise that they need to fulfil their controlling function.

Creating and defending the fiscal space for social policies

The best design and the most honest governance of social services and social security are meaningless if the necessary financial resources cannot be mobilized. This is in most societies not a question of resources

per se, but the ability of the State to collect sufficient taxes and to manage these funds prudently. Research by the ILO has shown that only very limited resources are required globally to provide basic social security for all. Even in the poorest countries in Africa devoting about 4 per cent of GDP to a basic set of cash benefits can reduce the poverty headcount by 40 per cent.⁶

Global tax competition creates pressure on national tax rates and reduces the available fiscal space. Simultaneously with an increasing interest in corporate social responsibility, the willingness by companies to pay their fair share of taxes has been decreasing. Companies are going to great lengths to avoid taxes and often reorganize themselves so as to avoid the obligations national law places on employers with respect to social security.

It is not true that international tax arrangements are impossible. In Europe governments agreed to harmonize consumption tax years ago. They agreed that there should not be unfair retail competition through extreme differences in VAT. In a similar way there is a need to prevent unfair competition on corporate taxation and to act jointly against tax evasion. It is regressive to tax disproportionately consumption and wages. It is not true that governments cannot do anything in the face of global capital mobility. To ensure a sufficient level of fiscal revenue for social security a wide range of additional tax policy options are available. Furthermore public procurement policies should exclude companies that do not provide the legally required social protection to their workers or are found guilty of tax fraud.

Global challenges require global responses

The protection of workers' interests requires that poverty be addressed by policies which provide a regulatory framework that ultimately extends social security to all. This is possible but it will require building a greater political will than exists currently. We need to forge a broad alliance

to move forward from a moral human rights consensus on social security to firm legal and fiscal commitments and policies that use the well-tested instruments of redistributive social security provision to make poverty history. Investing in providing a basic set of social security benefits to all the world's poor will cost less than 2 per cent of global GDP – a cost that will be paid back many times over through increased productivity of the global workforce.

In a global economy social security cannot be dealt with in national isolation.

The failure of any nation to adopt humane conditions of labour is an obstacle in the way of other nations which desire to improve the conditions in their own countries.⁷

The best strategy to avoid a race to the bottom is the creation and application of international labour standards. During the general discussion on social security at the International Labour Conference in 2001 governments, workers and employers reiterated the need to “anchor the ILO activities in social security in the Declaration of Philadelphia, the decent work concept and relevant ILO social security standards.”⁸

This common commitment at the ILO is important but more political momentum is required to achieve a basic social protection package as outlined earlier. The ILO must play a key role in building a global platform for social justice as a core element of the Decent Work Agenda.

Important social security standards have been adopted by the ILO over the last decades. These technical standards together with the principles enshrined in the ILO Constitution, the Declaration of Human Rights and the International Covenant of Economic, Social and Cultural Rights provide guidance and need to be ratified more widely.

Recent years have seen the emergence of new initiatives at the national level to extend social security coverage, such as *Bolsa Familia* in Brazil, *Oportunidades* in

Mexico, the “30 baht” health scheme in Thailand, the universal basic pension in Namibia and Lesotho, and the National Rural Employment Guarantee Act (NREGA) in India. These pioneering activities can contribute to a global debate about the best instruments, rules and tools to extend the coverage of social security. The ILO as the responsible UN organization for social protection is the place where this debate needs to take place. The trade union movement is an active partner in this process to build networks and alliances for universal social protection.

Social security for all is an investment in global social and economic development. Economic growth does not automatically lead to poverty reduction. Voluntary charity cannot provide the necessary funds and cannot create the mutual rights and obligations that are indispensable for social security as a concept of human rights and personal dignity. It is governments that have the ability to provide the framework and resources for sustainable social security provisions.

Making the human right to social security a reality for all is a moral obligation at the national and international level. The necessary resources are globally available; it is essential for development and equity; and it can and must be done.

Notes

¹ ILO, Governing Body, *Implementation of the Global Employment Agenda: An update*, 2007.

² ILO, *The end of child labour: Within reach*, 2006.

³ Universal Declaration of Human Rights, 1948, Article 22.

⁴ Declaration of Philadelphia Art. II a and c.

⁵ “Social protection as a productive factor”, doc. GB. 294/ESP/4, 294th Session, Geneva, 2005.

⁶ ILO, *Cash benefits in low-income countries: Simulating the effects on poverty reduction for Senegal and Tanzania*, 2006.

⁷ ILO Constitution, 1919.

⁸ Conclusion ILC, 2001.

The current pension debate for trade unionists:

A brief canvass of the issues

Across the differing retirement pension models being employed around the world, the central trade union concern will always be whether a particular model can provide adequate incomes to the largest possible number of people. However, where there is a significant informal economy other questions arise: whether the cost of payroll-based pension contributions discourages formal economy employment and whether tax-financed universal schemes more appropriate.

Bob Baldwin

Trade Union Advisory Committee to the OECD
Paris

In the first several decades following the Second World War a great deal of progress was made across much of the globe in putting pension arrangements in place, which in turn transformed for millions of workers the latter part of one's life. The ages-old pattern of working until one became disabled or died was replaced by a period of retirement when one could look forward to material comfort without having to be employed and while enjoying good health. A significant period of retirement became one of the most important forms in which the benefits of rising productivity were widely shared. Trade unions played a significant role in bringing about this new state of affairs.

Over the course of the past decade and more, the progress established in the earlier period has been eroded. In 2000, a document prepared by the Organisation for Economic Co-operation and Development (OECD) noted that 26 of the 29 member countries at that time had implemented reforms to their pension systems (OECD, 2000). Reforms included: raising the age of eligibility for benefits; lengthening the number of years over which earnings are averaged for purposes of calculating benefits; changing the method of indexation from wage indexing to price indexing; increasing the role of privately

administered arrangements; and, tightening the relationship between contributions made and benefits received by reducing cross-subsidies. (OECD, 2000) Acting as a central policy "think tank" for its member governments, the OECD endorsed these reforms as a necessary response to the combination of population ageing, decelerating population growth and ever earlier retirement. It viewed this combination of forces as a threat to the totality of economic growth, budgetary balances and the sustainability of public pensions.

Outside the OECD area, the World Bank became a very active player with respect to pension reform. It focused much of its attention on pay-as-you-go (PAYG) earnings-related, publicly administered pension plans which, in many World Bank client countries, tended to dominate pension systems. The Bank urged that these programs be replaced in whole or in part by mandatory individual savings accounts.¹ The Bank shared the OECD concern about future budgetary balances and also foresaw the possibility that mandatory retirement savings programs might stimulate innovation in financial institutions and instruments that might encourage economic growth. In many of its client countries, the publicly administered defined benefit (DB) programmes then in

place suffered from any or all of limited coverage, financial problems and poor administration.

Generally speaking, the reforms of the recent past have not been welcomed by trade unions. In some cases, trade union movements have been somewhat unhappily resigned to change. In other cases trade union movements have been prompted to initiate strikes and demonstrations to protest proposed changes. To date most of the trade union debate and dialogue on pension reforms has been conducted at a national level.

The general purpose of this article is to establish a basis for international trade union dialogue on pension reform. The article reviews and comments on a number of common issues that trade union movements are forced to address in pension reform debates: demographic change, the role of publicly and privately administered pensions, defined benefit (DB) versus defined contribution (DC) plans, and so on. It also notes some of the special issues that confront low-income countries. In the final section an attempt is made to articulate, at a high level, a general approach to pension reform for trade unionists.²

Given the broad scope and short length of this article, it passes rather lightly over a number of important issues. The treatment of pension issues in low-income countries warrants much further attention than it can be given here.

Trade union values and a murky debate

Not only have the outcomes of reform processes been awkward but the debates themselves have been difficult, in no small part because they are often quite disconnected from the central concerns of trade unions.

At the centre of trade union concerns about pension arrangements is the question whether they can provide adequate incomes to the largest possible number of people. The question of whether incomes are adequate is assessed against

two criteria: are incomes above a nationally recognized measure of poverty or low income; and, do the incomes allow people to maintain their standard of living as they move from work to retirement and throughout the period of retirement. Given that retirement periods have been increasing with life expectancy, the question of how pensions are adjusted to reflect changes in prices or wages through the retirement period is an increasingly important question. It is also of somewhat greater importance to women in light of their greater life expectancy, as is the question of whether some portion of retirement benefits carry on to surviving spouses.

In addition to being concerned about the adequacy of benefits, trade unions have also shown a concern that retirement income programs should have a substantial core that is predictable. Thus, they have shown a widespread but not universal support for DB plans over DC plans, and have also seen a strong positive role for publicly administered plans. Although it has seldom been articulated, in practice trade unions have shown a concern that the pension system not be subject to continual change.

The values that trade unions bring to bear on pension debates seem so obvious as to be not worth stating. Yet, part of what has made the pension reform debates difficult is that these basic considerations are often missing from the debate. Pension reform prescriptions endorsed by the OECD have tended to focus increasingly on the supply of labour of older workers, and protecting budgetary balances in the future. The World Bank has shared the concern about future budgetary balances and the future development of financial institutions and instruments. Whether one shares them or not, these objectives are recognizable as being significant, but beside the point of why pension plans exist.

To the extent that the question of income adequacy gets dealt with, it tends to get dealt with as a problem that has largely been solved in the OECD area, with only subsets of the population (e.g. widows

and immigrants) being a source of ongoing concern (OECD, 2001). This complacency reflects, on the one hand, the reality that the incomes of older people in OECD countries did improve significantly in both absolute and relative terms in the latter part of the twentieth century (Yamada, 2002). But in many countries the incomes of retirees who have totally withdrawn from the labour force are seldom looked at, and they are often well below the average incomes of the elderly. Furthermore, in countries with significant pre-funded components to the retirement income system, the incomes that they produced in the late twentieth century were strengthened by: very high returns on financial assets; low inflation and low wage growth. These pension arrangements will not produce the same incomes under different economic circumstances.

Not only have the central concerns of trade unions tended to be pushed to the margins of debate, but sometimes key terms in the debate are left with no clear definition. An important case in point is the term "sustainability", which has enjoyed a central place in much of the discussion of future pension expenditures. The term is seldom if ever defined clearly. Sometimes it is implied that if future expenditures would require tax increases they are unsustainable. If earlier generations had adopted this approach, much of what is now in place would have been deemed unsustainable years ago.

Demographic change

Across the world and in every continent, two demographic trends are underway that are very important to the debates on pension reform. Populations are getting older and population growth is decelerating. Thus, the portion of the global population over 65 was 5.2 per cent in 1950, 6.0 per cent in 2000 and is expected to be 16.1 per cent in 2050.³ The older subsets of the over 65 populations (e.g. 75 to 84 and 85 and older) will be growing even more rapidly. The world population grew by

142 per cent between 1950 and 2000 and is expected to grow by 49 per cent by the mid-twenty-first century.

There are quite different start and end points among countries and continents for these trends. Generally, Europe and Northern America (Canada and the United States) start out as older populations and remain older. But, there is a tendency to convergence with respect to age structures and some of the most rapid ageing will take place in the most prosperous parts of East Asia (e.g. Japan, China, Republic of Korea and Taiwan). While population growth will decelerate in all continents it will remain more robust in less developed regions. It will be negative in Europe.

Two factors underlie the ageing process. The first is increased life expectancy at older ages. Again this is a worldwide development that shows signs of convergence among continents. Thus, the life expectancy of 65-year-old European men increased by only 0.8 years between 1950 and 2000, while the average life expectancy of Asian women increased by 5.5 years over the same period.

The second factor is declining fertility which is also happening worldwide and in each continent, and again shows signs of convergence. Worldwide, fertility declined from 5.02 in 1950-55, to 2.65 in 2000-05, and is expected to decline to 2.05 in 2045-50. In 1950-55, fertility rates in less developed regions were more than twice those in more developed regions, and by 2045-50 they are expected to be 1.13 times those in more developed regions.

A fertility rate of 2.1 is required to maintain a population. By 2000-05, Europe and Northern America had fertility rates below this level and Italy, Republic of Korea and Spain had fertility rates of 1.2. Africa is the only continent expected to have a fertility rate above this level in 2045-50. The decline in fertility rates more than offsets the effect of increased longevity and accounts for the deceleration in population growth.

Many a horror story about the pension burden is told around these demographic trends. As the retired population

grows in relation to the population as a whole, it is true that the share of national income claimed by the elderly will grow too, assuming that their relative incomes are more or less constant. They are also likely to claim a larger share of government budgets. But, it does not follow that they impose an intolerable burden on the working-age population as is sometimes alleged because several forces will offset the impact.

First of all, it is important to remember that the elderly will be claiming a larger share of a larger per capita income. In most countries, wage and productivity increases of 1.0 to 1.5 per cent per year will be sufficient to keep wages net of pension contributions growing. These are not trivial rates of growth, but neither are they extreme. Moreover if population ageing and decelerating population growth give rise to labour shortages as is often suggested, these rates of wage and productivity growth will be easier to achieve.

Second, the increase in the portion of the population of pensioner age will be offset in large measure by a decline in the portion of non-working young. Thus, public and private transfers from the working-age population to youth will be declining as the transfers to the elderly will be increasing. This can be politically difficult as transfers to the elderly take place largely within the public sector while transfers to the young take place in private households.

Finally, it is important to note that the actual ages of retirement have stopped their downward trend in a number of countries. (Sudén, 2006) Moreover, many young workers have delayed key transitions in the early life course (Beaujot, 2004) and, as a result, will find it difficult to retire as early as their parents and grand-parents.

Given the persistently high unemployment in many high- and low-income countries, the greater worry in many countries would be that encouraging greater employment of older workers will succeed at the expense of job opportunities for younger workers. High unemployment

countries that want to encourage more employment of older workers should undertake a vigorous effort to increase employment overall.

Balance between publicly and privately administered pensions

The respective role of publicly and privately administered pension arrangements varies widely in the OECD area (OECD, 2005).

The right balance between public and private arrangements is bound to be a political issue that will never be fully resolved. On the one hand, the financial sector will always tend to look at publicly administered pensions as a market opportunity lost. On the other hand, trade unions and many social policy groups will have opening biases in favour of a strong role for publicly administered programmes.

There are many good reasons for the trade union bias in favour of publicly administered programmes. They have the greatest possible risk pooling potential which is vital to operating DB programs and making retirement incomes predictable. They do not require pre-funding for purposes of insuring benefit promises as is typically required in privately administered arrangements. They can achieve administrative economies of scale and, if they are funded to some degree, they can capture efficiencies in the investment area as well. In addition, compared to an alternative of "voluntary" workplace pensions, they have the advantage of solving chronic problems of limited coverage, portability and limited protection against inflation.

The coverage issue is particularly important as coverage for a significant part of working life is a prerequisite of ending work with a decent pension. In context it is worth noting that the only OECD countries where private pension coverage is well beyond 50 per cent of the paid workforce is in countries where coverage is effectively mandatory due to legislation that requires it or due to collective bargaining in countries with high degrees of

collective bargaining coverage (Queisser and Whitehouse, 2006).

In countries where employers can choose whether to put private pensions in place, it is generally labour market pressures and collective bargaining that cause them to do so. As a consequence, there is a general tendency for workers who are vulnerable or disadvantaged in the labour market (e.g. women, immigrants and migrant workers) to be less likely to be covered. In recent years these long-standing concerns have been accentuated by the growth in non-standard forms of employment (part-time and temporary contract work). People who are engaged in these forms of employment are often left out of voluntary private pension plans. Another development of the recent past that is important in the Anglo-Saxon world in particular, is a growing unwillingness of companies to sponsor DB pension arrangements. This tendency has become quite extreme in some cases and raises serious questions about the usefulness of employment as the platform for providing pension benefits.

Despite the clear advantages of publicly administered programs, there are both theoretical and practical reasons why a trade union movement might choose not to propose a pension system that is entirely publicly administered.

The fact that the balance between public and private provision is contested territory is always a consideration, as are prevailing values and beliefs. In countries dominated by liberal thought, including all of the English language high-income countries, it is difficult to move beyond the belief that some room needs to be left for market solutions to retirement income needs. Moreover, if there is an effective political limit on the ability to raise taxes, major public pension programs may be seen as a barrier to achieving other public policy objectives. The same problem can arise in low-income countries where the tax collection capacity of governments is limited for practical reasons.

Also, if a political system is prone to major swings in the outlook of those in

power, it may not be appropriate to encourage people to rely too heavily on a major public pension programme. It may be possible to develop decision-making structures that involve social partners that might mitigate this risk.

Sometimes, concern about political risk is embellished by concerns about corruption and/or incompetence of the politicians and public officials who are responsible for overseeing public pensions. Unfortunately, history has offered some support for this concern. On the other hand, private arrangements also require substantial regulation and tax support, and if public officials are too corrupt or incompetent to manage a public programme, they probably cannot be counted on to regulate a private one effectively.

There is also the question of whether retirement income needs are sufficiently homogenous to allow them all to be substantially met through one or more public programs. This issue is likely to be assessed differently in different countries, and may look different depending on what kinds of programs are currently in place and/or seem plausible in the foreseeable future.

To this point, publicly administered pensions have been referred to as if they are an homogenous entity. Yet there are at least three generic types that are commonly found:

1. means or income-tested programmes;
2. universal flat-rate programmes; and
3. compulsory earnings-related programmes.

The first two types focus on age versus retirement as the basis for payments, and they focus more on minimum income protection than on earnings' replacement. They tend to play a relatively more prominent role in liberal societies, other than the United States, than they do elsewhere in the OECD area. They are also found in Nordic countries where, except for Denmark, they exist side by side with substantial publicly administered earnings-related plans. However, it is worth adding that flat-rate benefit plans also contribute

to earnings replacement and do so in a redistributive manner.

The third type of plan is designed specifically to replace pre-retirement earnings. In continental Europe plans of this sort often form a substantial part of the entire pension system. This type of plan has substantial advantages over most alternatives as a way to provide retirement income to people retiring from long periods of formal employment. For others, they function less effectively. They may or may not include significant internal redistribution and the self-employed may or may not participate in them. Because plans of this sort are financed by earnings-related contributions, they can drive a substantial wedge between take home pay and total labour costs. Thus, they can induce tax avoidance, particularly on the part of low-wage workers and/or their employers. They are also vulnerable in periods of severe economic distress when their revenue base may contract, while their beneficiary base does not.

An important consideration with respect to the operation of each of these types of programme is how, if at all, they deal with the pension rights of immigrants and migrant workers. Ideally, globally mobile workers would accumulate rights to retirement pensions as they move from country to country. But making significant progress in this direction is by no means easy. Global migration patterns are dominated by movement from low-income to higher income countries. Many of the source countries still have rudimentary social security pensions so migrants may have had no pension coverage in their home countries. Moreover, because earnings in the source countries are very low compared to those in receiving countries, a benefit based in large part on a pension entitlement in the country of origin may not mean much in a host country. Compensating fully for the differences in earnings and the development of social security between countries of origin and host countries creates dilemmas of its own.

Defined benefit versus defined contribution

Most, but not all trade union movements have shown a clear preference for DB pensions versus DC pensions, and this widespread preference reflects the greater certainty of the benefits that will be provided on retirement by DB plans. The general absence of risk pooling in DC plans means that individuals bear virtually all of the risks entailed in the lack of certainty about future wages and salaries; rates of return on investment during working life; annuity prices at the date of retirement; and so on. Where participation in a DC plan leads to the purchase of an annuity, there is pooling of longevity risk which is taken on by the vendor of the annuity. But, where participation leads to a "phased withdrawal" of assets, the longevity risk is also born by the individual plan participant and there is a chance that retirement assets will be exhausted while the plan member is still alive.

In addition to the general risks to which DC plans give rise, there may be subtle (or not so subtle) differential impacts by gender. In the absence of direct subsidization of years spent bearing and raising children, it is likely that women whose working lives are interrupted by these events will end up with lower benefits than their male counterparts. In addition, there is some evidence in the United States that women are more cautious investors than men and may, as a result, end up with lower DC accumulations (Turner, 2001).

Two other aspects of DC arrangements are worth noting. First, because DC benefits rely on compounding interest during the accumulation phase, benefits tend to grow exponentially rather than proportionately over time. Second, DC plans take a significant period of time to mature and to deliver benefits whereas DB plans, whether they are pay-go or pre-funded, are capable of delivering newly established benefits relatively quickly.

In recent years, mandatory DC plans have become common place in World Bank

client countries and in some OECD countries as well. The risks that are inherent in these plans can be mitigated by: assigning a small place in the pension system as a whole to mandatory DC plans; having strong first pillar arrangements in place; providing rate of return guarantees; and allowing older workers (or all workers) to choose between old and new systems. Operating examples of all of these mitigating measures can be found.

The shift from DB to DC in both second and third pillar arrangements has given rise to important questions about the appropriate regulatory arrangements for DC plans and what needs to be done to provide plan members with the necessary knowledge to manage their DC accounts effectively. These issues are now in front of national authorities and are an important part of the work of the OECD's Working party on Private Pensions.

Pre-funding versus Pay-Go

Historically, the chief concern of trade unions in the pension arena has been the provision of adequate benefits to retired people. Given this focus, the question whether pensions should be pre-funded or pay-go has been addressed largely in terms of which method would provide benefits more quickly and securely than the other.

In the context of recent pension debates, the issue of pre-funding has taken on new significance as pre-funding has come to be equated in both policy discourse and actual pension reforms with a move to privately administered individual accounts. Yet, there is no reason in principle why the objective of a higher degree of funding could not be achieved by increasing the size of reserve funds under second pillar DB plans. There are, in fact, a number of examples of large reserve funds being associated with second pillar DB plans.

From the point of view of achieving improvements in benefits, there are some aspects of pre-funding versus pay-go that are worth considering.

As was suggested above, it is likely easier to phase in benefits quickly under pay-go DB plans and pre-funded DB plans, than under DC. Moreover, while fully funded DB plans can achieve this objective, they require very high levels of contribution in the early years if any element of past service is recognized under the plan and funding targets are linked to the plans' liabilities in whole or in part. The relative ease of phasing in benefits quickly under pay-go plans is one of its virtues. But, this strength of pay-go is accompanied by the common need to increase pay-go contributions with no increase in benefits as larger portions of the elderly population become eligible for the new benefits. This source of upward pressure on required contributions may be accentuated by an increase in the size of the older population. These contribution increases may cause the plans to be vulnerable to political attack. (The relative ease of phasing-in pay-go benefits causes some commentators to suggest that pay-go DB plans are prone to "unsustainable" benefit promises.)

Levels of contributions required by the two funding methods may differ even after the plans reach their maturity. Generally, if aggregate wage growth exceeds rates of return on financial assets, pay-go contributions will be lower and vice versa. If labour force and employment trends follow the population trends noted above, aggregate wages will be at or below levels of individual wage growth. Rates of return on financial assets might be expected to exceed aggregate wage growth on average over the long term, but much more caution on this point is required than is found in much of the commentary supporting pre-funding.

There will be feedback from demographic change into the operation of pre-funded systems and in general the feedback will lead to an increase in the contributions required of pre-funded pensions. Even if pre-funded contributions are lower, they will not be on a dramatically different trajectory than pay-go contributions.

If increased funding lowers required contributions, it does so by supplementing

contribution income with investment income. Investment income comes generally from the capital income stream in the economy, which is much narrower and more volatile than labour income.⁴ Thus, if increased funding is associated with very precise DB funding targets, the targets are likely to be exceeded or missed on a regular basis. This reality can translate into volatility in pension contributions which may be more troublesome than higher but more stable contributions in a pay-go regime.

Also, in a closed economic context, pre-funding is no different than pay-go in terms of the share of national income that will be paid out by a pension scheme. The amount paid out is determined entirely on the benefit side of the programme. What changes with pre-funding is the income streams that are tapped to pay for the pensions. But, even here, one could conceive of a pay-go tax base that included non-wage income. Indeed, most first pillar programs rely on the general tax base of governments as a source of financing.

Much of the argument in favour of increased funding bears little relation to the adequacy of the retirement benefits that will be provided or to the best way of providing them. It focuses largely on the economic consequences of different funding systems and relies generally on some variant of the unproven, noting that pre-funding will enhance savings, investment and economic growth.

Another argument that has been made in favour of pre-funding that has the appearance of a pension argument is that pre-funded systems are fairer between generations. But the key term has no fixed meaning (Wolfson and Rowe, 2006) and much of what is said about it relates more to the rate at which benefits are phased in than to the funding method.

It is also worth questioning how important it is to establish intergenerational equity within a pension system. Many of the early beneficiaries of net intergenerational transfers in second pillar DB plans are the currently elderly and the elderly of the recent past. In many societies it is accepted that these generations endured a

great deal and left an important, positive economic and social legacy. The fact that they are on the receiving end of an inter-generational transfer through the pension system is an acceptable quid pro quo.⁵

Special considerations in low-income countries

In low-income countries there are formal sector workers who have every reason to look forward to a financially secure retirement, just as in the high-income countries there are people who never succeed in establishing a lasting attachment to paid employment and for whom pensions and retirement are not a meaningful concept. But the balance between the two groups can be quite different in high- and low-income countries and this can lead to somewhat different considerations in terms of how a pension system might be designed.

Where informal employment predominates it goes without saying that earnings-related pensions will be limited in their scope of operation. Coverage rates for employment-related pensions outside the OECD area are seldom as high as 50 per cent, even for mandatory second pillar regimes, and coverage rates are often less than 10 per cent (Asher, 2006, Barrientos, 2006, Mesa-Lago, 2006 and Phang, 2006). Moreover, close attention needs to be paid to the question of whether financing earnings-related pensions from payroll contributions is increasing the numbers of people engaged in informal employment by driving a wedge between labour costs and take home pay.

To provide pension benefits to people who have spent much of their working life in informal employment, a tax financed, first pillar programme may be most appropriate. Bearing in mind that tax-raising capacity can be a problem in low-income countries, an income- or means-tested version of a first pillar programme may be attractive because it will involve a lower level of government expenditure than a universal programme that provides the same income guarantee. However, an

income- or means-tested programme may be administratively expensive and also involve perverse interactions with programmes that are in place for workers in the formal economy.

The tax-back rate under the income- or means-tested programme will reduce the value of income from other sources for people who receive benefits from the means- or income-tested programs and other sources as well. These perverse interactions can become extreme in cases where the income range to which the tax-back applies overlaps with income to which a personal income tax applies, and/or the income range to which tax-backs under social service programmes like subsidized housing apply.

While there are many important issues to resolve in designing first pillar programmes, they can overcome the coverage problems of the employment-related programs that tend to be predominant in low-income countries. Moreover, they are generally judged to make an effective contribution to poverty reduction (Barrientos, 2006 and ILO, 2006). They can also have a variety of positive side effects for the households that include elderly recipients of first pillar (Asher, 2006).

It is a legitimate aspiration of formal sector workers in low-income countries to have a decent retirement pension and it is reasonable for governments to support this aspiration. However, a question that is relevant in almost all contexts takes on particular significance in low-income countries and that is the question of how much revenue should be sacrificed through tax support for third pillar pensions, given the possible alternative uses of the revenue. Also, since formal employment in low-income countries is heavily concentrated in the public sector, it is important that public employee pension costs be reasonable in a total compensation context.

In high-income countries, the elderly who are poor are often treated more generously than the lower income non-elderly. It is not clear how this logic does or should apply in countries where low income and poverty are pervasive. Also, it might be

that in low-income countries the balance in the overall provision for the elderly should focus more strongly on the provision of necessary services (health, housing and transportation) rather than on income provision. This could be particularly important where the elderly have been separated from other generations in their extended family and where HIV/AIDS has broken up networks of family support.

Conclusions

The past decade has been a difficult period for many trade union movements as far as pension policy is concerned. Pension reforms have been implemented that do not reflect trade union priorities. In many cases, unions have mounted substantial opposition to them. Moreover the debate on pension reform has been frustrating. It has often focused on issues that are not germane to either the purpose of pension plans or the central concerns of trade unions. In addition, arguments in favour of recent reforms have often relied too heavily on unreasonably pessimistic predictions about the demographic future and its consequences.

In considering a trade union response to the current situation, it is important to acknowledge the reality of a wide variation in national circumstance in all of the economic, political and demographic spheres. These national differences will (and should) have an impact on what trade unions recommend with respect to pensions systems, and to the likely outcome of future reform processes.

Despite national differences, there is likely to be common ground among trade union movements on a few basic points:

- Pension and retirement income systems should be judged primarily, if not exclusively, on their ability to deliver adequate retirement incomes, without imposing an inequitable burden on the working-age population;
- Adequate retirement incomes should allow people to retire from extended

periods of formal employment without a significant loss in living standards, and provide all older people with incomes above nationally recognized low-income measures;

- Pension systems should have core programmes that provide benefits which are reasonably predictable;
- Publicly administered pension plans have a positive role to play in any pension system, and universal flat-rate programmes can be useful in both high- and low-income countries;
- Pay-go financing of public programmes has many desirable features and should not be readily abandoned; and
- Representatives of workers/plan members should play an important role in the governance of second and third pillar programmes.

Moving forward on pension issues creates some important challenges for trade unions. It will be difficult to stem the tide on undesirable pension reforms unless trade unions succeed in bringing the focus of pension discourse back to income adequacy. This is an issue that needs to be addressed in terms of the well-being of the retired population overall. It also needs to be addressed with particular populations in mind, notably women and immigrants.

Trade unions also need to do general pension education work with all levels of their membership. Trade union leaders need to be knowledgeable and confident advocates of progressive change. More specialized training is required for those who take on governance roles. Not all of this training has to be provided within the trade union movement. But the trade union movement does have a responsibility to be sure that the training is available.

It is also important to encourage a life-course perspective on pension and retirement issues. These issues often get dealt with as if they are only relevant to the current elderly, whose interests are sometimes pitted against those of currently younger

age groups. But, one reality of the youth population at any point in time is that they will be the older population at a later point in time. It is necessary to encourage among today's youth a sense of interest and concern for how they will be provided with income and cared for in old age.

Finally, it is important for trade union representatives to engage in dialogue on pension issues with employers and government representatives, as well as policy specialists. But, there are likely very few political contexts where a trade union movement on its own will be able to establish the political support required to implement a progressive pension agenda. Trade union movements need to identify and engage other groups in society that are likely to share a common perspective on pension issues.

Notes

¹ World Bank reform programmes typically supported some form of tax-financed minimum income programme for the elderly (i.e. a first pillar), and greater reliance on "voluntary" retirement programmes (i.e. a third pillar). Many commentaries and critiques of the World Bank's efforts are now available. One important source of critical commentary is the *International Social Security Review* (Blackwell Publishing on behalf of the International Social Security Association). Many of the issues and the intensity of the debate are captured in a collection of papers prepared by the Bank itself: (World Bank, 2001), and by World Bank, 2006. A self assessment of the Bank's work is provided by: Holzmann and Hinz, 2005. A trade union commentary on the Bank's approach was prepared by Peter Bakvis of the ICFTU. (See: Bakvis, 2006).

² A more complete version of this paper is available from <http://www.ilo.org/public/english/standards/relm/gb/docs/gb294/pdf/esp-4.pdf>. It has benefited from comments from Frank Hoffer of the ILO AC-TRAV, colleagues from the Trade Union Advisory Committee to the OECD and from the ICFTU, as well as trade unionists from many countries who participated in a seminar organized by the Global Union Research Network in Lisbon in October, 2006.

³ All actual demographic data are from the UN population database and projections represent UN mid-range projections.

⁴ To the extent that pre-funded pensions are invested in government bonds, the income streams that are paying for pensions are those that make up the general tax base of a government. This will

be predominantly labour income. In practice, many of the new mandatory DC schemes have been regulated so that they are invested largely in government bonds. Unless this changes in the years ahead, these plans will function very much like pay-go plans with somewhat different distributional characteristics than the old earnings-related DB plans. (World Bank, 2006)

⁵ The issue of intergenerational fairness is a serious one. But, while much of the commentary on the issue focuses on financial issues, the main issues have non-financial definitions. It is important that each generation of young people inherit from their predecessors: a capital stock of sufficient size and quality to permit full employment at high incomes; an environment that is useful for both production and consumption; the skills and knowledge required for production, civic responsibility and personal enjoyment; and social peace.

References

- Asher, Anthony, 2006. "Pensions in Africa", in Gordon L. Clark, Alicia H. Munnell and J. Michael Orszag (eds) *The Oxford Handbook of Pensions and Retirement Income* (Oxford: Oxford University Press).
- Bakvis, Peter. 2006. "ICFTU/Global Unions" analysis of *Pension Reform and the Development of Pension Systems: An Evaluation of World Bank Assistance* by the Independent Evaluation Group of the World Bank (Washington, D.C.: World Bank).
- Barrientos, Armando, 2006. "Pensions for Development and Poverty Reduction" in Gordon L. Clark, Alicia H. Munnell and J. Michael Orszag (eds) *The Oxford Handbook of Pensions and Retirement Income* (Oxford: Oxford University Press).
- Beaujot, Roderick. 2004. *Delayed Life Transitions: Trends and Implications* (Ottawa: Vanier Institute of the Family).
- Gillion, Colin, John Turner, Clive Bailey and Denis Latulippe. 2000. "Social Security Pensions: Development and reform". (Geneva: ILO).
- Holzmann, Robert and Richard Hinz. 2005. *Old Age Income Support in the 21st Century: An International Perspective on Pension Systems and Reforms*. (Washington, D.C.: World Bank).
- International Labour Office (ILO), 2006. "Social security for all: Investing in global social and economic development – A consultation". (Geneva: ILO).
- Mesa-Lago, Carmelo, 2006. "Structural Pension Reform – Privatization – in Latin America" in Gordon L. Clark, Alicia H. Munnell and J. Michael Orszag (eds) *The Oxford Handbook of Pensions and Retirement Income* (Oxford: Oxford University Press).
- OECD, 2005. *Pensions at a Glance: Public Policies Across OECD Countries*. (Paris: OECD).
- OECD 2000. *Reforms for An Ageing Society*. (Paris: OECD).
- OECD, 2001. *Ageing and Income: Financial Resources and Retirement in 9 OECD Countries*. (Paris: OECD).
- OECD, 1998. *Maintaining Prosperity in an Ageing Society*. (Paris: OECD).
- Phang, Hanam S., 2006. "Retirement Income Systems in Asia" in Gordon L. Clark, Alicia H. Munnell and J. Michael Orszag (eds) *The Oxford Handbook of Pensions and Retirement Income* (Oxford: Oxford University Press).
- Queisser, Monika and Edward Whitehouse, 2006. "Pensions: the Work of the OECD Social Policy Division" (presentation to the OECD Working Party on Private Pensions).
- Sudén, Annika, 2006. "Unending Work" in Gordon L. Clark, Alicia H. Munnell and J. Michael Orszag (eds) *The Oxford Handbook of Pensions and Retirement Income* (Oxford: Oxford University Press).
- Turner, John, 2001. *Women and Portfolio Choice* (Washington, D.C.: American Association of Retired People).
- Wolfson, Michael and Geoff Rowe, 2006. "Ageing and Intergenerational Fairness – a Canadian Analysis" (paper presented to the International Association for Research on Income and Wealth, Joensuu, Finland, August, 2006).
- World Bank, 1994. *Averting the Old Age Crisis: Policies to Protect the Old and Promote Growth* (Washington, D.C.: World Bank).
- World Bank, 2001. *New Ideas about Old Age Security* (Washington, D.C.: World Bank).
- World Bank, 2006. *Pension Reform and the Development of Pension Systems: An Evaluation of the World Bank Assistance* (Washington, D.C.: World Bank).
- Yamada, Atsuhiko. 2002. "The Evolving Retirement Income Package: Trends in Adequacy and Equality in Nine OECD Countries" Labour Market and Social Policy Occasional Paper No. 63. (Paris: OECD).

Social security for all: Investing in global social and economic development

There is a need to arrive at a new consensus on the responsibilities of the global society, the nation State, communities, social partners, civil society and individuals for the provision of social security. Global minimum social standards and global financial transfers are to some extent substitutes. The key role of the nation State needs reconfirmation but the complementary and supporting role of the global community also has to be defined. The wider the implementation of minimum social standards at the national level – enabled by sufficient fiscal space – the less international transfers will be needed to combat poverty.

Michael Cichon

Director
Social Security Department
ILO

This article seeks to explore the framework within which the ILO should promote a principled, practical and responsive approach to social security policy¹ in the new millennium. This is an abridged version of a consultation paper issued by the Social Security Department of the ILO in August 2006.²

The most important single reference source is the general discussion held at the 89th Session of the International Labour Conference in June 2001. The vision of social security that emerged during this discussion gave rise to a set of 21 conclusions, which confirmed the validity, within the developing paradigm of decent work, of the general approach to social security which had been developed by the ILO throughout almost all its history since 1919. That approach is rights-based and formulated in terms of a specific set of contingencies, most of which threaten the capacity of an individual worker and her or his family to generate their own income.

Aspects of rights and principles

Social security has been a core element of the ILO's mandate, virtually since its creation in 1919. At the ground-breaking 26th Session of the International Labour Conference in Philadelphia in 1944, the ILO enshrined its recognition of the need to provide an adequate level of social protection in the Declaration of Philadelphia. Both before and after 1944, the Organization has developed a series of Conventions and Recommendations concerned with social security. Over time, the notion of social security as a basic human right has gained wide acceptance, and has been progressively developed in many other forums and Conventions.

Aspects of social solidarity

A vital role for social protection is to provide income security in the event of such contingencies as old age, sickness, invalidity, maternity and unemployment – in

addition to the provision of appropriate medical care for all.

A number of issues have come to the fore in recent years which impact social security provision in many, if not all countries, particularly those which are economically less well developed. Foremost among these is the need to extend social security provision to those lacking coverage, who are largely represented in the so-called informal economy and generally very difficult to enrol in formal systems of social security. For this reason, the conclusions adopted by the Conference in 2001 stressed the overall responsibility of the State in the promotion, facilitation and extension of coverage.

There are a range of gender-related issues which are specific to social security. These relate not only to the principle of gender equality at the workplace but also to the problems encountered by women if family responsibilities preclude them from accruing adequate benefits under social insurance.

Guiding principles

The discussion at the Conference in 2001 also considered the way social security systems have evolved over time, the manner in which each country might develop a national strategy, and the role of the ILO in working effectively with its member States towards extending social security. It was agreed that ILO activities should be anchored in the Declaration of Philadelphia, the decent work concept and the relevant ILO social security standards. Finally, a major initiative was recommended in the form of a campaign to be launched to promote the extension of social security coverage.

In sum, the following principles, which should underlie the ILO's future work in social security, may be distilled from the conclusions adopted in 2001:

- coverage should be universal and benefits adequate;
- the State bears the ultimate and general responsibility of guaranteeing a

framework of good governance and the assurance that benefits will be paid as and when due;

- social security should be organized on the basis of social solidarity between, inter alia, men and women, different generations, those in and out of work, and the rich and poor;
- social security systems must be sustainable;
- the rule of law must prevail at both the national and international levels.

In support of these specific principles, wider linkages are also needed to:

- the principles enshrined in ILO legal instruments;
- the further principles enshrined in the concept of decent work, the promotion of which will ensure an additional linkage with all other ILO activities, in particular employment generation;
- strong and well-functioning social dialogue, involving social actors – specifically the ILO's social partners – in building and managing social security policy.

1. Social security is a basic human right

In order to capture adequately the scope of the measures and provisions for discussion, this article is based on a rather broad understanding – rather than a precise definition – of social security as: *the set of institutions, measures, rights and obligations whose primary goal is to provide – or aim to provide – according to specified rules, income security and medical care to individual members of society.*

This formulation may be interpreted in relation to societies – nations – as a whole, to social groups and to both formal and informal economies. On an operational level, social protection or social security systems may therefore be understood as incorporating:

- those cash transfers in a society that seek to provide income security and, by extension, to prevent or alleviate poverty;
- those measures which guarantee access to medical care, health and social services;
- other measures of a similar nature designed to protect the income, health and well-being of workers and their families.

From a global legal perspective, the recognition of the right to social security has been developed through universally negotiated and accepted instruments that proclaim that social security is a fundamental societal right to which every human is entitled. This principle is laid down in:

- Article 22 of the Universal Declaration of Human Rights; and
- Article 9 of the International Covenant on Economic, Social and Cultural Rights.

The International Labour Conference adopted the first international labour Conventions on social security at its very first session in 1919. Social security as a human right is part of the ILO's mandate and is enshrined in a series of ILO Conventions; most prominent among these is the Social Security (Minimum Standards) Convention, 1952 (No. 102), which became the blueprint for the European Code of Social Security.

This legal framework implies that any State that has decided to become a member of the United Nations and the ILO has the general and fundamental legal obligation to put in place decent social protection for its people.

2. The need and demand of people for social security

A large majority (about 80 per cent) of the global population live in conditions of social insecurity, i.e. they have no access to formal social security beyond the limited possibilities of relying on families, kinship groups or communities to secure their standard of living. Among these 80 per cent, 20 per cent live in abject poverty – the cruellest form of insecurity.

An alternative model of poverty prevention and alleviation relies largely on the positive “trickle-down” effect of economic growth. While a variety of approaches may well complement each other, there is no doubt that the benefits of the trickle-down effect will take much longer to reach those in need unless policies of direct and immediate poverty relief through social transfers are in place. The ILO estimates that only 2 per cent of global GDP would be needed to provide the entire world's poor with a minimum package of social benefits and services (access to basic health care, basic income transfers in case of need and basic education). Most of these resources could be raised nationally. Nonetheless, substantial global transfers would be needed to help the poorest countries with a GDP per capita close to – or below – the global poverty line to cope with their problems.

There is clear evidence from Europe and OECD countries that social transfers successfully reduce poverty and social insecurity and that there is a strong correlation between the size and levels of these transfers and the strength of the poverty reduction effect. As a recent OECD study pointed out:

The relationship between government policies and poverty outcomes is striking: across countries, relative poverty rates among the working-age population are lowest where (non-health) social spending on the working-age population is highest. Within each country, the combined effect of the tax and benefit systems is to lift out of relative income poverty more than half of the population at risk, on average.

This effect, which ranges between around one-fourth of those below the poverty threshold before taxes and transfers in the United States and more than two-thirds in Denmark, declined however over the second half of the 1990s in most OECD countries, as the growth of real benefits most often lagged that of median disposable income.³

Experience with social transfers in developing countries is more ambiguous, since overall transfer volumes are comparatively small. However, some basic social protection transfers, such as benefits of social health insurance and basic non-contributory pension schemes, have proven to be potent means in the fight against poverty. Ill health is the main reason for poverty: not only does it lead to high costs – e.g. in the form of user fees – but it is likely to impact significantly on income generation. It has been observed⁴ that social health protection can effectively address health-related poverty if benefits are adequate and affordable. Recent experience with modest universal pension systems in a number of developing countries has also shown positive poverty-reducing effects for whole families. They not only provide benefits for the old and disabled but also use this disadvantaged group – whose status in families is greatly enhanced through the cash income they receive – as effective agents of social transfers for whole families. Pension recipients redistribute cash income in the household, finance school fees and medication, etc.⁵

It is calculated that such social security benefits in most countries would cost between 1 and 2 per cent of GDP or 5 and 10 per cent of national budgets.⁶ Implementing this benefit would be, for many countries, a fast first step towards attacking a chronic poverty pocket. Another ILO simulation exercise shows that even a very modest universal pension, costing about 1 per cent of GDP, would reduce the poverty gap in Senegal and the United Republic of Tanzania by more than 20 per cent.⁷

An important dimension of overall human security is economic security – and one of the main aspects of economic

security is income security. Income security is about living in a situation in which basic needs, such as food, housing, health care and education, can be secured in an uninterrupted way. This not only requires having both an adequate and regular source of income; it also requires being assured that there are mechanisms in place if something unexpected happens to the regular source of income. These mechanisms should be able to provide income replacement to close the emerging income gap and/or to guarantee access to goods and services necessary to meet those unexpected needs.

3. Social security and economic performance

National social protection systems and their perceived effects on economic performance have been subject to intense policy debates in many countries over recent decades. There are experts who claim that social redistribution of up to 35 per cent of countries' GDPs is an impediment to growth, with negative effects in both the short and the long term. Others hold an opposite view and consider social protection – if well managed – to be a genuine productive factor. A team of ILO writers concluded recently:⁸ "Once all the arguments are on the table, the outcome of the theoretical debate on the potential positive versus negative economic effects of the welfare state appears to be a draw ...".

Social transfers may well have a direct positive impact on growth; but the key issue is to recognize that substantial levels of social expenditure and economic growth can coexist⁹ and that such transfers are the tool to make the economic growth equitable, thus strengthening its sustainability.

The substantial global economic growth rates in many countries over recent years have not translated into an equally fast decline in poverty or social insecurity. Indeed, social insecurity has been increasing in many countries alongside cuts in social protection. Neverthe-

less, since the mid-1970s major welfare states such as Austria, France, Germany, the Netherlands and others broadly maintained their social expenditure, as measured by the percentage allocation of GDP, at the levels reached in the mid-1970s.

According to the paradigm of containment, low European growth rates have come about mainly as a result of social protection provisions which are too high and wrongly designed. All that can be observed at present is that social expenditure in European OECD countries (measured in percentage of GDP) has stabilized at long-run levels – and this applies equally to low and to high growth economies. It is evident that cost containment policies have not brought about higher economic growth.

Some believe that too much security, particularly income security, undermines people's incentives to engage more in economic activities and to be inventive and productive. But the truth is likely to be exactly the opposite: the less secure we feel, the more averse we are to take risks. Studies reveal that poor people are risk-averse. Rational risk-averse individuals will only take a risk if the potential loss is relatively small compared to their wealth. The poor are usually not eager to risk even small amounts as this threatens their very survival. Wealth provides security, and more can be risked. For many people, social security substitutes wealth. Those who have no access to relevant protection mechanisms against numerous social risks will avoid taking any additional economic risks, as they have to focus on protecting themselves.

Social protection, however, is not only about risk management. Providing income security to the poor is one of the important mechanisms to provide greater equality of opportunity, income and wealth than that at present experienced in the world. Social transfers are usually expected to result in a distribution of income in society that differs from the one brought about by market forces. No private market mechanisms can redistribute income in this way. Income redistribution has to be provided mainly

through public social security interventions (along with the tax systems) and cannot be delegated to private arrangements – either market ones or even traditional ones based on extended family or community income sharing.

The importance of equitable growth is meanwhile recognized widely. A World Bank source states: "Others have suggested that greater equity comes at the expense of lower growth and that there is a trade off between growth and equity [...]. A large number of recent empirical studies [...] have found that there is not necessarily such a trade off and that equity in its various dimensions is growth enhancing". "... most developing countries will likely have substantial scope for enhancing the quality of growth [...] through policies aimed at improving income distribution."¹⁰ That is precisely what a well-designed social security system does.

But how much social security is affordable? OECD countries spend between 10 and 30 per cent of GDP on social security – usually between one-third and one-half of total public expenditure. Countries at the same level of economic development differ significantly in how much they spend on social security.

In the OECD region there is a strong positive correlation between social expenditure (per capita of the population) and labour productivity (GDP per hour worked). The correlation between "simple" per capita (per worker) productivity and social expenditure (per capita of the population) is also positive but less tight. While the nature of the actual causality behind this correlation may not yet have been fully researched, one conclusion is obvious: an extensive social security system is not incompatible with a highly productive economy.

4. The main challenges to social security systems

The global demographic transition

The demographic environment of a social protection system, which includes the morbidity structure of the population with which the health system has to cope, co-determines the system dependency ratio. Demography is not the exclusive determining factor, as governance too has a marked impact on dependency. The economy co-determines the number of unemployed while national law, which is a governance factor, co-determines the number of people who are retired and of those receiving education.

The other determinants – economic development and governance factors – being equal, ageing is the most important factor of influence on social transfers to elderly populations (both formal and informal) which are, in turn, the biggest expenditure items in developed national social protection systems. However, while developed regions are substantially “older” than less developed ones, the pace of ageing is actually much faster in the developing world. The less developed countries in relative terms will face an even more serious ageing problem between 2000 and 2050 and have to build strong transfer systems well prepared to face this challenge.

One of the most dramatic aspects of the demographic transition is rapidly dropping fertility rates. The global average fertility rates dropped within the three decades between 1970-75 and 2000-05 from 4.49 to 2.65, i.e. by about 40 per cent. This is by no means a phenomenon that only applies to developed countries.

Changes in health, society and the labour market

Public health issues

New public health threats constitute another factor that may rapidly change the demographic environment in which some

national social protection systems operate – in particular in developing countries. Among infectious diseases expected to become a pandemic, HIV/AIDS is the most acute. In some regions of Africa, the infection rate is estimated to have reached almost 40 per cent. This implies, in all probability, that within the next five to ten years at the latest, 40 people out of every 100 alive today will have died. It is probably fair to say that HIV/AIDS will wipe out all the financial and fiscal room for improvement in social protection that growth in Africa might have produced under normal conditions. But it should not be forgotten that malaria, although less prominent and confined to the poorest regions of the world, has an even more dramatic effect on population structures and morbidity structures.

Migration and family composition

The ILO estimates that, at the beginning of the new century, about 175 million people worldwide were living outside their country of birth or citizenship,¹¹ among which about 90 million were migrant workers. At the same time, there has been a movement of people from rural to urban areas. From 1995 to 2005, the share of rural employment in total world employment fell by three percentage points, or around 90 million workers, to about 40 per cent. Together with migrating dependents, the total number of persons moving from rural to urban areas might be in the order of 200 million people within decades. Including migrants in national social security systems is one way of helping them integrate into their new countries or the cities in which they choose to live. In addition, the remittances of migrant workers have become the major source of income for many families in a large number of countries. These financial flows might help to finance more income security in the “labour-exporting” countries and regions.

Informalization of labour markets and economies

The “dual economy” model had assumed that most agricultural workers would move from rural into urban areas into higher productivity manufacturing jobs. This assumption simply no longer holds true. Manufacturing has ceased to be a major sector of employment growth in many regions and the rural-to-urban movement of labour is largely absorbed by trade, in particular informal petty trade. Hence the expectations that there would be a gradual movement towards the formalization of the largely informal agricultural labour force have also not been met. The ILO has estimated that, at the end of the 1990s, the share of informal employment in non-agricultural employment was 48 per cent in North Africa, 72 per cent in sub-Saharan Africa, 51 per cent in Latin America and 65 per cent in Asia.¹²

Globalization and the new uncertainty

The increased international economic integration during the last decades of the twentieth century coincided with rising income inequality in some countries. In addition to the impact of internationalization on wages and employment, which reduces the national tax base, there is an erosion of the capacity of national governments to set their own targets with respect to social protection. Critics of the “welfare state” have argued that increased international openness creates difficulties in raising sufficient revenues, and therefore requires a downsizing of the “welfare state”. There is some evidence that countries are currently engaged in tax competition – although the effects seem to be much smaller than might be expected. In a number of OECD countries, average tax rates on labour have increased, perhaps to compensate for the loss of capital tax income although it could also be due to the shrinking tax base of employed people.

There was a strong belief in some quarters that the reforms converting wide-

spread defined-benefit pension schemes, financed on a pay-as-you-go basis into pre-funded defined contribution schemes, would help to ensure the availability and affordability of pension schemes. There were several assumptions:

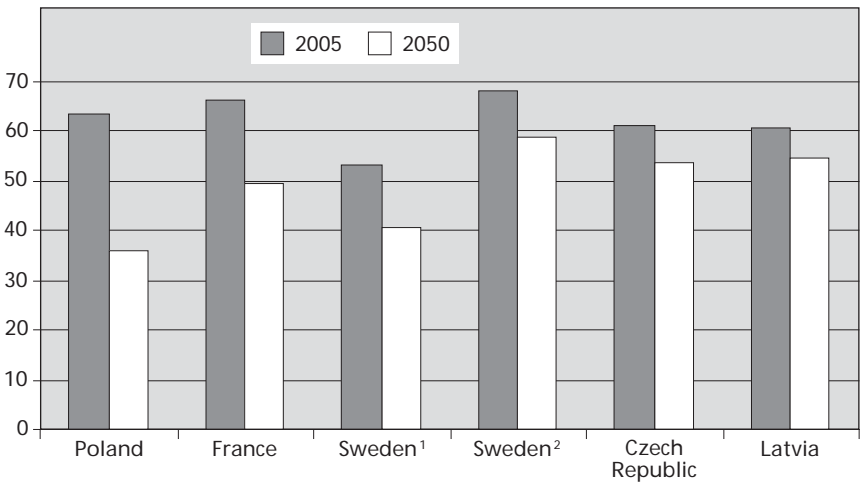
- Despite ageing populations levels of contributions and costs would be maintained because people would contribute longer and retired later in order to maintain benefit levels.
- Linking amounts contributed with future benefits would provide very strong incentives to contribute, even on a voluntary basis.
- Those incentives would thus extend coverage to all those who were uncovered, particularly the self-employed.
- Privatization would strengthen these incentives by providing higher rates of return and also by gaining higher public confidence than allegedly bankrupt public schemes.

The Chilean pension reform, introduced already at the beginning of the 1980s, was the first attempt to implement policies following this new paradigm. The World Bank’s publication, *Averting the old-age crisis* (1994), announced this new pension policy paradigm as relevant globally. Over the past few years, the ILO has undertaken numerous studies¹³ of the reformed pension systems, particularly of those in Latin America and of the transition countries in Central and Eastern Europe. These studies confirm that the outcomes of the reformed pension schemes may:

- reduce the income security of those covered when they become old;
- reduce the actual effective coverage of those previously covered;
- fail to increase coverage of those not previously covered; and
- fail to increase national savings rates.

ILO concerns have in the meantime been echoed by the World Bank’s own

Figure 4.1. Theoretical gross replacement rates in selected European Union Member States: Average earnings, 40 years of contributions, retirement at age 65



Notes: ¹ National pension system only; ² Including occupational pensions.

Source: Own comparative analysis of data included in national pension strategy reports as available on http://europa.eu.int/comm/employment_social/social_protection/pensions_en.htm.

Independent Evaluation Group (IEG). The Group's report on the evaluation of the World Bank's assistance to pension reforms¹⁴ concluded, inter alia: "There is little evidence that privately funded pillars have succeeded in increasing national savings or in developing capital markets ..." and "... the Bank's preoccupation with fiscal sustainability tended to obscure the broader goal of pension policy, that is, to reduce poverty and improve retirement income adequacy within a fiscal constraint."

Some countries in Europe have introduced – or are considering introducing – reforms similar to those in Latin America, aimed mainly at reducing future costs of pensions to the public budgets in the hope that such systems will encourage later retirement. ILO studies, quoted above, also point to high and long-lasting transitional costs, high administrative costs and expected low replacement rates, especially for women or other persons with short, broken careers and lower incomes (or

those who – like the self-employed – obligatorily contribute only a certain low minimum amount).

Figure 4.1 shows expected theoretical replacement rates for selected EU Member States as reported in their national pension strategy reports. From these projections it is obvious that it is not only schemes which go through so-called paradigmatic reforms or privatization (Poland, Sweden and Latvia) which will see reduced replacement rates: public schemes will also experience declines (France and Czech Republic). The alternative to decline would be for people to contribute significantly longer and retire much later, to increase contributions or for the State to subsidize contributions via increased tax revenue.

Between universalism and pluralism: The changing pattern of solidarity

In contrast to the demographic challenge, the possible detrimental effects of global tax competition on the level of social security in some countries are less easily manageable. What is required is international recognition – and corresponding agreements – that the extension of social security coverage and the ensuing eradication of poverty would be an investment; this would avoid the resentment that creates national social unrest and potential global security problems.

The past few years have witnessed new developments in this area. There seems to be increasing recognition of the role of social security as an investment in poverty alleviation. There is growing support for a new social security developmental paradigm based on the introduction of basic universal benefits. Following the “new consensus” on social security reached by the International Labour Conference in 2001 and the launching by the ILO in 2003 of the Global Campaign on Social Security and Coverage for All, the World Commission on the Social Dimension of Globalization promoted the idea of a socio-economic floor for the global economy and indicated that social security and wider social protection had to become an important component of such a set of minimum social standards (see box 4.1).

Almost unnoticed, the global community has already assumed more responsibility for the provision of basic services in a number of developing countries. In Ghana and the United Republic of Tanzania, for example, direct budget support from donors already accounts for substantial proportions (i.e. 40 per cent and 50 per cent, respectively) of the national health budget. A “White Paper” on international development, entitled “Making governance work for the poor” and published by the Government of the United Kingdom in 2006, commits “at least half of all future UK direct support for developing countries to public services, to get children into school, improve health

care, fight HIV and AIDS, provide more clean water and sanitation, and offer social protection”.¹⁵

At the same time, the question of the responsibility of the State in providing basic benefits is once again central to the debate taking place in countries which undertook a partial “privatization” of their social security systems in the 1980s and 1990s.

Some say that the acceptance of the concept of solidarity is deteriorating as many social protection schemes are broken down into smaller and smaller risk pools (right down to the financing of risks by individual accounts). Others observe that the commonly accepted notion of solidarity is simply changing, now focusing more on the attainment of basic security for more people rather than equal security for a few. In any case, social security systems are becoming more pluralistic. Pension schemes are turning into systems in which the basic public provision of income security mechanisms is topped up by social insurance or privatized savings arrangements with benefits that have a much closer link to earned insured income – which in turn are topped up by voluntary or mandated arrangements. The consequence is a wide range of different income levels at retirement between varying population groups.

Community-based health schemes are springing up everywhere in the developing world, most frequently in Africa and parts of Asia. At present, the global coverage of such mutual schemes is estimated to be about 40 million persons. There is certainly room for further growth and qualitative improvements in governance of these schemes. They cannot constitute or substitute a universal basic layer of security based on national solidarity. Community-based schemes have the potential to increase the overall resource base, at the national level, for social security. The development of these schemes represents a first step forward to the “formalization” of the informal economy.

Box 4.1 Socio-economic floor

A minimum level of social protection for individuals and families needs to be accepted unequivocally as part of the socio-economic “floor” of the global economy. Donors and financial institutions should contribute to the strengthening of social protection systems in developing countries.¹

In his Report to the International Labour Conference in 2004, the Director-General identified four major areas in which the ILO had found positive experiences. He considered that they could make a major contribution to developing the concept of a socio-economic floor:

First, *community-based health insurance*. The demand for health insurance is strong, particularly among those without any form of protection. One option for workers and families in low-income countries is community-based social security schemes. The ILO has acquired experience and knowledge on the strengths and weaknesses of such funds. Their financial viability is often called into question if one considers these funds in isolation. However, innovative modalities have been introduced in some cases, combining local contributions, public expenditure and international assistance. Linking local initiatives with national insurance schemes is another method that merits further exploration.

Second, *minimum pension schemes*. A number of countries have shown that minimum pension schemes financed from tax revenues for poor elderly persons, disabled people, single mothers and orphaned families affected by the HIV/AIDS pandemic are affordable. The manifold benefits of these schemes – from gender equality to family cohesion and school attendance – are well documented. The ILO could consider extending assistance to demonstrate the viability of these programmes in other countries and develop guidelines. Where fiscal constraints currently prevent such an option, proposals for international financial assistance should be elaborated.

Third, *cash grants for primary education*. Scores of millions of children are unable to go to school or complete basic education because of family poverty. Most of them are driven into some form of child labour. A few countries, most notably Brazil and South Africa, are considering or experimenting with schemes for cash grants to poor families tied to school attendance for their children. The ILO's International Programme on the Elimination of Child Labour (IPEC) has gained considerable experience with schemes that combat child labour by combining family support for education and other essential needs. There is scope for scaling up these successful initiatives to national levels and extending them to other countries facing similar problems. A combination of national efforts with generous international assistance is required.

Fourth, *reorienting public expenditure for expanding basic coverage*. Statutory social security systems, even with modest coverage, are faced with severe constraints of overall governance, technical and administrative capacity and financial viability. Although higher social expenditure can be financed through faster economic growth, the costs are often perceived to exceed fiscal capacity in the short term. In many countries, the first objective is not to increase spending but to reorient present expenditure towards basic coverage. There is sufficient knowledge and experience world-wide to enable social security systems to achieve long-term financial and administrative viability. The ILO can assist in making such expertise available when and where required. A code of good practice or basic principles in the management of social security schemes could be considered.²

Notes: ¹ World Commission on the Social Dimension of Globalization: *A fair globalization: Creating opportunities for all* (Geneva, ILO, 2004) p. xiii. ² ILO: *A fair globalization. The role of the ILO*, Report of the Director-General on the World Commission on the Social Dimension of Globalization (ILC, 92nd Session, Geneva, 2004), pp. 36-37.

5. A policy vision: Establishing the appropriate paradigm

Some people may not want to believe that social security is a prerequisite for growth because it is impossible to demonstrate the exact logical causality. The evidence, simply, that economic performance and solid social security can and do coexist is compelling.¹⁶ Many European and non-

European OECD countries would not have experienced such great economic and social development as they did during the post-war period had they not introduced such comprehensive social security programmes.

Seeing social security expenditure only as an additional cost that may negatively affect economic performance is short-sighted. Social security responds

to the basic needs and clearly expressed preferences of societies, a public good that people are willing to pay for in terms of taxes and contributions – provided these are well spent. Social security transfers are the only direct means to overcome poverty and social insecurity in the short term.

The role of the agents of change

The role of individuals and communities

Many social insurance schemes provide income-replacement payments in the event of certain contingencies. The replacement rates of these benefits are inevitably lower than unity. A 100 per cent income replacement is unrealistic and would most likely provide adverse incentives. Income replacement beyond a certain level therefore has to be provided for by individuals through secondary and tertiary security systems or the accumulation of assets that may be turned into income streams when such contingencies strike. While the ultimate responsibility of the State is indispensable, paternalism that restricts individual responsibility is highly unlikely to be compatible with modern societies. Community-based initiatives – where the top-down approach through the nation State is not forthcoming and particularly when the State is failing – might be a first step towards developing national social security systems through a bottom-up approach, potentially paving the way for a gradual development of governance ethics and good practices.

Reconfirming the responsibility of the nation State

While private schemes and arrangements can improve the level of income replacement in the event of certain contingencies for various groups in a society, basic social security, i.e. a fair distribution of income even in times of economic distress, can only be underwritten by societies at large.

Income security requires social protection in the form of public social security interventions. Indeed, core security remains a task for the State – which is also the only institution that can formulate an overall national social security development plan.

Private insurance fails to deal adequately with social risks: first, not all risks are insurable in full or in part; and, second, more pragmatically, the poorer sections are unable to pay for a full level of insured coverage.

It is also not enough to rely on informal, traditional social protection arrangements to provide basic security through extended family and community networks. Not only are these traditional arrangements slowly disappearing on account of urbanization and industrialization but they very often provide security at a high cost and are not usually based on altruism. In addition, mutual support by families and communities tends to be distributed in a very unequal way. In other words, poor people can usually only expect support from their almost-as-poor families and communities; providing support (e.g. in the case of catastrophic health costs) may, in fact, force entire families and communities into lasting distress.

However, it is simply not feasible to implement appropriate programmes and establish the necessary institutions to secure decent work in countries where governments are not able to collect the taxes or contributions needed to provide for basic public and social services and basic infrastructure. Equally, citizens must have confidence in the government's capacity to manage social protection, and this can only be built in a democratic environment.

But, within the context of globalization and having regard to the evidence of tax competition between nation states in attracting investment, the global community has to organize the global economy and the global society in such a way as to enable nation States to achieve nationally and internationally defined policy objectives. This would mean searching for ways in which the global community might protect the fiscal space of the nation State.

The nature of rights derived from ILO and other international instruments

There is a range of international legal instruments through which Member States of the United Nations or the ILO derive an obligation to provide some degree of social security to all their citizens. Binding instruments are:

1. the ILO Constitution;
2. the Universal Declaration of Human Rights;
3. the Social Security (Minimum Standards) Convention, 1952 (No. 102); and
4. the Social Policy (Basic Aims and Standards) Convention, 1962 (No. 117) as it relates to developing “broad systems of education, vocational training and apprenticeship”.

Additionally, there is a series of recommendations and conclusions, which are weaker than ratifiable instruments, which contribute to the obligations upon member States:

1. The Income Security Recommendation, 1944 (No. 67);
2. The Medical Care Recommendation, 1944 (No. 69); and
3. The conclusions of the general discussion on social security at the 89th Session of the Conference in 2001.

The ILO interprets the entirety of the above instruments as a mandate to define a basic minimum protection package (that could also be described as a “social floor”) to fulfil the international recommendations, notably the requirements of Article 22 of the Universal Declaration of Human Rights. The floor should, in fact, consist of a hierarchy of floors that has to be reached at different levels of development.

Setting global floors for social rights and social transfers may halt “the race to the bottom” – when it comes to curbing social rights and social spending – at an acceptable decent level. ILO social security standards with a support of core labour

standards can be seen as a tool in the global process to protect the fiscal space of social security systems. New and wider instruments might have to follow.

Building a policy vision: Development approach to social security – Towards universal coverage

The ILO policy development vision focuses on building country-specific effective and efficient national social security systems, affordable to countries at different levels of development. Such an approach has thus to be:

- (a) flexible, to accommodate to national circumstances;
- (b) progressive, i.e. it has to permit a gradual build-up of more comprehensive systems as societies mature (in an economic sense); and
- (c) normative, i.e. it has to accept the benefit levels and entitlements defined by the ILO’s minimum standards (for example, Convention No. 102) as an ultimate minimum desired level of protection.

Such a basic social protection package would have a major impact on the reduction of poverty and the improvement of living standards. Access to basic social services, notably health care and education, undoubtedly has marked effects on increasing productivity and reducing poverty in the short and long run. In addition, cash transfers can play a major role in providing basic income security to those who do not have any earnings capacity, as shown in a GTZ¹⁷-sponsored pilot project in the Kalomo district of Zambia.¹⁸ Recent ILO micro-simulations reveal, in the case of the United Republic of Tanzania, that the combination of basic universal old-age pensions and child benefits to school children and orphans under the age of 14 would reduce overall poverty rates by about one-third.¹⁹

The key objective is universality. That is the core mandate of the ILO global campaign on social security and coverage for

all. As mentioned above, the International Labour Conference in 2001 unanimously entrusted the ILO with conducting that campaign. “Universality” may refer to the various dimensions of social security. Here, the main emphasis is on universality of access of individuals to formal systems of social protection. The notion of a universal benefit, payable without distinction to all qualified members of a scheme, on the other hand, fits well into the concept of a rights-based scheme, but may in practice have to be tempered by some form of targeting of resources, when these are limited.

Attention should first be focused on building up benefits with a strong social investment character. We thus believe that social security in the poorest countries can gradually start with basic elements such as:

- access to basic health care through pluralistic national systems that consist of public tax-financed components, social and private insurance components, equity funds and community-based components that are linked to a strong central system;
- a system of family benefits that helps to combat child labour and permits children to attend school;
- a system of targeted basic cash transfer programmes of social assistance associated with public work programmes and similar labour market policies (like cash-for-work programmes); and
- a system of basic universal pensions for old age, invalidity and survivorship that in effect support whole families.

Extending access to health care, if necessary supported by additional donor financing, should undoubtedly be a priority everywhere – but particularly in countries affected by mass diseases like malaria and the HIV/AIDS pandemic. The provision of free or affordable access to basic health services should, in the first place, be extended to children, disabled persons and the elderly.

Extending access to affordable health care should also be linked to employment and income policies, as well as to occupational safety and health policies, with a particular stress on providing security in the event of an employment-related sickness, injury or accident. This applies both to employees and the self-employed. As regards the self-employed, the focus should also be on awareness raising and the creation of mutual insurance schemes.

Family/children cash benefits (conditional or not on school attendance and/or participation in preventive health programmes) will be effective only if combined with an attempt to make the human and physical infrastructure of health and education systems available. All these factors together would be a major input of social protection to policies aimed at eradicating or preventing child labour.

Expanding social protection/social security systems is always tantamount to integrating those in the informal economy into more formal structures. Alongside this “formalization” and subsequent economic development, social protection may gradually extend beyond the minimum package described above.

As stressed by the International Labour Conference in 2001, social security should promote and be based on the principle of gender equality:

... this implies not only equal treatment for men and women in the same or similar situations, but also measures to ensure equitable outcomes for women. Society derives great benefit from the unpaid care which women in particular provide to children, parents and infirm family members. Women should not be systemically disadvantaged later in life because they made this contribution during their working years. ... Social security and social services should be designed on the basis of equality of men and women. Measures which facilitate the access of women to employment will support the trend towards granting women social security benefits in their own right, rather than as dependents.

6. Conclusions

Social security systems are powerful tools to combat poverty and social insecurity and to achieve greater levels of income equality. People need and want social security. Social security systems foster long-term economic performance, social peace and international security.

There is a need to arrive at a new consensus on the responsibilities of the global society, the nation State, communities, social partners, civil society and individuals. Clearly, global minimum social standards and global financial transfers are to some extent substitutes. The key role of the national State needs reconfirmation. The complementary and supporting role of the global community has to be defined. The wider the implementation of minimum social standards at the national level – enabled by sufficient fiscal space – the less international transfers are needed to combat poverty.

The ILO global tripartite structure is optimal for initiating a global debate with a view to reaching a necessary consensus on the new roles and the potential new instruments. It is also the ideal place to empower the different players in social security with knowledge and skills that might contribute to sound national and global governance of social security.

But first and foremost the ILO seeks a comprehensive vision of a national and global social security: a system that is flexible to adapt to the state of economic development and yet pursues the key objectives of universality, poverty alleviation, the containment of social insecurity through social rights, the promotion of long-term growth and national and international security and a fair distribution of income and non-discrimination. The discussion at the International Labour Conference in 2001 was a step in that direction.

Notes

¹ A global framework, yet one within which the ILO would work with its member States to develop appropriate national policy perspectives and instruments.

² ILO, 2006; *Social security for all: Investing in global social and economic development – A consultation* at <http://www.ilo.org/public/english/protection/secsoc/downloads/publ/1519sp1.pdf>

³ M. Förster and M. Mira d'Ercole: *Income distribution and poverty in OECD countries in the second half of the 1990s*, OECD Social, Employment and Migration Working Paper No. 22 (Paris, 2005), p. 28.

⁴ X. Scheil-Adlung et al: *What is the impact of social health protection on access to health care, health expenditure and impoverishment? A comparative analysis of three African countries*, (Geneva, ILO, ESS Paper No. 24, 2006).

⁵ See: HelpAge International: *Age and security: How social pensions can deliver effective aid to poor older people and their families* (London, 2004).

⁶ See: K. Pal, C. Behrendt, F. Léger, M. Cichon, K. Hagemeyer: *Can low-income countries afford basic social protection? First results of a modelling exercise*, Issues in social protection series, Discussion paper 13, ILO Social Security Department (Geneva, 2005).

⁷ See: F. Gassmann, C. Behrendt: *Cash benefits in low-income countries: Simulating the effects on poverty reduction for Tanzania and Senegal*, Issues in social protection series, Discussion paper 15, ILO Social Security Department (Geneva, 2006).

⁸ M. Cichon, W. Scholz, et al.: *Financing social protection* (Geneva, ILO, 2004), p. 121.

⁹ P. Lindert: *Growing public: Social spending and economic growth since the eighteenth century*, Vols. I and II (New York, Cambridge University Press, 2004).

¹⁰ J. Kingman (ed.): *A sourcebook for poverty reduction strategies* (two volumes) (Washington, DC, World Bank, 2002), Vol. 2, Chap. 12 (Macroeconomic issues), sections 12.2.4 and 12.2.5.

¹¹ *ibid.*, p. 26.

¹² *ibid.*, p. 28.

¹³ For a list of these studies, please see footnotes 25 and 27 in the ILO full consultation paper on which this article is based: ILO, 2006; *Social security for all: Investing in global social and economic development – A consultation* at <http://www.ilo.org/public/english/protection/secsoc/downloads/publ/1519sp1.pdf>

¹⁴ World Bank: *Pension reforms and the development of pension systems: An evaluation of World Bank assistance* (Washington, DC, 2006) pp. xvi and xvii.

¹⁵ Department for International Development (DFID): *Eliminating world poverty: Making governance work for the poor*; White Paper on International Development (London, 2006).

¹⁶ P. Lindert, op. cit.

¹⁷ Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ- German Technical Cooperation Institute). The GTZ was established in 1975. It is organ-

ized as a private company owned by the German Federal Government. It works on a public benefit basis, using all funds generated as profits exclusively for projects in international cooperation.

¹⁸ See, B. Schubert: *Social cash transfers – reaching the poorest. A contribution to the international debate based on experience in Zambia* (Eschborn, GTZ, 2004).

¹⁹ See, F. Gassmann, C. Behrendt, op. cit.

Challenges of old-age security reform in developing and transition countries: A trade union perspective

There is union support for the ILO's global campaign for social security, although there is still scope in which unions believe the ILO can play a greater role. But the capacity of the ILO to shape global pension policy is itself shaped by the dominating and at times damaging influence of the World Bank on national pension debates.

Peter Bakvis
Director
ITUC*/Global Unions
Washington Office

The ILO's consultation paper *Social Security for All: Investing in Global Social and Economic Development*¹ expresses several objectives that trade unions will certainly agree with regarding the future of social security in the world. The ILO paper follows the path set out by the 2001 International Labour Conference (ILC) in the conclusions of a general discussion on social security held at the conference. This ITUC response identifies some points of the ILO consultation paper that unions particularly endorse and makes a few suggestions where we think the ILO could play a stronger role than it has done up to now in promoting social security. Lastly, this paper delves with some additional detail into the particular challenges of reform of old-age security in developing and transition countries, focusing on the very important role that the World Bank has played in recent years in these countries by promoting a model of reform that has proved to have serious flaws.

The ILO's consultation paper on social security

The ILO's consultation paper notes that one of the conclusions of the 2001 ILC discussion was that the ILO should undertake a global campaign to promote the extension of social security coverage. The global union movement hopes that this consultation paper represents the start of an intensification of the campaign. The ILO should expect that the union movement in all countries will be a willing and active partner for such a campaign. Unions are particularly in agreement with the paper's affirmation that social security is a basic human right, but a right that is not being respected for the majority of the world's workers, who do not currently enjoy even minimum coverage.

The ILO's consultation paper provides a very useful calculation of the relatively modest cost – about 2 per cent of global GDP – of providing the entire world's poor with a minimum package of social benefits and services.² This shows very forcefully that the objective of social security for all is not only a pressing need but one that is eminently attainable, provided the world's decision-makers put their priorities in the right place. The ILO's demonstration

* The International Trade Union Confederation (ITUC) is the new organization formed in November 2006 by the amalgamation of the ICFTU (International Confederation of Free Trade Unions) and the World Confederation of Labour.

would be reinforced if it were to show how the basic package it suggests would permit achieving several of the Millennium Development Goals (MDGs), notably the MDGs related to minimum income, health and education objectives. Some organizations have done a total costing of achieving the MDGs and what is striking is the relatively modest cost involved – only a small fraction of what some countries currently devote to military expenditures, for example. Demonstrating how the ILO's campaign on social security is central to the attainment of the MDGs by 2015 would lead any sceptics to support the campaign more seriously.

Another particularly cogent part of the ILO's paper is the discussion on how substantial levels of social expenditure, high productivity and strong economic growth are not only compatible, but also how the first can reinforce the latter two.³ This economic relationship is reinforced by the complementary interaction between social security and the labour market. For example, the paper notes that Denmark is the European country having both the highest level of social security expenditure and the highest employment rate. This flies in the face of those who claim that high social expenditures are an employment disincentive!

An area in which the ILO could expand its analysis is the interaction between social security and labour market institutions. While the tax system and social security expenditures play a crucial role in providing income redistribution, this is but one facet of the decent work equation. Given the international role of the ILO in ensuring respect for workers' rights, the ILO should also spell out that the guarantee of fundamental workers' rights through adequate labour market institutions, in combination with social security systems, are the key factors for ensuring equitable income distribution.

In detailing some of the current and future challenges to social security systems, the ILO paper notes the expectation that labour migration will continue to intensify, in part to respond to differing

demographic patterns between countries.⁴ A particular challenge will be to ensure the access of migrant workers to social security, and the international trade union movement believes the ILO can contribute more to achieving that objective.

In addressing various facets of the impact of globalization on social security, the ILO paper states that there is "some evidence that countries are currently engaged in tax competition" which undermines financing of social security systems.⁵ A recent ICFTU (International Confederation of Free Trade Unions)⁶ study demonstrates convincingly the destructive impact of one particular type of tax competition, that concerning corporate income taxes.⁷ The ICFTU in its publication suggests some strategies for international organizations to resolve the problem or, as the ILO put it in its consultation paper, "ways in which the global community might protect the fiscal space of the nation State".⁸ Some of these could include phasing out export processing zones and other institutional arrangements that give certain companies tax advantages over other actors, taxing corporations where their workers are and real value is added rather than in artificial tax havens, and establishing standards that require multinational corporations to refrain from harmful tax avoidance and evasion.

Appropriately, the ILO has affirmed the primary role of the State as "the only institution that can formulate an overall national social security development plan".⁹ This emphasis on the role of the State in social security provision, which was also a strong point of the 2001 ILC resolution, contrasts with the approach taken by some international institutions, most notably the World Bank. Such institutions have put most of their emphasis on reducing State responsibility for old-age security and on shifting this "responsibility" in a large part to the private sector, often with unsatisfactory results (as discussed below).

Unions welcome that the ILO consultation paper refrains from asserting that in providing social security for all it is

necessary to destroy it for some who already have it. Again, this contrasts with the approach of the Washington-based international financial institutions (IFIs), which have put so much of their efforts into reducing government commitments to current social security systems that they have forgotten that, they too, have agreed with the objective of extending social security to those not covered. There is no evidence that savings from reduced social protection – or for that matter, from lower wages or working conditions – in the formal economy will automatically transfer as increased benefits for workers in the so-called informal economy. Yet this is the simplistic approach one hears at times from the IFIs. If anything, the existence of an adequate level of protection for some workers is likely to create social and political pressures to provide improved social protection for those who are unprotected.

The World Bank's pension reform model

Satisfyingly, the ILO discussion paper deals head-on with the multi-pillar model put forward by the World Bank. In reforming the pension regimes of developing and transition countries over the past several years, the World Bank has advocated and pushed a shift from public, defined-benefit schemes, financed on a “pay-as-you-go” basis, to pre-funded defined contribution schemes managed by the private sector.¹⁰ The paper notes that Chile first introduced this new pension model during the Pinochet regime and later, in 1994, the World Bank declared that the model was relevant globally. Over the years, the Bank made some airlines happy by organizing multiple pilgrimages of pension administrators from around world to Santiago, Chile, to witness the glories of privatized pensions. However these missions have fallen off sharply in recent years since the major flaws of Chile's privatized pension system have become evident. In fact, during the 2006 presidential election in Chile,

even the right-wing candidate agreed with the victorious Michelle Bachelet that the privatized system was costly, unfair and inefficient, and required a major overhaul.¹¹

The ILO consultation paper lists a number of studies carried out by the ILO on World Bank-sponsored pension reforms in developing and transition countries. In doing so the ILO notes the reforms' many failures, including reduced income security for those covered, reduction of effective coverage for those already covered, and lack of progress in extending coverage to those not previously covered.¹² The trade union movement endorses all of these points and adds some others:

- high administrative costs in privatized schemes;
- the unpredictability of pension benefits paid out from the private funds; and
- the growing inequality between women and men under these schemes.

Starting in the 1990s, trade unions in Latin America and Central and Eastern Europe, the two regions where the World Bank was most active in trying to disengage the State from pension provision, were among the first to call attention to the problems of the Bank-sponsored reforms. In 1998 in Slovenia, the unions waged a public campaign highlighting the negative effects of pension privatization and managed to convince the government to roll back a Bank-sponsored reform that the government had agreed to implement. In 2001, the ICFTU issued a statement which expressed alarm at the negative impact of the Bank-sponsored reforms: “the World Bank's haste to scale back or dismantle public pension schemes is troublesome in view of the high level of corruption and administrative costs associated with the privatized ‘multi-pillar’ schemes”.¹³

The Bank initially rebuffed trade unions when they attempted to raise these issues. The Bank's attitude started changing around 2003, when the Bank's own internal reports confirmed the claims unions

had been making for years. The ILO's consultation paper cites a 2006 report of the Bank's Independent Evaluation Group that echoes many of the concerns of the ILO.¹⁴ An earlier report by the Bank's Latin American department, the first version of which was issued in 2003, went even further in declaring that the Bank's privatized schemes had failed to extend coverage to the previously uncovered and had such high administrative costs that future pension benefits would be drastically reduced. According to this report, the so-called transition costs to the new systems had created serious new public sector liabilities in some countries, and overall, the much-vaunted financial sector development the reforms were supposed to induce had not materialized.¹⁵

A new World Bank approach?

Looking forward, there is some evidence that the World Bank may finally be budging from the dogmatic pro-privatization approach on pension reforms that it has taken for well over a decade. Some, who point out the strong influence of the United States over the World Bank, have seen the shift as being due to the spectacular defeat of US president George W. Bush's proposal, launched in November 2004, to partially privatize the country's public pension scheme, called Social Security. The plan, for which the World Bank had offered a degree of moral support, encountered such strong public opposition that members of Congress from the president's own Republican Party compelled Bush to abandon it in mid-2005. However the shift within the World Bank has by no means been linear, and the Bank has certainly not lost its bias in favour of at least partial privatization as the preferred option where political circumstances permit it.

In 2005 the Bank issued a new pension reform policy paper, *Old-Age Income Support in the 21st Century*, which admitted many of the deficiencies of the privatized systems that the Bank's own studies

showed, including the high administrative costs, the unpredictability of benefits and the failure to extend coverage.¹⁶ The new paper also largely abandoned one of the Bank's major but unproved arguments for shifting to pre-funded privatized schemes, namely that they offered better protection against demographic changes, i.e. an ageing workforce, than public "pay-as-you-go" systems. The paper announced that the Bank would adopt a more flexible approach as to whether countries should privatize their pension systems and stated that trade unions should be involved in all stages of pension reform processes. The latter constituted a refreshing change from the Bank's earlier attitude. In 2001, for example, the Bank's lead pensions specialist told an international trade union delegation that the Bank would not commit to consulting unions on the reforms it sponsored because "unions have nothing useful to say on pension reform".

However neither the announced flexibility nor the intention to consult systematically unions on pension reforms have been incorporated into all of the Bank's interventions to reform pension systems. Some of the Bank's current Country Assistance Strategies continue to push governments to take steps to create partially privatized "multi-pillar" systems. In the following telling passage, the Bank's 2005 pension policy paper confirms that Bank staff are likely to persist in prioritizing the creation of a privately managed "second pillar", despite enunciated claims of taking a more flexible approach: "Most Bank staff see the potential economic benefits of a multi-pillar scheme with a major second (mandated) or third (voluntary) funded pillar ...".¹⁷

As for the promise to consult trade unions on pension reforms in which the Bank is involved, there seems to be no consistent practice. In countries where progressive governments have been elected with the support of trade unions, the Bank has consulted unions on reforms, perhaps because the government gave the Bank no choice. Such is the case currently in Uruguay, for example. In other countries, however, the

Bank appears to continue the practice of consistently seeking the support of the financial services industry, which stands to benefit from pension privatization. But the Bank does not necessarily seek the views of trade unions on pension reform, despite the fact that unions represent workers and present and future retirees; in other words, those directly affected by the reforms.

Nor has the World Bank placed any importance on collaborating with the ILO on pension reform, despite the ILO's long-standing expertise in setting social security standards and providing technical advice. The Bank's latest *Social Protection Sector Strategy*, which was launched in the same year that the ILO's annual conference devoted an important discussion to social security, not only completely ignored the ILO's role in social security system design but boasted that the Bank had become the "key player and recognized depository of knowledge on pension reform".¹⁸

The ILO could certainly play a much more influential role in putting forward alternative approaches to pension reform. As the 2001 International Labour Conference affirmed, these activities should consist of ILO technical cooperation with governments and social partners that puts a priority on goals such as "extending and improving social security coverage", "developing innovative approaches in the area of social security to help people to move from the informal economy to the formal economy" and "introducing means to overcome discrimination in outcomes in social security".¹⁹ None of these goals has been an important objective for the World Bank's country-level interventions in reforming pension systems. Even if the Bank has stated its commitment to goals such as extending social security coverage, major reviews by the Bank's Latin America department and the Independent Evaluation Group both show that the Bank never made them priorities in its country-level work and therefore failed to achieve them.

Perhaps the principal reason why the World Bank has not contributed more to extending social security coverage to those

not covered is that the Bank has prioritized goals that have nothing to do with improving old-age security. It is remarkable that the Bank's latest pension policy paper, *Old-Age Income Security in the 21st Century*, has not yet abandoned the idea that one of the main aims of pension reform should be to help the financial service industry develop. This, in spite of the total lack of evidence, as confirmed by the Bank's own evaluations, that pension privatization has been a necessary condition for financial market development in any country. Despite repeated questions from trade unions, the World Bank has never offered a rationale as to why workers and retirees should be forced, through the creation of privately managed "second-pillar" funds, to sacrifice part of their income to inefficient private-sector administrators. Surely the ILO, by giving priority to improving old-age security systems in the interests of workers and retirees rather than prioritizing unrelated goals, can and should play a much more important role in social security reform.

Notes

¹ ILO, *Social Security for All: Investing in Global Social and Economic Development. A Consultation* (Geneva, 2006). For an abridged version of this paper, see pp. 21-35 of this issue. The full ILO consultation paper is available at <http://www.ilo.org/public/english/protection/secsoc/downloads/publ/1519spl.pdf>, to which the relevant footnotes below refer.

² *ibid.*, pp. 7-8.

³ *ibid.*, pp. 11-14.

⁴ *ibid.*, p. 18.

⁵ *ibid.*, p. 19.

⁶ Amalgamating partner in the newly formed ITUC.

⁷ ICFTU, *Having their Cake and Eating it Too: The Big Corporate Tax Break* (Brussels, 2006).

⁸ ILO, *op. cit.*, p. 31.

⁹ *ibid.*, p. 29.

¹⁰ *ibid.*, p. 20.

¹¹ "Chile's Candidates Agree to Agree on Pension Woes", *New York Times*, 10 January 2006.

¹² ILO, *op. cit.*, p. 20.

¹³ ICFTU, TUAC & ITS, *Statement by the ICFTU, TUAC and the ITS to the Spring Meetings of the IMF and World Bank* (Washington, April 2001), p. 8.

¹⁴ ILO, op. cit., p. 20.

¹⁵ For more details on the internal World Bank debate on its pension reform policy see Peter Bakvis, "Social security systems and the neo-liberal challenge" in upcoming publication of the *Deutsches Institut für Menschenrechte* (Berlin).

¹⁶ World Bank, *Old-Age Income Support in the 21st Century: An International Perspective on Pension Systems and Reform* (Washington, 2005).

¹⁷ *ibid.*

¹⁸ World Bank, *Social Protection Sector Strategy: From Safety Net to Springboard* (Washington, 2001).

¹⁹ ILO: *Report of the Committee on Social Security*, Record of Proceedings, International Labour Conference, 89th Session, Geneva, 2001, pp. 33-37; see <http://www.ilo.org/public/english/standards/relm/ilc/ilc89/pdf/pr-16.pdf>.

Addressing the bases of insecurity of the Philippine social security system

The publicly-run Philippine Social Security System has reversed the trend of fund deficit through a combined strategy of improving accessibility to self-employed workers and employers, targeting fraud and non-payment of contributions, and an increase in contributions, while also being able to increase benefits in 2006. With sustainability forecast to 2031, the Philippines demonstrates that privatization is not the sole solution to sustainability.

Melisa R. Serrano*

University Extension Specialist
U.P. School of Labor and Industrial Relations
Philippines

Social security and growing labour insecurities

The uncertainties brought about by globalization continue to threaten the Philippine Constitutional mandate to “afford protection to labor”. Social security is a key area in this protective mantle. As the trend towards liberalization accelerates, workers all over the world are facing greater insecurity of work. Standing (1999) stresses that the era of flexibility is also an era of more generalized insecurity and precariousness, in which many more men as well as women have been pushed into precarious forms of labor. Without doubt, the increasing flexibility of work arrangements erodes traditional systems of social security in the workplace.

At the same time, the Philippine Social Security System (SSS), the state-owned and operated social insurance programme for workers in the private sector,

is continuously faced with the problem of sustainability. Asher (1998) stresses that the SSS is unlikely to be sustainable in the medium term if no significant reforms are undertaken to improve compliance levels, increase tax rates or reduce benefits, lower the ratio of administrative costs to contributions, and significantly improve the rate of return on investment. These areas along with issues of governance (or the need for more workers’ voice in the SSS) are the bases of insecurity of the SSS.

Enabling urgent reforms through the Republic Act 8282

Taking cognizance of urgent reforms and the need to adopt corrective measures to protect and strengthen the life of the social security fund, the Philippines enacted the Republic Act 8282 (RA 8282) in 1997, which amended the original pension law of 1957. The enactment of RA 8282 was crucial to render social security schemes more relevant in the present socio-economic environment. When the SSS was established in 1957, the Philippines was at the threshold of economic development, recognized as among the leading economies in Asia. Jobs were abundantly available and the

* This article is a revised and an updated version of the publication by Melisa R. Serrano and Mary Leian C. Marasigan, 2003, *The Bases of Insecurity of the Social Security System*. Quezon City: School of Labor and Industrial Relations and Friedrich Ebert Stiftung. Acknowledgment is due to the Friedrich Ebert Stiftung-Philippine Office for funding support of the said publication.

economy was robust. But times have changed. The economy remains lacklustre, often stagnant, and insecure jobs are increasingly becoming the norm.

The enactment of RA 8282 has enabled the SSS to take on certain measures to address major issues and problems confronting the system. RA 8282 empowered the SSS to undertake the following reforms and adjustments (Amante et al., 1999: pp. 33-38):

- Expand membership coverage to non-covered sectors, to include agricultural workers who are not paid regular daily wages or who do not work for an uninterrupted period of at least six months, household helpers, informal sector workers, parents employed by children, and children of minor age employed by parents.
- Enhance and rationalize the benefits for its members, namely the age pension, the funeral benefit, and the maternity benefit.
- Broaden investment alternatives and improve the management of its reserve fund.
- Impose stiffer penalties for violators of the social security law.
- Enforce penalties on delinquent contributors.
- Establish a voluntary provident fund for members.

In the years that followed, the SSS adopted various programmes and schemes to implement these reforms. However, the 1997 financial crisis, the political instability in the country, and the frequent change of leadership in the SSS bogged down implementation and at one point put the SSS in clear danger. It was only in 2001 that reforms and programmes started to be actively implemented.

What has happened since? An assessment of the impact of the key changes

Expanding membership coverage

Pursuant to RA 8282, the SSS has been moving towards universal coverage. As of June 2006, there were 26.4 million individuals registered with the SSS (SSS web site) or 79 per cent of the total employed (33.23 million) in July 2006. Of the total membership, 20.9 million are private sector employees (including household helpers) and 5.5 million are self-employed workers and voluntary members (SEVM). Registered employers counted 774,040. Included in the SEVM count are 533,859 registered OFW-members (Overseas Filipino Workers). The total number of SSS members who have become pensioners due to retirement, disability and death is 1,138,755 as of June 2006 (SSS web site).

Although the SSS reported a total membership of 26.4 million individuals in 2006, lumping together private sector employees, the self-employed and voluntary members, and the employers, the decline on the number of employee-members should be noted, from about 22.6 million in 2000 to 20.976 million in 2006 (table 1). This is indicative of the growing trend of employment insecurity, particularly in the formal sector. Table 2 shows the decrease in the number of new registrants beginning the year 2001.

Nonetheless, the SSS reported an overall increase in membership of 3 million since 2001 (SSS web site). This was due to a number of strategies adopted by the SSS, namely: coverage drives, regional information seminars, and the setting up of the Employer/Self-employed Online Business Clearance System using point-of-service (POS) terminals in local government units for the issuance and renewal of business licences. The latter strategy is covered by an agreement of the SSS with the Department of Interior and Local Government (DILG) that Republic Act 8282 formalized.

Overseas Filipino workers (OFWs) are beyond the scope of the country's social

Table 1. SSS membership growth, 1998-2006

Year	Employee-members	Employers	Percentage increase/(decline)	
			Employee	Employers
1998	20,164,123	547,400	5.7	2.0
1999	21,316,172	573,314	5.7	4.7
2000	22,621,038	600,182	6.1	4.7
2006 (June)	20,976,613	774,040	(7.3)	28.9

Source: SSS 1998, 1999, 2000 Annual Reports and www.sss.gov.ph.

Table 2. SSS coverage for the year (new registrants)

Year	Number
2000	1,304,866
2001	901,834
2002	775,367
2003	743,201
2004	615,152
2005	561,250

Source: SSS 2005 Annual Report.

security law. Their membership to the SSS is thus voluntary. Like the self-employed members, they too shoulder the employer and employee's counterpart of the monthly contribution rate. To capture more OFWs under its umbrella, the SSS has adopted a two-pronged approach: (1) forging of bilateral agreements on social security for Filipino immigrants; and (2) setting up foreign offices to promote its programmes for land-based OFWs who are excluded from the social security schemes of their host countries (SSS 2005 Annual Report). The SSS nonetheless recognizes that membership of the OFWs should be mandatory to allow full protection for all OFWs. In this regard, the SSS is now pursuing a shift towards mandatory membership of OFWs. This may be part of another round of proposed amendments to RA 8282.

Other initiatives were also undertaken to improve member services and contribution collection. A new payment scheme called the branch tellering project was introduced in 2004. This scheme allows members to directly pay their pre-

miums and loan accounts while they are in an SSS office, in view of the limited hours provided by banks for the acceptance of payments from SSS members. This affects especially the self-employed and voluntary members. There are currently 41 tellering systems and the SSS reports that plans are afoot to add 169 tellering systems in 79 branches by 2006. Other payment schemes are likewise being put in place, such as remittance through over 600 Bayad Center payment facilities nationwide, collection through third party agents like LBC Express, payment through Philpost, use of self-service payment terminals in SSS branches, payment through text-messaging, and payment through co-operatives (SSS web site).

There have been many cases of fraud in the claim of pensions, i.e. members who are already dead or have remarried, or been re-employed and who continue to claim pensions. To safeguard the funds, the SSS implemented the Annual Confirmation of Pensioners (ACOP) Program to verify members' identities and status.

The programme resulted in the suspension of some PHP2 billion in pension payments and recovery of PHP723 million from accounts of pensioners who were confirmed to have either died, remarried, or were re-employed (SSS web site).

*Expanding coverage,
increasing liability:
The benefits-contributions issue*

Concomitant with expanding membership coverage, the SSS aims to increase benefit levels. The SSS now provides an average monthly pension of PHP2,546. To date, the minimum monthly pension is PHP1,000 and the maximum is PHP14,970. Since 1991, self-employed farmers and fishers with income between PHP1,500 and PHP18,000 per annum are covered. With the inclusion of the more marginalized sectors of workers in SSS coverage, the SSS will have to subsidize the benefits, particularly the retirement pension that would be paid to these workers – a function of the social adequacy principle which means that the benefits paid provide a certain standard of living to all contributors.

The low-income groups receive relatively larger retirement pensions than do other groups compared to their contributions. According to Amante et al. (1999: p. 17), in the SSS those who are in the lower income brackets benefit more. The benefit payments for the poorer groups are much greater compared to the contributions ratio for all income levels. For example, given 15 years of service, the monthly retirement pension of a worker with a PHP1,000 average monthly salary is more than 14.2 times his/her monthly contribution, but the monthly retirement pension for a worker with a PHP6,000 average monthly salary is more than 4.7 times his/her monthly contribution.

Since its establishment in 1957, the SSS has implemented 20 pension increases, the last being a 10 per cent increase in September 2006. This last pension increase was made possible because of the improved financial standing of the SSS as a result of

robust contribution collections, sustained investment earnings and tempered operating expenses.

The contribution rate, on the other hand, had been increased only four times – in 1974, 1978, 1979, and 2003. The contribution rate has remained at 8.4 per cent since 1979 (*SSS News and Updates*, 31 August 2001). From March 2003, the total contribution rate went up by 1 percentage point to 9.4 percent, of which 6.07 per cent is the employer's counterpart and 3.33 per cent the employee's share. The contribution increase was shouldered by the employers. Nonetheless, the SSS President, Mrs Corazon dela Paz, emphasized that although this contribution increase, along with other initiatives, may have extended the life of the fund to 2031 from the previous estimate of 2015, the current 9.4 per cent contribution rate should be gradually raised to at least 12.5 per cent to bring the SSS fund life back to perpetuity (SSS website).

Between 1999 and 2004, SSS benefit payments exceeded contributions collection in view of the weak link between the contribution rate vis-à-vis the benefit structure of the program (table 3). It should be noted that the fund's investment earnings make up for any contribution shortfall. Reforms undertaken in the SSS helped remedy the imbalance and enabled the SSS to make headway in reversing the deficit into a surplus so that the gap between contributions and benefits narrowed down from PHP7.6 billion in 2001 to PHP0.9 billion in 2004. In 2005, the SSS reported a record surplus of PHP1.3 billion, the first in the last seven years (SSS web site).

The SSS does not get any funding subsidy from the government. Member contributions are the primary funding source of benefits, so that SSS has been putting greater effort into increasing collections. For the period 2001 to 2005, contribution collection grew at an average of 10 per cent annually. According to the SSS, the steady growth of contributions since 2002 was a result of several policy measures, most significant of which were:

Table 3. SSS benefits and contributions, 1997-2006 (in million pesos)

Year	Benefits paid	Contributions
1999	28,770.80	27,124.00
2000	34,479.51	30,320.53
2004	44,882.52	43,935.82
2005	46,269.82	47,602.07
2006 (June)	25,045.98	25,517.63

Source: SSS Annual Reports, 1998-2000 and www.sss.gov.ph.

Table 4. SSS investment ceilings

Area of investment	Ceiling (%)
Private securities	40
Housing	35
Real-estate related investments	30
Short- and medium-term member loans	10
Government financial institutions and corporations	30
Infrastructure projects	30
Any particular industry	15
Foreign-currency denominated investments	7.5

Source: SSS Finance and Investments and Information Systems Group.

- the one percentage point increase in the SSS contribution rate in March 2003, to 9.4 per cent from the previous 8.4 per cent (which dated back to 1979),
- the increase in the monthly salary credit ceiling from PHP12,000 to PHP15,000,
- more stringent redefinition of credited years of service,
- the revision of the instalment payment scheme for delinquent employers and the pursuit of legal actions against them,
- expansion of the tellering system to 41 major branches,
- increased resources for collection efforts, foremost of which was the hiring of additional accounts officers (now at 598), and
- implementation of the accounts monitoring system (SSS web site).

Broadening investment alternatives and prudent fund management

In the past, the SSS came under serious attack due to its questionable investment undertakings as well its operational expenses (particularly the alleged “fat” salaries and benefits of some of its top executives and some employees). This article does not dwell on these issues as cases have already been filed in the appropriate courts.

During periods when benefit payments exceed contributions collected the SSS undertakes investments to generate income higher than inflation, to preserve assets’ real value. RA 8282 provides specific ceilings on the SSS’s investment areas (table 4).

Data from the SSS indicate that the average return on investment (ROI) of the SSS is about 12 per cent. In other countries, the average ROI of social security institutions is between 16 to 18 per cent. If in the

short run the SSS benefits will be increasingly dependent on investment income, and considering the subsidies required to ensure the universal coverage of the system to certain sectors, the SSS must endeavor to be more prudent and maximize its remunerative investment portfolio.

The SSS reported that as of June 2006, its investment portfolio amounted to PHP200.48 billion, higher by 6.5 per cent than the PHP188.25 billion investment level at the end of 2005. The four biggest items in its portfolio are as follows: equities, PHP68.5 billion; government securities, PHP48.45 billion; member loans, PHP32.61 billion; and housing loans, PHP29.86 billion. About PHP20.37 billion is invested in properties and in development loans. Earnings from investment in the first six months of 2006 totaled PHP5.92 billion, an average return on investment rate of 6.2 per cent (SSS web site).

The SSS recognizes that investments in government securities are the most liquid and highest yielding, at 12 per cent per year as of 2006. However, the institution points to the liquidity needed to service member loans and pensions as the reason for the decline in its holdings of government securities, from about PHP32 billion in year-end 2000 to PHP19 billion in 2003. Beginning in 2004, however, SSS investments shifted back to government securities reaching PHP45 billion as of March 2006 (SSS web site).

Controlling operational expenses has also been part of the corrective measures on prudent fund management undertaken by the SSS. It should be recalled that the SSS came under serious attack in the past due to its huge operational expenses. For the period 1991 to 2000, operating expenses increased at an average rate of over 24 per cent per year. With the cost-cutting measures adopted since 2001, the SSS was able to limit operational expenses to just 6 per cent per year. Austerity measures such as cutbacks on employee benefits, office space rentals, rent escalation rates and equipment rentals have resulted in savings totaling PHP2 billion for the period 2001-2004. From January

to June 2006, operating expenses totaled PHP2.84 billion, lower by 4.4 per cent than the budgeted PHP2.97 billion, and representing only 9.7 per cent of SSS' total revenues (SSS web site).

Labour campaigns to ensure the financial health of the fund

In 1999, a research team of the U.P. School of Labor and Industrial Relations, with the support of the Friedrich Ebert Stiftung, Philippine Office, conducted a study entitled "Social Security and Labor Insecurities Under Globalization". The study came up with the following recommendations and proposals for policy reforms for the SSS (Amante et al., 1999: pp. 33-38), a number of which were contributed by the trade unions.

Recommendations to fill the gaps in policy reforms

1. Target the inclusion of selected disadvantaged and vulnerable groups in the agenda for long-term reforms.
2. There must be clear provisions for the social security of retrenched, laid-off workers and those with reduced workdays and workload.
3. Provide incentives for voluntary coverage of self-employed individuals.
4. There should be a better balancing of the social protection and member-development function of the SSS/GSIS (Government Service Insurance System) and their financial growth.
5. Limit the acceptance of delinquency and enforce penalties.
6. There is a need to supplement social security pensions.

Recommendations on future institutional reforms

1. The SSS should be more union-friendly, by accrediting unions as “whistle blowers” and active partners/implementers to discourage delinquent employers.
2. The need for new employers or investors to provide for separation pay; employers’ premium contributions for separation pay will form the *unemployment fund reserve* for the purpose.
3. Organized consumer groups should have a voice in the SSS Commission.
4. Need for social security coverage for excluded groups who are not necessarily of low income.
5. Putting flesh and muscle to tripartism, through greater sectoral consultations and accountability for labour representatives.

Meanwhile, trade unions never wavered in their call for reforms in the SSS. Box 1 highlights a recent initiative from the trade unions who aim, among other things, to propose reforms in the SSS. The initiative was a follow-up to a series of national conferences and forums on social security from 1998 to 2001 convened by the U.P. School of Labor and Industrial Relations and the Friedrich Ebert Stiftung-Philippine Office. These activities provided venues for dialogue and consultation between organized labour and the officials of social security institutions in the country. A publication entitled *The Bases of Insecurity of the Philippine Social Security System* (Serrano and Marasigan, 2002), an output of these consultations, was presented to the SSS. The President of the SSS, Mrs Corazon de la Paz, acknowledged in writing that the proposals put forward in the book would be seriously studied and considered by the SSS. Some of the corrective measures adopted by the SSS in recent years, i.e. adjustment in contribution rate, marketing new products to capture OFWs as members, strategies to expand membership in micro and small enterprises, fiscal control

of operational expenses, reviewing the salary and benefits of SSS officers and employees, reflect the recommendations of the 2002 publication.

Cognizant of the call for reforms, the SSS from the beginning of 2001 embarked on various programs and measures aimed at restoring the financial health of the social security fund and extending the life of the SSS fund, hopefully for perpetuity. As discussed earlier in this article, these initiatives include:

1. Increasing contribution collection;
2. Increasing earnings from investment and other sources;
3. Managing benefit payments; and
4. Controlling operating expenses.

These programmes and projects have significantly improved the fiduciary life of the fund so that in the 2003 actuarial study done by the SSS, the life of the fund has been extended up to 2031.

Nonetheless, much needs to be done to further extend the life of the social insurance fund. The SSS may have extended the fund life to 2031 but it must be stressed that this expansion assumed that the SSS would not provide any pension increases to its members. However, a 10 per cent across-the-board increase was implemented in September 2006. Moreover, as emphasized by the SSS President, the current 9.4 per cent contribution rate should be raised to at least 12.5 per cent to bring the SSS fund life back to perpetuity. For the SSS, the best way to do this is to add actuarial years to the SSS fund life gradually.

Some recommendations

Corrective measures undertaken by the SSS from 2001 may have averted a potential financial crisis in the SSS. Today however, with the uncertainties and insecurities brought about by intense globalization processes, the premises that created the SSS in the late 1950s are no longer the norm. The

Box 1. Towards a joint policy agenda for labour – Security at work and social protection

In 2004, representatives from various labour centres, labour federations in the private and public sectors, other labour federations and alliances, labour research institutions, and solidarity support organizations came together to discuss in a series of meetings a proposed policy agenda for labour. The outcome was a handbook which documented the process from April to July 2004 and which initially catalogued the various proposals. The handbook entitled *Towards a Joint Policy Agenda for Labor – Managing the Social Impact of Globalization through Stronger State Adherence to Decent Work* which was presented to the President and the legislators in time for the May 1 (Labor Day) celebration in 2005 included the trade unions' proposals for reform in the SSS.

Trade unions called for the extension of social security and health insurance coverage for all workers whether in the formal or informal sector, as part of decent work. To this end, the unions proposed the following:

Security at work/social protection

Expansion of medical and health benefits by:

- increasing coverage of medical/health contingencies (coverage against contingencies is currently under 50 per cent of health costs);
- intensifying the PhilHealth indigent programme
- providing resources for effective implementation of the Philippine AIDS Law
- implementing appropriate action in the prevention of SARS, HIV/AIDS and work-related diseases
- reviewing occupational safety and health policies to make them more attuned to globalization trends
- massive promotion of and provision of technical assistance to enterprises on the ILO-designed "SOLVE Program"
- revival or revitalization of the Retirement Insurance Commission by broadening its functions and recomposing its membership to include more representatives from workers' and employers' groups which could recommend changes in the architecture, benefits, administration and financing of a more unified and comprehensive social protection scheme, including the beginnings of a workable Employment Insurance Scheme
- broaden opportunities for livelihood and social protection for women. Local government units should designate common terminal, vending and production areas for the informal sector
- review of the Government Service Insurance System (GSIS) and the SSS Laws and the PhilHealth Indigency Program with the participation of unions and informal sector associations
- implementation of the Law on Domestic Helpers.

Social dialogue and genuine representation

Genuine representation of unions and workers' associations in governing boards of welfare agencies, social security agencies, government-owned and controlled corporations and government financial institutions to further endure transparency and acknowledge unions' role in ensuring public service delivery.¹

¹ *Towards a Joint Policy Agenda for Labor – Managing the Social Impact of Globalization through Stronger State Adherence to Decent Work*. 2004. Manila, Philippines, pp. 6-7, 8-9.

incremental strategies to stretch the life of the fund may not be enough to address the sustainability issue confronting the SSS in the longer term. Three other measures that need to be seriously considered are:

- Finding effective strategies to substantially capture micro and small enterprises for coverage by focusing on issues of traceability and affordability of contribution rate;

- Reforming investment portfolios by limiting or inhibiting fund exposure in the stock market; and
- Enhancing workers' voice in the Social Security Commission.

Conclusion

Corrective measures undertaken by the SSS may have extended the life of the social insurance fund but the question of long-term sustainability still remains. Radical reforms in the SSS may be needed in the near future. Some sectors are proposing privatization as a strategy to safeguard the financial health of the system. However, experiences of many countries on privatization showed that it did more harm than good to the general public. As Ofreneo asks (2001), is privatization the issue or is it workers' control? It should be recalled that the labour sector has been clamouring for genuine representation in the Commission, through greater sectoral consultations and accountability for labour representatives; even proposing that the labour representatives should be chosen or elected by the trade unions themselves and not appointed by the President of the Philippines.¹ Moreover, the unions have been proposing that representation should be based on membership size among the trade unions. If this measure was to be implemented, a system of recall could be put in place so that a labour representative who fails to genuinely represent workers' interests would be easily replaced. In this light, a study on mechanisms for greater workers' control of the pension system may be able to address the issues of governance and equity that are crucial in the long-term sustainability of the social insurance fund.

Note

¹ The Social Security Commission is composed of the Secretary of the Department of Labor and Employment, the SSS President and seven members appointed by the President of the Philippines. Three of the seven appointive members represent the workers' group, another three from the employers' group, and one representing the general public. It is not clear how the President selects and appoints the representatives of the workers' group, although a labour organization's affinity or link to the political leadership, not the size of membership, appears to be the main determining factor.

References

- Amante, Maragtas S.V., Melisa R. Serrano and Ina A. Ortiz. 1999. *Social Security and Labor Insecurities Under Globalization*. Quezon City: U.P. School of Labor and Industrial Relations and Friedrich Ebert Stiftung.
- Asher, Mukul G. 1998. "The future of retirement protection in Southeast Asia", in *International Social Security Review* Vol. 51, Jan.
- National Statistics Office (NSO). 1995. 1995 Urban Informal Sector Survey in Metro Manila.
- Ofreneo, Rene E. 2001. "Social Security Challenges Facing the Tripartite Actors," outline of paper presented in the SSS Forum on 'Is the SSS Secure?', 30 Oct. 2001, U.P. School of Labor and Industrial Relations, Diliman, Quezon City.
- Serrano, Melisa R. and Mary Leian C. Marasigan. 2002. *The Bases of Insecurity of the Social Security System – Issues, Concerns and Reform Proposals in the SSS*. Quezon City: U.P. School of Labor and Industrial Relations and Friedrich Ebert Stiftung.
- Social Security System (SSS). 2001. *News and Updates*, posted on 31 August 2001. www.sss.gov.ph/news/feat2021.htm, visited 25 Oct.
- , 2001. *SSS earns P23B income for the first half of 2001*, *SSS News and Updates*, posted on 20 August. www.sss.gov.ph/news/feat2021.htm, 25 Oct.
- , 2005. Annual Report. www.ss.gov.ph; accessed on 8 Nov. 2006.
- Social Security System (SSS) website. www.sss.gov.ph
- Standing, G. 1999. "Global feminization through flexible labour: A theme revisited, *World Development* Vol. 27, No. 3.
- Towards a Joint Policy Agenda for Labor – Managing the Social Impact of Globalization through Stronger State Adherence to Decent Work*. 2004. Manila, Philippines, pp. 6-7, 8-9.

The role of trade unions in reforming social security and pensions in Ghana

Ghana is currently considering the introduction of a three-pillar system of pensions. The capacity of unions to respond is hampered by their limited access to expertise to assist them analyse the proposal. But with 90 per cent of workers in the informal economy, wider questions exist as to how to extend social protection to all in Ghanaian society.

David Kwabla Dorkenoo

Head of the International Department
Ghana Trades Union Congress

The emergence of a formal social security system in Ghana was the result of colonization, industrialization and urbanization. With colonization, the British introduced a new work culture into Ghana, the then Gold Coast. This work culture entailed migration of workers from traditionally socially protected rural areas to take up jobs or employment in the urban areas. Workers and their dependants were virtually uprooted from their “cozy traditional set-up” to urban centres where they were exposed to social contingencies similar to those experienced by the British during their Industrial Revolution.

The extended-family system is the bastion of social protection and serves as the cohesive unit it provides income security for not only aged and disabled, but also cares for the sick members of the family, the new-born child and the mother, the orphan, the widow etc.

To help adapt to the new social contingencies, the Government and some private sector actors introduced private social security schemes to “create for urban wage earners a rudimentary system of material security”.

Compulsory Savings Act of 1961

The Government of Ghana soon after independence introduced the Compulsory Savings Act of 1961. This Act was passed to provide pensions for formal sector workers. The Compulsory Savings Scheme collapsed because its operations were grossly mismanaged. The scheme was not able to keep records of all its contributors, many records were lost and many workers could not get back their contributions.

Social Security Act 1965

On the demise of the Compulsory Saving Scheme, a more rational comprehensive social security package was proposed. Consequently on 17 February 1965 a new Social Security Act was passed in the First Republican Parliament. The law fixed retirement age at 60 years for men and 55 years for women and called for the establishment of a Social Security Fund for the provision of the following benefits:

- superannuation
- invalidity
- death/survivors
- emigration¹
- unemployment.

The Social Security Act 1965 provided for the payment of lump sums or what are known as provident funds. In terms of contributions to finance the scheme, the law made provision for workers to contribute 7.5 per cent of their monthly basic income while employers were to add 15 per cent, thus making the total contribution of 22.5 per cent per month in respect of each worker's salary. However, six months into the scheme, it was realized that the contribution rates were too high. Therefore, the contribution rates were reduced from 7.5 per cent and 15 per cent to 5 per cent and 12.5 per cent for workers and employers respectively, being a reduction in total contributions from 22.5 per cent to 17.5 per cent.

In terms of administration of the scheme, there were two main institutions, namely the Department of Finance under the Ministry of Finance and the State Insurance Corporation. The Department of Finance was responsible for the policy and general administration of the fund while the State Insurance Corporation was in charge of the inspectorate and operational divisions.

Ghana Trades Union Congress (GTUC) noted that the provident fund nature of the scheme was not in the interests of the working class. The GTUC called for the scheme to be reformed into a pension, so that retired workers would enjoy monthly pensions instead of the payment of a one-off lump sum which would be quickly eroded. Trade unions also called for the establishment of a single institution for the administration of pensions in the country. The above weaknesses of the 1965 Social Security Scheme were ultimately addressed through the establishment of a subsequent, more comprehensive system.

Earlier reforms

The first encompassing scheme established by Government to address the short comings of the 1965 Provident Fund Scheme was the passage of the NRCD 127

1972: Social Security and National Insurance Trust. This decree rectified some of the short comings of the 1965 scheme by establishing the Social Security and National Insurance Trust (SSNIT) as an independent body corporate to administer social security schemes in the country.

Under the NRCD 127, retirement age was reduced from 60 to 55 years for men and 55 to 50 years for women. However, the new scheme was still providing lump-sum benefits to retired workers. The scheme also provided coverage for workers in establishments that employ at least five workers. An establishment with less than five employees had the option to join the scheme but there was no compulsion.

The current scheme – PNDC Law 247 1991: Social Security and National Insurance Trust

In February 1991, the Government of Provisional National Defense Council (PNDC) repealed the 1972 Social Security Decree, NRCD 127, and replaced it with PNDC Law 247, captioned “Social Security Law, 1991”. PNDC Law 247 was an attempt to redress some of the major defects of the defunct Provident Fund Scheme. The main thrust of this new law was to convert the system of one-off lump sums into a pension scheme of periodic monthly payments until a member's death.

Coverage of the PNDC Law 247 scheme

Under the PNDC Law 247, coverage is more encompassing than under the NRCD 127. Law 247 provides that the scheme is open to all classes of employees, both in the formal and informal economy. Unlike the defunct provident fund scheme which exempted firms with less than five employees, the new scheme covers even self-employed persons, who may opt to join the scheme. The scheme does not cover officers of the Ghana Armed Forces, Police,

Prison Service and Legal Public Service Officers. For this category of public sector workers, the pension is non-contributory with defined benefits under the CAP 30 scheme of 1946.

Financing of the scheme

The social security scheme is to be self-financing and self-sustaining through the contributions of members. Under the PNDC Law 247 of 1991, the Government and the social partners did not change the rates of contribution which are maintained at 17.5 per cent: 5 per cent from employees and 12.5 per cent from employers.

Employers are enjoined by the law to remit within 14 days at the end of each month the contribution of their workers and their counterpart contribution. A penalty of 3 per cent per month of the contribution payable is levied when contributions are not paid within the prescribed period.

Benefits under the scheme

Although the defunct Provident Fund Scheme made provisions for five contingencies, the benefits provided for under PNDC Law 247 are only three:

- superannuation/old-age pension
- death/survivors' benefits
- invalidity benefits.

Old age/superannuation

For a worker to qualify for old-age full pension payment, he or she should have contributed to the scheme for at least 240 months or 20 years, and should have attained either the voluntary retirement age of 55 or compulsory age of 60.

The minimum pension payable is calculated based on 50 per cent of the average of the three best years' salary for a minimum contribution period of 240 months. For additional months served after 240 months,

every 12 months worked a worker earns an additional 1.5 per cent on top of the 50 per cent base pension. However, if a contributor is not able to work up to 240 months before he or she retires either voluntarily or compulsorily, he or she would be entitled to receive his or her actual contribution plus interest at half the Government Treasury Bill Rate.

Death/survivors

If a contributor dies while still a member, his or her dependants qualify for a lump sum of the earned pension. When a member contributes to the fund for 240 months before dying, a lump sum equal to the value of his or her pension for 12 years shall be paid to his or her survivors. If a member dies without having contributed to the fund for 240 months, his or her survivors will be paid a lump sum equal to his or her proportional pension for a period of 12 years. Where a member who has retired dies before s/he is 72, his or her survivors will be paid in lump sum the pension up to age 72. When a pensioner dies after age 72, his or her survivors or beneficiaries are not entitled to any benefit.

Invalidity pension

To qualify for invalidity pension, a member shall have contributed to the fund for 12 months within the last 36 months before becoming disabled. In addition, the member should have been certified permanently disabled and incapable of gainful employment by a medical board including a medical practitioner appointed by SSNIT.

Ownership of SSNIT

One of the major challenges facing SSNIT has to do with the ownership status of the trust. According to session 20 of PNDC Law 247 which established the scheme and the trust, "the Board of SSNIT shall

cause to be maintained for each member an account to which shall be credited all contributions". Therefore, the true owners of SSNIT are workers of all categories on whose behalf money is paid.

Hence, the Social Security Fund in Ghana is a private fund with Government assuming custodial responsibility, and there is a legal and financial basis for stating that the fund belongs to workers. Government resources or public funds are not used to administer the Fund: whatever money the Government pays to the fund is in its capacity as employer of specified employees. However, it has been observed that succeeding governments have been using the fund without any recourse to the workers/owners of the fund. For example, the current Government appropriated 2.5 per cent of workers' contributions to set up the National Health Insurance Scheme when the previous scheme was not able to provide adequate benefits to its owners. Furthermore, the Government did not hold discussions with stakeholders before deciding to redirect 2.5 per cent of the national social security fund.

Governance and policy

In terms of governance and the policy formulation of SSNIT, the Board of Directors is to be in control. Session 8 (1) of PNDC Law 247 states that "The Board shall, subject to the provisions of this Law, have general control of the funds and investments of the scheme and the management of the Trust on matters of policy."

In all, the board of directors, which is tripartite with representatives of workers, employers and government, is made up of 14 members. Although there is tripartite representation, the eight government representatives on the board exceeds the six combined workers' and employers' representatives. Therefore, government policy decisions or use of the funds are almost always carried out. It is the Government who elects the Director-General and he or she usually holds allegiance to the Government.

Inadequate income and pension

The current pension level received by retired workers is woefully inadequate. This is because pensions in Ghana are directly linked to incomes which are very low. A 2004 study entitled *Building State Capacity in Africa: New Approaches, Emerging Lessons* published by the World Bank compared public sector salaries in Ghana with those of countries in sub-Saharan Africa with a similar level of economic development. It found Ghanaian public sector salaries were lower than those in several of these countries. In 2001, for example, the top public sector salary in Ghana was estimated at \$3,275 (in dollar parity terms) compared to \$8,523 in Benin, \$12,337 in Tanzania, and \$13,300 in Uganda.

The bottom public sector salaries in Ghana was estimated at \$252 per annum compared to \$923 in Benin, \$1,045 in Senegal, \$701 in Tanzania and \$523 in Uganda.

With the level of pension benefits being linked to previous salary levels, the direct impact of the low level of salaries in Ghana is that retired workers are paid low pensions. Currently, the lowest pension that SSNIT is paying per month is ₵150,000 per month Ghanaian cedi (\$17), whilst the highest pension is ₵77,000,000 per month (\$8726). We can also deduce from this that not only are pensions low in Ghana but that there is a huge wage differential in the country.

Another very important challenge facing pensions in Ghana has to do with inequality by gender. SSNIT has been designed in such way that it favours formal sector workers, the majority of whom are men. Thus, in the informal economy where many women are found only a small proportion of them benefit from social security and pensions. In terms of the distribution of pensioners by gender, out of the 66,971 SSNIT pensioners at the end of 2004, only 7,326 (11 per cent) were women. As at the end of 2004, only 7,000 informal economy operators had registered with SSNIT compared to 1,068,728 formal sector contributors.

There is not one universal social security system in Ghana, with there being more advantageous schemes for public sector employees. Currently, there are four different public sector pension schemes, namely CAP 30, SSNIT, Ghana Universities Staff Superannuation Scheme (GUSSS) and the Ghana Armed Forces Pension Scheme. Some of these schemes are defined contribution schemes while others are run on a non-contributory basis, and so many workers are clamoring to join the non-contributory scheme where benefits are also more generous.

Current debates on reforming pensions in Ghana

Pensions in Ghana cover just about 10 per cent of Ghana's labour force of about 8.5 million. The majority of this 10 per cent with coverage are people employed in the formal sector. The vast majority of workers in the informal economy have no social security coverage. Even though membership of the SSNIT pension scheme is open to all workers in the informal economy on a voluntary basis, patronage has been very poor.

It is important to state that those formal sector workers who are covered by SSNIT are not happy about the benefits the scheme is providing to retired workers in the country. Many retired workers are not able to cater for their basic necessities of life like food, clothing and shelter with their monthly pensions. Consequently, formal sector workers, particularly those in the public sector, have been campaigning for reform of the existing pensions, with many of them opting for CAP 30 instead of SSNIT.

This campaign prompted the Government to set up a Presidential Commission on Pensions on 4 August 2004. The commission was charged with the responsibility of examining existing pension arrangements and to make appropriate recommendations for a sustainable pension scheme that would ensure retirement income security for Ghanaian workers, with special reference to the public sector.

In its report, the commission recommended that to secure retirement income security for Ghanaian workers a three-tier pension structure be implemented, comprising two mandatory schemes and a voluntary scheme. This proposal is described in the following sections.

First tier

This tier would be a restructured SSNIT, retained as a mandatory state social security pension scheme, paying monthly and other pension benefits. The commission further stated that this should be a defined benefit scheme. The existing contributions rates of 5 per cent from workers and 12.5 per cent from employers would continue. Out of the total of 17.5 per cent, 5 per cent will be directed to the second tier scheme (see below) to pay for a lump-sum benefit and the remaining 12.5 per cent will be retained in this first tier SSNIT scheme to pay monthly pensions.

Second tier

This would be a mandatory, privately-managed occupational pension scheme. The commission proposes this to be a defined contribution pension scheme, paying mainly lump sum benefits. The commission suggested that the minimum total contribution into this scheme should be legislated at a minimum of 5 per cent.

Third tier

This tier would be comprised of a voluntary, privately managed personal pension scheme offering attractive tax incentives for contributions.

Other reforms

The commission also suggested review of the SSNIT Law to:

- reduce the “overbearing” government presence on the SSNIT Board and the de facto control of the Fund by Government;
- redefine the responsibilities of the Board to reflect best governance practices;
- introduce a statutory reporting system;
- restructure the existing scheme to reflect the proposal for a three-tier pension system.

Current situation

On 25 August 2006, the Government issued a White Paper on the commission's report, virtually accepting all the recommendations made by the commission. In early November 2006 the Government announced its decision to implement the pension model adopted in the White Paper. However, the Ghana Trades Union Congress had difficulty in responding adequately to the Government's White paper.

The role of trade unions in reforming pensions in Ghana

Trades unions in Ghana have been at the forefront in advocating improvements to social security and pensions since the introduction of these systems of social protection in the country. Furthermore, one of the fundamental responsibilities of trade unions is to ensure adequate social protection for its members. This the trade unions do through collective bargaining and negotiations at national level.

For the purpose of this article, I will classify the role trade unions have played in shaping and improving social security in Ghana into two parts, namely governance and technical issues.

Governance and structural economic issues

Let me start by stating that the role trade unions representing their members have played in improving pensions in Ghana since independence has focused more on governance of the scheme than on technical matters. This argument is supported by the TUC policy objective on pensions which states “On pensions, our policy is to continue to pursue the goal of redesigning SSNIT to reform it to cater for the majority of workers, particularly those in the informal sector and women.”

Therefore, the trade unions have focused more on reforming the institutional framework of social security in the country. Meanwhile, many of the issues that have to do with reforming the scheme are imbedded in the legal instrument that established the scheme. Even though trade unions have been calling for the need to reform the law establishing SSNIT in order to give more power to the real owners of pensions – the workers – and to give them a strong say in the management of the scheme, governments have not supported such changes.

It was trade unions who advocated for a change in benefits paid to retired workers, to shift it from lump-sum payments to monthly payments of pensions. Although this has helped in improving the standard of living of pensioners, it fails to address the challenges facing pensioners in Ghana. The fundamental problem has to do with the fact that incomes are woefully inadequate in Ghana, as pointed out earlier in this article. While incomes continue to be low it will be very difficult for retired workers to enjoy decent pensions.

Trade unions have played an important role in ensuring that many Ghanaians get decent work which will in turn allow them to contribute financially towards employment growth. In this respect, Ghana TUC has established Labour Enterprise Trust (LET). Union members contribute to a fund which has now opened an insurance company, a bank, a city car park, and radio taxi and water tanker services.

These enterprises have contributed to job creation in Ghana, thereby making it possible for more Ghanaians to have access to decent jobs.

One other main reason why incomes and pensions have become inadequate has to do with the effect of poor economic management on the part of government. Between the 1980s and the 1990s, high inflation became a regular feature of the economy, thereby eroding the value of income for both workers and pensioners. Currently, Ghana TUC is in the process of setting up an independent Labour Research Institute to help trade unions intervene in national policy formulation. When this centre becomes more active, we believe it will contribute to shaping national economic policy formulation.

One of the major features of the Ghanaian economy, particularly in the 1980s and 1990s, was the financing of budget deficits through the printing of money. The practice contributed to the collapse of the economy to the extent that essential commodities became very scarce. For example, inflation was as high as 123 per cent in 1983. During this period of high inflation, trade unions managed to convince the Government to link pension benefits to the level of the national minimum wage. As a result, once the National Tripartite Committee has determined the national minimum wage, pensions are automatically adjusted. Trade unions have thus ensured that the income of pensioners is appropriately protected. Furthermore, to address the problem of low incomes in Ghana, trade unions have managed to put on the agenda of the National Tripartite Committee the discussion of a Living Wage instead of the Minimum Wage.

Even though the trade unions and other labour associations are represented on the Board of Social Security and National Insurance Trust (SSNIT), experiences over the years show that this representation has been cosmetic, since many a time government by-passes the SSNIT Board in making decisions. On some occasions it simply uses its numerical advantage on the Board to force through deci-

sions. Nevertheless, on other occasions trade unions have used their presence on the Board to influence decisions in favour of workers and pensioners.

Currently, the minimum pension of ₵150,000 is way below the poverty line. Pensioners should not be made to live under the poverty line. We believe strongly that the SSNIT scheme can pay pensioners over and above the poverty line if we reduce the inefficiencies in the management of the scheme.

The TUC and trade unions generally have adopted a policy of attempting to extend social protection to workers in the informal economy, and have started organizing workers in this sector. We have also collaborated with SSNIT to organize programmes for informal economy operators with the aim of introducing them to social security and other social protection options available in Ghana. Issues pertaining to the ILO's Decent Work Agenda have also been discussed with these informal economy operators.

Technical issues

By the term technical issues, I mean the ability of trade unions to scrutinize the investment portfolio of SSNIT. Trade unions need the capacity to advise on the type of investments the fund should make. Unions need also to be able to be capable of initiating proposals on how to sustainably restructure pension benefits to improve pensioners' incomes.

For example, the formula used in calculating pensions is based on 50 per cent of the average of the three years' best salary of the pensioner. We have not been able to do any technical calculation to challenge the basis of determining pensions. It may be possible to use a 60 to 70 per cent benchmark instead of the 50 per cent that the fund is currently using.

Unfortunately, Ghana TUC does not have the capacity to undertake this type of technical work to propose alternative means of calculating pensions. There is a need for trade unions to work towards

building their technical capacity to match government and employers when it comes to analysis of social security systems.

Conclusion

Issues of social security are too important to be left in the hands of government, and so trade unions must build their capacity actively to engage government on social security issues. It is the desire of trade unions to create a society that avoids social alienation, and to create national conditions for genuine economic and social progress. In the democratic society that we seek today, a solidarity based on a society which is caring is essential to ensure that those who participate in the political process develop confidence in it and begin to see democracy as the means to securing economic and social justice.

Note

¹ Emigration allows immigrants or foreigners working in Ghana to contribute to the scheme and also benefit under the scheme when they leave the country.

References

- Ghana, Government of (2006), *Presidential Commission On Pensions Report*.
- Gockel, A. F. (1996), *The Formal Social Security System in Ghana*, Friedrich Ebert Foundation, Accra.
- Kumado, K., and Gockel, A. F. (2003) *Social Security in Ghana*, Friedrich Ebert Foundation, Accra.
- Adu-Amankwah, K. (2005) Presentation Made During the 60th Anniversary Symposium of GHANA TUC.
- Adu-Amankwah, K. (2006) *A Realistic Income and Pensions Policy: The Role of Trade Unions*, A Presentation Made During the 57th Annual New Year School.

SEWA's health insurance programme

The labour union Self-Employed Women's Association (SEWA) demonstrates that it is possible to create an accessible level of social protection, in this case, health insurance for workers in the informal sector, despite operating in the largest, private and unregulated health industry in the world.

Mittal Shah

Secretary

Self-Employed Women's Association (SEWA)

Tara Sinha

Research Coordinator

Vimo SEWA

The Self-Employed Women's Association (SEWA) is a labour union of 796,000 women workers engaged in the informal economy, based in Ahmedabad, Gujarat. SEWA members have no fixed employer-employee relationship nor are they covered by protective labour legislation. SEWA's membership can be categorized into four main occupational groups: (1) manual labourers and service providers, for example, agricultural labourers, construction workers and cleaners; (2) street vendors; (3) home-based workers, for example, incense stick rollers and embroiderers; and (4) small-scale producers, for example, gum collectors and craft workers. These women work long, hard hours, and because of the nature of their employment, they do not obtain even basic social protection such as health insurance, maternity benefits and sick leave.

Being the poorest of workers, and living most often in environments without basic water and sanitation, SEWA members and their families are often sick. The high cost of health care often prevents an informal sector worker from seeking treatment, which may result in the worsening of her state of health. The poorest quintile of Indians is 2.6 times more likely than the richest to forgo medical treatment when ill, and despite higher rates of illness, is

only one-sixth as likely to undergo hospitalization (Peters, Yazbeck et al., 2001). Poor health, when it results in lost wages and/or health care expenditures, leads to indebtedness, loss of assets and further poverty. According to an analysis by Peters et al. (2001, p. 157), at least 24 per cent of all people hospitalized in India in a single year fell below the poverty line because they were hospitalized. In theory, government provision of health care should cover the poor, but in practice it often does not.

It was in this context that SEWA began to organize women for their economic rights three decades ago. Our goals are to organize workers for full employment and self-reliance – both economic and in terms of decision-making and control. Full employment includes security of work and income, food security and social security. Social security, in SEWA's experience, must include at least health care, child care, insurance and shelter.

One of SEWA's first initiatives, after its inception in 1972, was addressing women's needs for financial services – savings and credit. This has been achieved through women's own micro-finance organization, SEWA Bank. Over the years, through SEWA Bank, we have learned that sickness is the major and recurring

Box 1. Woman worker's injury reimbursed promptly by Vimo SEWA

Shantaben is 52 years old and a resident of Bharoda village in Kheda district – the centre of Gujarat's dairy and tobacco industries. Shantaben has been a member of Vimo SEWA for five years. She works for daily wages, either as an agricultural labourer or as an assistant with the mid-day meal programme at the village school. Recently, while closing a high window at the school, she fell and injured her back. Initially, she tried to treat the pain at home by applying salt and turmeric, but the pain only worsened. She was taken by rickshaw to a nearby non-profit hospital, where she was admitted for ten days and treated with bed rest and medicines for her pain. The cost of hospitalization was around Rs. 1800 (US\$40). She borrowed the money from her nephew free of interest. After just two weeks, she was reimbursed by Vimo SEWA. She has now paid back her nephew and says that because of the health insurance, she has been able to continue saving money to replace her *kutch*a house.

crisis in women's lives. A study in 1977 of women who were not repaying their loans regularly revealed that the major cause was sickness of the woman or her family members. We regularly witness women selling or mortgaging assets and utilizing their hard-earned savings during illness episodes.

1. SEWA Health Insurance

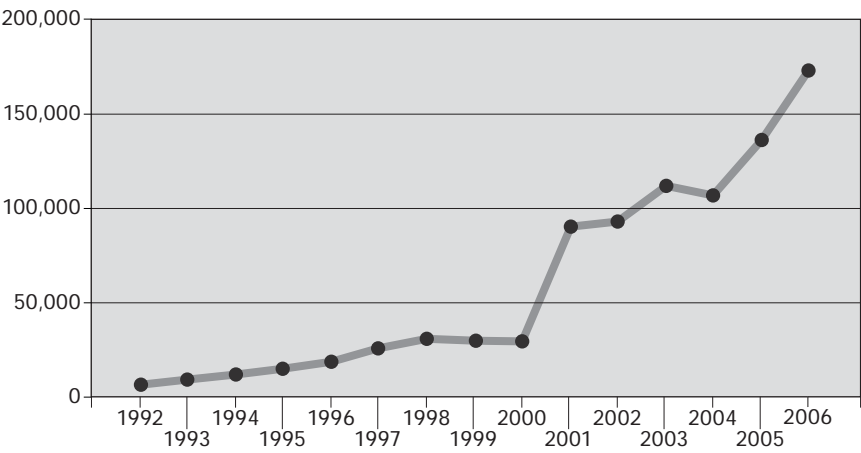
SEWA's Health Insurance activity was started in 1992, and is administered by Vimo SEWA or SEWA Insurance. Health insurance was offered to members as part of an integrated package covering life, accident, asset and health insurance (box 1). In 2003, 90,432 women members were enrolled in SEWA Insurance. The programme offers two schemes, one with a lower premium and coverage (Scheme 1) and a second with a higher premium and coverage (Scheme 2). The less expensive scheme is more affordable to SEWA members, and around 90 per cent of its membership is in Scheme 1. This article focuses on the health insurance component of the scheme, and quantitative information refers to Scheme 1 only. All other aspects of the discussion pertain equally to both schemes. The scheme has changed considerably since its inception, and continues to change in response to members' needs and priorities. In each section we describe briefly the changes that have occurred to date.

2. The Health Insurance Scheme

The HI scheme covers hospitalization expenses; it does not cover outpatient care. Each member pays a composite premium from all four covers, viz. life, accident, asset loss and health. The premium for the integrated package starting January 2007 is Rs. 125 (approximately US\$2.75). Hospitalization expenses are covered upto a maximum of Rs. 2000 (approximately US\$44.5). Membership is voluntary, and is available to women members of SEWA and their husbands and children. Adult membership covers persons from 18 to 70 years of age. Child membership is from three months of age to 17 years.

SEWA Insurance collects the premium from the members and passes it onto the insurance company. Premium to the insurance company is paid annually. Members however, can choose between an annual membership and a long-term membership. In case of the annual membership, members pay their premium annually. If they choose a long-term membership, they pay a lump sum to the programme. This lump sum is put into a fixed deposit at SEWA Bank. The annual interest earned on the fixed deposit goes towards the member's annual premium. The scheme's membership has grown steadily over the years, as shown in figure 1.

Figure 1. Membership growth in Vimo SEWA from 1992 to 2006



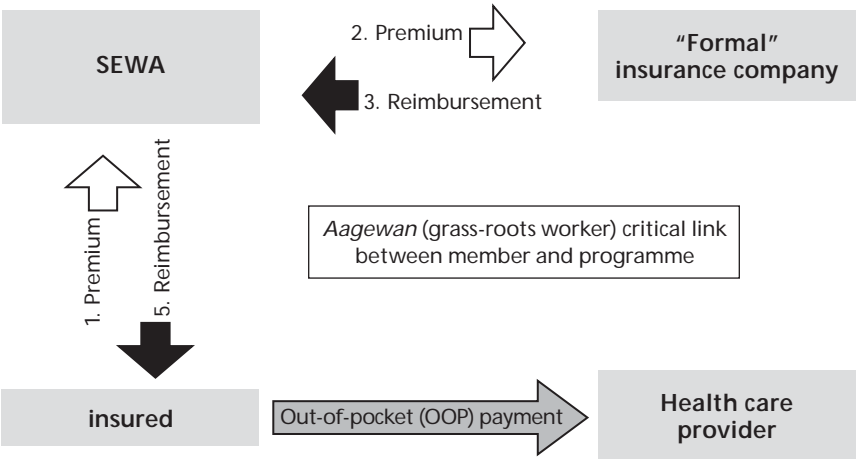
2.1. How the system works –
Scheme administration

The key players in the HI programme are the members, the health insurance company, the health care provider and SEWA. Figure 2 illustrates the cash flows between the four players as they exist currently. Vimo SEWA is run by a team of full-time staff and local women leaders called *aage-*

wans. The *aagewan* is a grass-roots level union member who is the critical link between members and scheme administrators. She works as an insurance promoter.

Enrolment is carried out by *aagewans* and staff members of SEWA. *Aagewans* from SEWA Insurance and from the other activities of SEWA join in this effort. Marketing is done through community level meetings and advertisements in the media.

Figure 2. Cash flows of premium and reimbursement in SEWA's Health Insurance



Source: Kent Ranson, 2002.

Marketing tools include video films, posters and banners.

Claims processing is carried out by the SEWA Insurance team on behalf of the insurance company. SEWA Insurance has instituted a claims committee which includes member representatives and programme staff. The claims committee meets regularly and reviews each submitted claim. The participation of member representatives brings greater transparency in the claims processing and enhances the credibility of the programme among the members.

SEWA Insurance has a **customer service cell** in its Ahmedabad office. Members can walk in at any time with queries and comments and are attended to by this cell.

2.1.1. Evolution of the scheme's administration

When the integrated programme started in 1992, Vimo SEWA collected the premium from the members and passed it on to the health insurance company which bore the risk. Soon, difficulties arose in part due to the nature of the risks covered and in part due to the procedural requirements for enrollment and claims and subsequent poor quality of service to members. In 1994, therefore, SEWA decided to de-link from the insurance company and carry the risk itself. This was an important period of learning for SEWA, and greatly strengthened its understanding of the administration of health insurance. In 2001 SEWA once again linked up with the insurance company for health insurance. A rising claims ratio (claims paid as a per cent of premium received) made it financially unviable for SEWA to carry the health insurance risk.

2.1.2. Decentralizing scheme administration

SEWA Insurance is headquartered in Ahmedabad, Gujarat. The membership is spread across 11 districts in the state and seven states in the country. As its operations expand, the insurance programme

gradually decentralizes parts of the scheme's administration depending upon the readiness of the local unit. Currently, claims processing is decentralized in five districts of Gujarat state.

3. Impact of the scheme

3.1. Patterns in scheme utilization

The scheme's objective is to provide financial protection to its members for health care expenditures, and claims reimbursed to members are evidence of the financial protection provided by the scheme.

The claims rate, i.e. number of claims submitted by 1,000 members is shown in figure 3. As the figure shows, the rate has been going up steadily, indicating an increase in the proportion of members benefiting under the health insurance scheme.

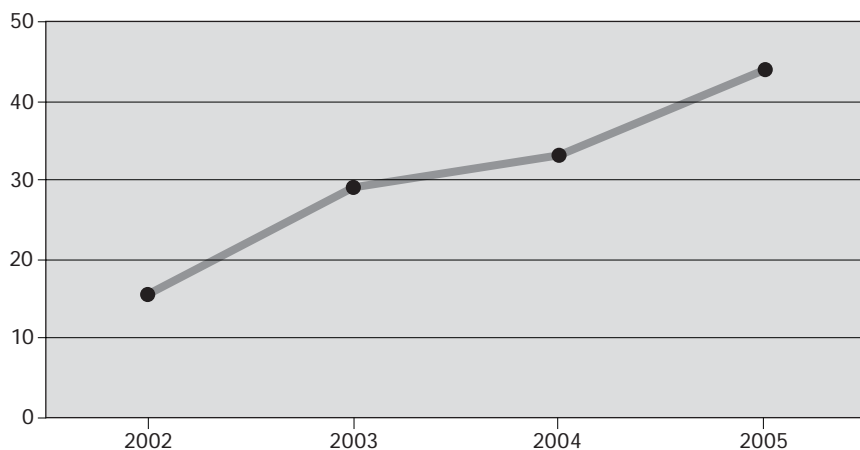
3.2. Protection against health expenditures

SEWA Insurance constantly tries to balance the affordability of its insurance scheme with the financial protection it provides its members. At the current premium rates, the HI covers hospitalization expenses up to Rs. 2000. Among claims submitted, the rejection rate is around 11 per cent, and the majority of claims are reimbursed.

Despite the capped benefits, research has shown that the scheme confers considerable financial protection. An analysis of all claims submitted between 1994 and 2000 (Ranson, 2002) revealed that the median rate of reimbursement for all reimbursed claims was 92.6 per cent (mean 76.5 per cent). Reimbursement more than halved the percentage of "catastrophic" hospitalizations (i.e. those where total expenditures exceeded 10 per cent of annual household income).

A later analysis done by Denis Garand (an actuary who works with SEWA Insurance) in 2006 found that in 50 per cent of the cases, 100 per cent of the hospitalization expenses were reimbursed to claimants.

Figure 3. Health claims rate per 1,000 members, from 2002 to 2005



4. Health insurance as an organizing tool in a trade union

SEWA Insurance was designed to meet the risk protection needs of the SEWA union members. As of September 2006, 90,432¹ of SEWA's 796,000 union members are enrolled in the health insurance programme. SEWA aims to provide health insurance coverage to all its members. However, the HI programme is voluntary, and members have to pay the required premium to enrol. More and more union members are steadily enrolling in the insurance programme, as seen in the increasing membership. SEWA Insurance directs its marketing efforts at all possible forums of the union, and grass-roots workers from all the different union activities are involved in enrolling members.

In fact, the health insurance programme has become an organizing tool for the union, and several union members enter the union through the HI programme. Subsequently they get linked to SEWA's other activities.

5. Governance of SEWA's Health Insurance

SEWA's HI is a part of SEWA Union. While it has an independent management and operational team, it is governed by the union's elected executive body. The union's executive body comprises representatives from the different trade groups in SEWA's membership. All changes in the insurance programme, such as premium increase, or changing from an open-provider system to cashless tie-ups with hospitals, are approved by the union executive.

The Coordinator of SEWA Insurance is on the Union Executive and regularly presents the insurance programme's progress to the Union Executive.

6. Sustainability of the scheme

SEWA Insurance is committed to building a sustainable insurance programme. It is following a two-pronged approach to make its insurance programme financially self-sufficient, viz. increasing its administrative efficiency, and reducing the claims ratio.

6.1. Increasing administrative efficiency

SEWA Insurance is taking a number of steps to increase the administrative efficiency of its programme.

Since 2005, it has also consciously promoted **family membership** as against individual membership. Members who purchase a family package receive a discount in the premium. A thrust on family membership provides coverage to the entire family. Additionally, it reduces the administrative cost of enrolment. In a single visit, a grass-roots worker is able to enrol an entire family instead of a single member.

The programme makes a conscious effort **to renew its annual-pay members** each year. This is done by making individual contact with each member in their homes at least once after enrolment. These house-to-house visits build the programme's credibility and are an opportunity for members to clarify any issues regarding the programme.

Membership in the state of Gujarat, (which accounts for approximately 90 per cent of members) spans a large geographical area. Members are spread over hundreds of villages in 11 districts and all over Ahmedabad city. In the last two years, the programme is following a strategy of deepening its membership in existing geographical areas. This reduces the cost of enrolling and servicing members.

6.2. Reducing the claims ratio

SEWA's claims ratio, i.e. the proportion of benefits paid out to members as a proportion of the premium paid to the insurance company, has been more than 100 per cent for the last several years. The high claims ratio is due in part to its claims rate and in part to the average claim amount paid. The insurance programme is trying to improve its performance on both counts.

To contain the claims rate, which is high particularly among its urban membership,

Vimo SEWA has initiated a system of Cashless Tie-ups with selected hospitals in Ahmedabad city. This initiative is described in section 7. By moving from a system of provider choice to one where members are required to select a provider from a given list, it is hoped that unnecessary hospitalizations will be controlled. Also, the thrust on family membership will reduce any adverse selection that may exist in the programme and thus reduce the claims rate. Further, the insurance programme is moving towards greater convergence with *Lok Swasthya Mandli*, SEWA's health cooperative, for strengthening the preventive care received by the insurance members.

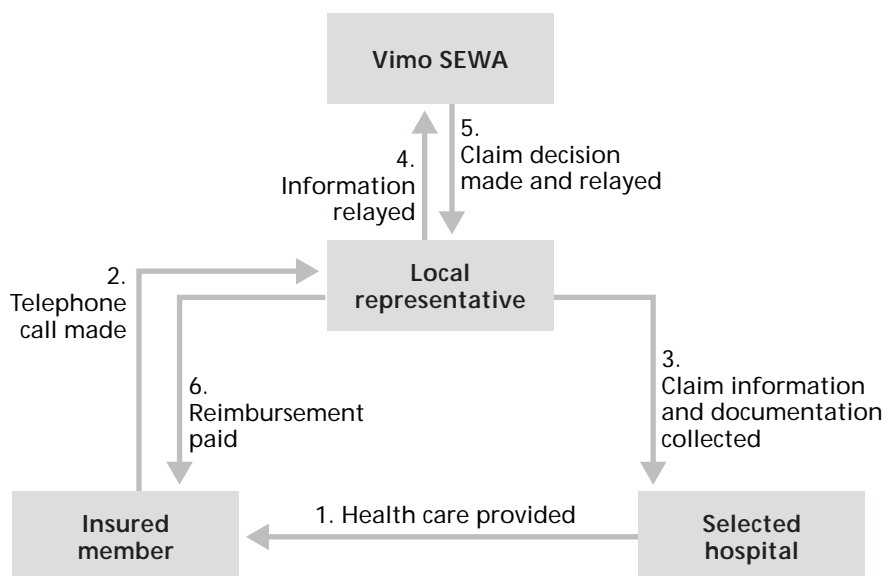
To contain the cost of claims paid, Vimo SEWA is gradually moving to a system of tying up with selected hospitals and negotiating a fair payment schedule for services rendered by the provider.

7. Recent initiatives

An important recent initiative in SEWA's Health Insurance Programme has been to provide Cashless Services to Health Insurance members. As mentioned above, the prevailing system has been for members to get hospitalized with a provider of their choice, make out-of-pocket payments, and upon discharge submit the required documents for reimbursement. Research carried out in 2003 indicated that this system was preventing the poorest of SEWA's members, particularly in rural areas, from benefiting under the scheme. The burden of making out-of-pocket payments and collection of all the hospitalization documents was proving to be a barrier to hospitalization and claims submission (Sinha, Ranson et al., 2005).

To address these barriers a system of Cashless Services was piloted in eight sub-districts in 2004. Under this system, members who are admitted to selected hospitals are reimbursed for their expenses prior to discharge. Figure 4 illustrates this system. In essence, members telephone Vimo SEWA on getting

Figure 4. Functioning of the Cashless system in SEWA's Health Insurance



Source: Sinha, T., Ranson, M.K. et al., 2005.

hospitalized. Vimo SEWA's local representative visits the member in hospital, verifies her status with Vimo SEWA and reimburses her while she is still in the hospital. This facility is available in selected hospitals with whom Vimo SEWA enters into an agreement to provide quality services at reasonable cost. This system has now been extended to Ahmedabad city, which houses about one-third of Vimo SEWA's members.

Care has been taken to select hospitals that provide quality services. Payment protocols for services provided by the hospital have been negotiated with the hospitals. The above ensure quality care to members at affordable rates, and contribute to the sustainability of the programme.

Analysis of claims paid from January to June 2006 indicate that the cashless system is not only benefiting the members, it is also contributing to the sustainability of the insurance programme. On average, a claim paid under the Cashless system is lower than a claim paid under the regular system.

8. Some lessons learned

The steadily growing membership in the Health Insurance programme is an indication of its benefit to union members. In the course of providing health insurance for the last 14 years, SEWA has learned useful lessons which are shared below.

1. Health Insurance is the top priority of the poor. Since 1992, 17,879 women have obtained Rs. 2.5 *crores* or Rs. 25 million by way of hospitalization. This is quite a substantial economic support.
2. It makes sense to link an insurance scheme with other "development oriented" activities (like provision of savings, credit, education, work-generation and health care services). First, women may be more likely to have money available, and to make plans for the future, if their other needs (for example, work and food security) are being seen to. Second, women are more likely to participate in a scheme if they have benefited from other services provided

- by that organization in the past (i.e. if they trust the insurer). Third, women may be more willing to join an insurance scheme if they feel a sense of trust and community with others who are joining the scheme.
3. It is valuable to members to bundle health insurance with other kinds of insurance (for example, life and assets insurance). It has been the experience at Vimo SEWA that life insurance is also in demand among poor women. Women see life insurance as something that they can do for their children. Selling life insurance as part of a package that includes health insurance also encourages the women to do something for themselves.
 4. Linkages with hospitals and clinics are critical. Without access to affordable, geographically suitably located hospitals, health insurance cannot succeed. Further, cashless or "on-the-spot" claims payment is preferable to workers, as they then do not have to borrow from money-lenders or sell their land and other assets to pay for hospitalization.
 5. Simple, decentralized mechanisms and procedures are required to ensure that workers can actually avail of the services offered. Workers are willing to contribute for premium, provided they get good quality services at their doorsteps. Implementation must be undertaken by local organizations – unions, cooperatives, self-help group, mandals and NGOs is essential. Implementation must be as close to local people as possible, by local women preferably.
 6. Health Insurance creates demand for public health services, as insured members go these facilities first, since they are more economical.
 7. Education and constant contact with members is critical. It builds trust and gives regular feedback to improve the services.
 8. Providing insurance to the poor, many of whom may be participating in an insurance scheme for the first time, involves substantial education, promotion, and communication costs. This makes viability of health insurance more difficult but not impossible.
 9. Making health insurance viable in India is a huge challenge for several reasons, including the fact that we have the largest, private and unregulated health industry in the world.
 10. When workers run and control their own health insurance and, preferably, their own insurance cooperative, they feel empowered. It also gives a boost to further organizing and unionizing.

Note

¹ In addition to the 90,000 women members, a total of 52,271 men and 30,235 children are also enrolled in the programme. The total membership is thus 172,938.

References

- Chatterjee, M. (2005): "Microinsurance for Workers in the Informal Economy", SEWA Social Security.
- Chatterjee, M. M.K. Ranson and M. Shah (2002): "SEWA's Health and Health Insurance Activities: learning from experience and looking to the future", Vimo SEWA.
- Peters, D. A. Yazbeck et al. (2001): "Raising the sights: better health systems for India's poor", Delhi, The World Bank (Health, Nutrition, Population Sector Unit): p. 173.
- Ranson, M.K. (2002): "Reduction of catastrophic health care expenditures by a community based health insurance scheme in Gujarat, India: current experiences and challenges". *Bulletin of the World Health Organization* 80(8): pp. 613-21.
- Sinha, T., M.K. Ranson et al. (2005): "Barriers Faced by Low-Income Families in Benefiting from Community-Based Health Insurance": *Health Policy and Planning* 2006 March; 21 (2) pp. 132-42.
- Sinha, S. and the Vimo SEWA Team (2006): "Vimo SEWA: A Case Study": ILO, SEWA, PLAN.

New challenges for social protection in the European Union

The evidence within the European Union points to a convergence in social protection expenditure among the EU Member States. However, despite shared economic pressures and increasingly shared political pressures and direction, welfare policy has not shown the same degree of convergence, suggesting that the evolution of national social protection systems remains path-dependent.

Maria Jepsen

Janine Leschke

European Trade Union Institute for Research,
Education and Health and Safety

There is a vast literature dealing with the impact of European integration on social policies in the EU Member States (e.g. Hemerijk, 2006; Jepsen and Serrano, 2006; Zeitlin and Pochet, 2005; Taylor-Gooby, 2004). Issues covered range from the impact of the European process on national legislation and institutional settings to its effects on financing and spending on social policies. The conclusions converge in stating that there is indeed an impact stemming from the EU level, but there would seem to be less convergence with regard to the nature and magnitude of this impact.

Introduction

National social policies are affected by European initiatives through various channels (Hemerijk 2006, Jepsen and Serrano 2006, Välimäki 2006). The most direct and tangible effects are those stemming from the “Community method” and the interpretations of the European Court of Justice (ECJ), namely:

- the Treaties and Community law with which all acceding and Member States are required to comply.
- adjusting to the EU social security co-ordination rules (1408/71)

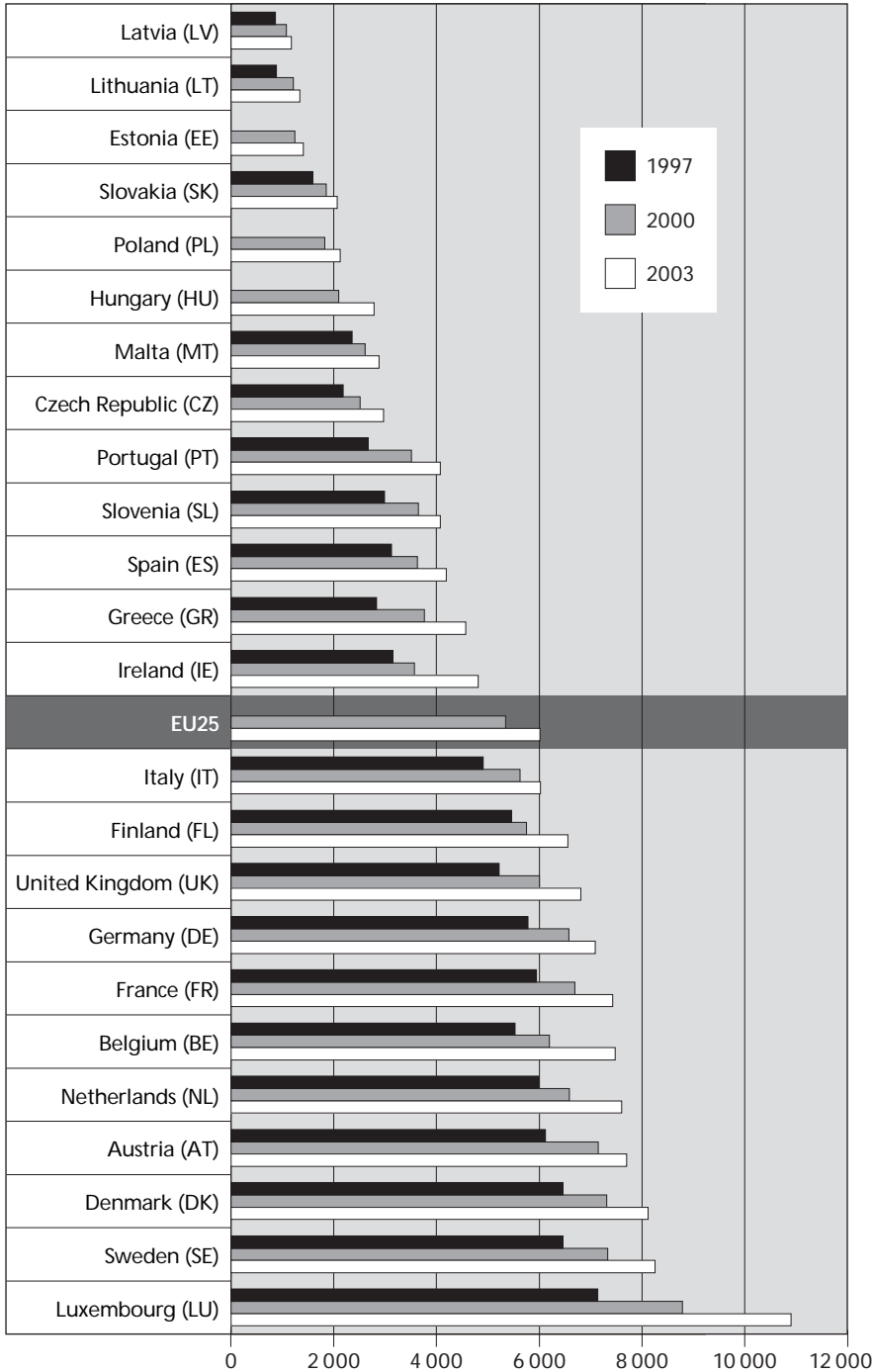
- ECJ orders.

Probably even more numerous, however, are effects stemming from more indirect channels, such as:

- the need for stability in public finances stressed in European Monetary Union (EMU) criteria and the Stability and Growth Pact (SPG), which implies macroeconomic constraints
- the various Open Methods of Coordination (OMC) on social policy areas that set the agenda on various issues, defining common challenges and common solutions in order to deal with emerging European social problems
- the creation of the internal market and the common rules entailed by it
- the political utilization of EU pressures in the national debates.

Despite the fact that social policies are not a competence of the European Union, and that any proposal for European-level binding initiatives is subject to unanimity voting, it is clear from the above list that European-level action can have a considerable impact on national social policies through various indirect and/or non-binding initiatives.

Figure 1. Total social protection expenditure per capita in purchasing power standards (PPS)



Note: 1997 data missing for some countries.

Source: Eurostat, ESSPROS database.

EU-wide coordination on social protection and social inclusion has been strengthened over recent years but the European mandate in this sphere remains limited. Under the open method of coordination common objectives are defined, national action plans outlining the specific policies to achieve these goals are drawn up, and good practices exchanged between Member States. Key areas of coordination in the field of social protection are poverty and social exclusion (since 2000), adequate and sustainable pensions (since 2001) and high-quality access to health care and long-term care (since 2004). As of 2006 the parallel processes on these three areas have been brought together into a new “streamlined” OMC on social protection and social inclusion.

The review of the Lisbon strategy in spring 2005 reaffirmed that strengthening social protection and fostering social inclusion are key priorities; it therefore stipulated a closer interaction between OMCs on social protection and social inclusion and policies on employment and growth (cf. Commission of the European Communities, 2006). Strong emphasis is placed on the interaction between social inclusion and employment in the 2005 *Joint Report on Social Protection and Social Inclusion*. Among the seven key policy priorities identified, the goal of increasing labour market participation through expanding active labour market policies and ensuring a better linkage between social protection, lifelong learning and labour market reforms is seen as the most important priority by most Member States (Commission of the European Communities, 2006).

The next section will take a closer look at the evolution and composition of social security expenditure in the EU Member States. The question of whether common problems and pressures among EU Member States lead to convergence of social expenditure and financing systems will be examined in the following section, while the last section discusses recent trends in dealing with social issues at the EU level.¹

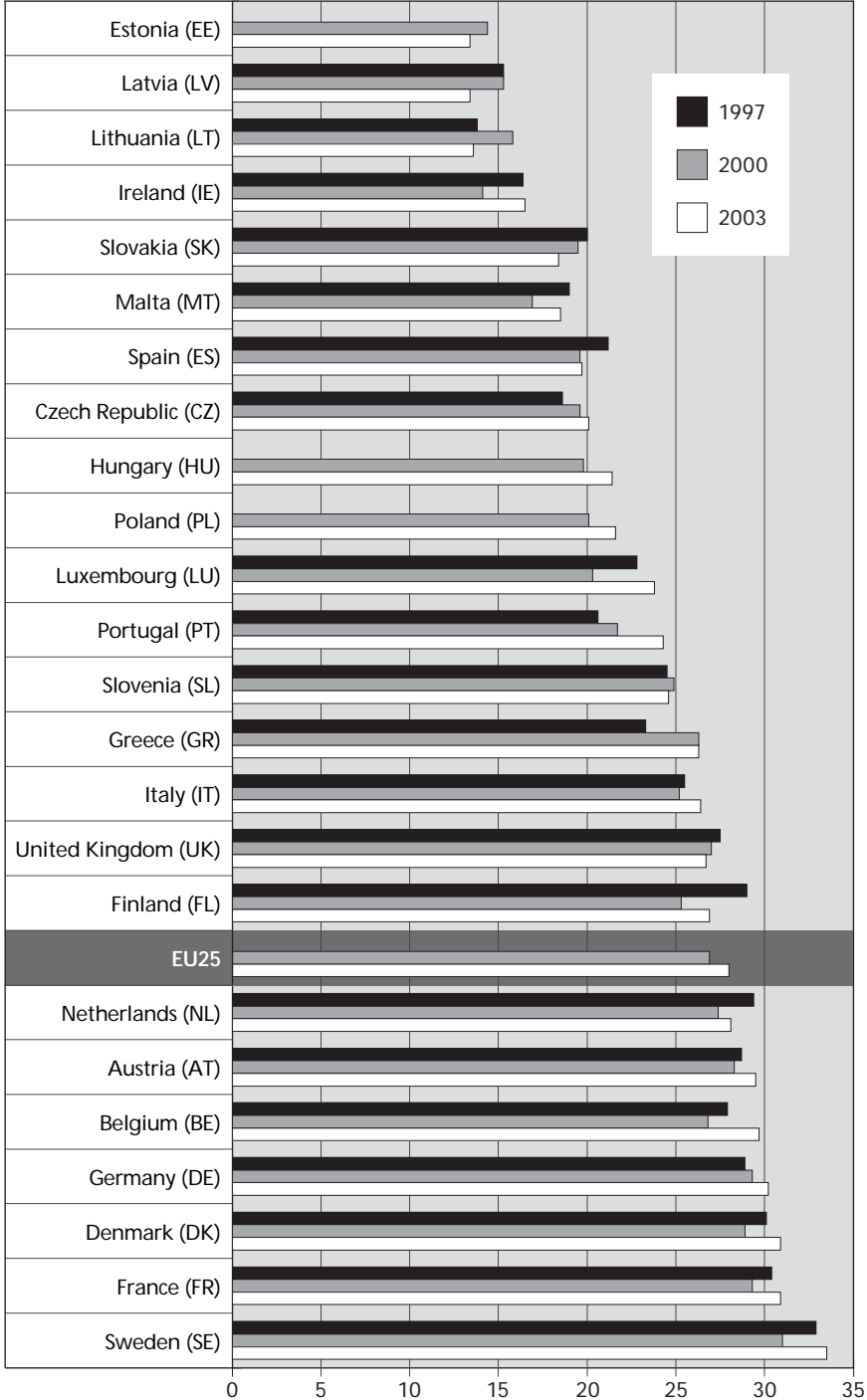
Evolution of social security spending

Figure 1 presents the evolution of total social security spending per capita in purchasing power standards (PPS). Presenting social expenditure per capita in PPS allows us to account for differences in population size as well as in living costs, and hence to focus on those national differences that are mainly a result of different levels of wealth and, even more importantly, of the diversity in social protection systems, demographic trends, unemployment rates and social, institutional and economic factors.

Though, throughout the European Union, an increasing amount of money has been invested in the population, this increase in spending is not evenly spread. With only a few exceptions, the countries already spending a lot saw larger increases in absolute terms than those spending less. With regard to percentage increase in per capita spending, there is no clear picture across the different countries, the highest percentage growth in social spending between 2000 and 2003 having been observed in Hungary and Ireland, and the lowest in Italy and Germany. The reasons for these disparities are manifold and include economic cycles, financial constraints and “catch-up” effects. This latter factor may indeed be significant, it being a question of countries with low spending and underdeveloped welfare systems during a given period experiencing high percentage increases to align themselves with the level of social provision in the surrounding countries, in order to provide better services to their population.

Broadly speaking, the countries can be grouped into three categories. The first group with the highest per capita spending consists of the Scandinavian and the continental European countries as well as the United Kingdom. The second group with medium expenditure levels includes the southern European EU15 countries, as well as Ireland and Slovenia, while the third group with spending levels considerably below the EU25 level consists of

Figure 2. Total social protection expenditure as a percentage of GDP



Note: 1997 data missing for some countries.

Source: Eurostat, ESSPROS database.

the other New Member States. Per capita social protection expenditure is lowest in the three Baltic States.

As shown in figure 2, the story is slightly different with regard to the evolution of the percentage of GDP spent on social protection. Since the beginning of the 1990s, there has been a trend towards stabilization or even reduction, as the economic situation has improved, of the share of GDP spent on social security. In other words, the percentage of GDP spent on social protection is counter-cyclical (see ETUI, 2005), and since economic cycles and growth rates vary across EU Member States, this may partly explain the differences in shares of GDP spent on social protection. In countries faring well, one might therefore expect the rate to decrease, while in countries faring badly one might expect the share to rise as the GDP growth rate decreases and the proportion of people seeking benefits increases.

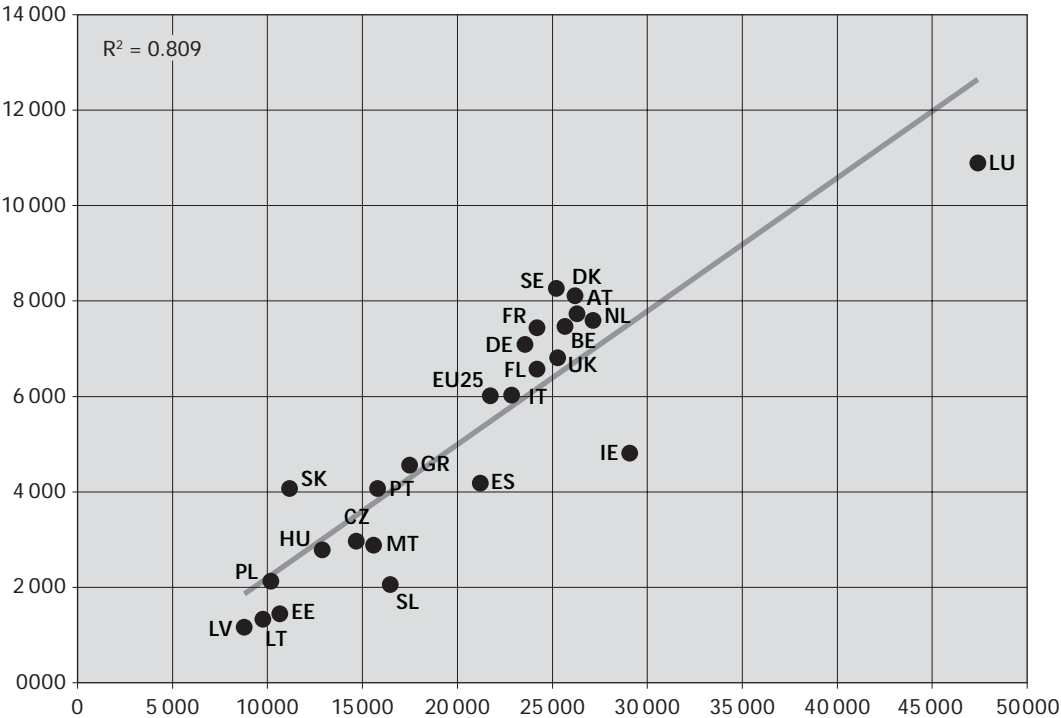
However, more careful scrutiny also raises the question of whether the “catch-up” effect of social provisions, which has been the “rule” so far in the European integration process, will also occur in the current enlargement. This question has its roots in the observation that, while countries spending a low share of GDP on social protection, but with high growth rates, might be expected to build up and consolidate their social protection systems, this is not the case in the three Baltic countries, Slovakia and Malta. In addition to spending a relatively low share – in European terms – of their GDP on social protection, these countries, in contrast to most other EU25 countries, actually saw this share decrease. Though there has been a modest increase in spending per capita, this has not been as high as the increase in GDP.

Preliminary estimates provided by 10 EU-15 countries² for 2004 actually show a slight decline in the share of social protection expenditure in GDP. Measured in constant prices, benefits increased by 2.3 per cent in 2004 (compared to 3.7 per cent in 2003). A higher rate of growth in

real terms was observed only for “housing and social exclusion”, while family-related benefits showed the least increase, this being due to a drop in the population aged under 20 in these countries (compare Eurostat, 2006b).

Figure 3 illustrates the frequently discussed phenomenon whereby the higher the GDP per capita, the higher is the social spending per capita. The correlation is very strong with an R-squared of 0.8. A correlation with a competitiveness index will produce much the same results, as the countries with a high score on the world competitiveness index are also among those that spend the highest share of their GDP on social security. In terms of social policy theory this constitutes a “productive factor” in the sense that it “feeds in” to economic growth by investing in the population and enabling them to deal with economic and social changes by making them well-trained, healthy and motivated. Last but not least, it ensures a stable and secure state characterized by social cohesion. On the other hand, countries must have a sound economic foundation in order to finance encompassing social spending: in other words, economic growth is needed to finance social spending. These ideas constitute one of the main foundations of the consolidation of the European Economic and Social Model. Economic growth must go hand in hand with social cohesion. However, taking together the results from figures 1–3 we may well ask whether economic growth will continue to cause an increase in social investment in the population: the share of GDP spent on social protection is not increasing, especially in the low-spending countries, despite their high economic growth rates. Since social spending is a proxy for the level of social protection and hence of the welfare state, states with minimal welfare states should be encouraged to build them up and invest in their populations.

Figure 3. Correlation between GDP per capita and social protection expenditure per capita in PPS in 2003



Source: Eurostat, ESSPROS database.

The different functions of social protection benefits

With a share of about 46 per cent, old-age and survivor's benefits accounted for by far the major share of total social protection expenditure in 2003. The next largest expenditure was sickness and health care, on average 28 per cent of total expenditure. Invalidity as well as family and child benefits on average accounted for about 8 per cent each while the average for unemployment benefits was 6.6 per cent of total benefits. Housing and social exclusion took the smallest share with on average 3.5 per cent. There were hardly any differences between the EU25 and the EU15 averages but figure 4 shows that on some indicators strong country differences can be observed. Expenditure for old-age and survivor benefits is very low in Ireland, a

situation attributable at least in part due to its population profile – it is the youngest in Europe with about 29 per cent of the population under 20 years of age in January 2003 (compare Eurostat, 2006b).³ Poland and Italy, on the other hand, spend a very large share of their social protection budget on elderly people. In Italy, for instance, 25 per cent of the population were aged 60 and over in January 2003 compared with an average of 21.6 per cent in the EU25 countries (cf. Eurostat, 2006b). Health expenditure exceeded old-age and survivor benefits in Ireland and was very high also in the Czech Republic. Family and child benefits were especially high in Luxembourg but also well above the average in Ireland, Denmark and Hungary. Cash family benefits actually accounted for more than 70 per cent of total expenditure under this function group. Increases

in expenditure on family and child benefits were recorded for the period 1999 to 2003, even though the population aged between 0 and 19 years fell during the same period. Family-friendly reforms have thus taken place in a number of countries (compare Eurostat, 2006b).

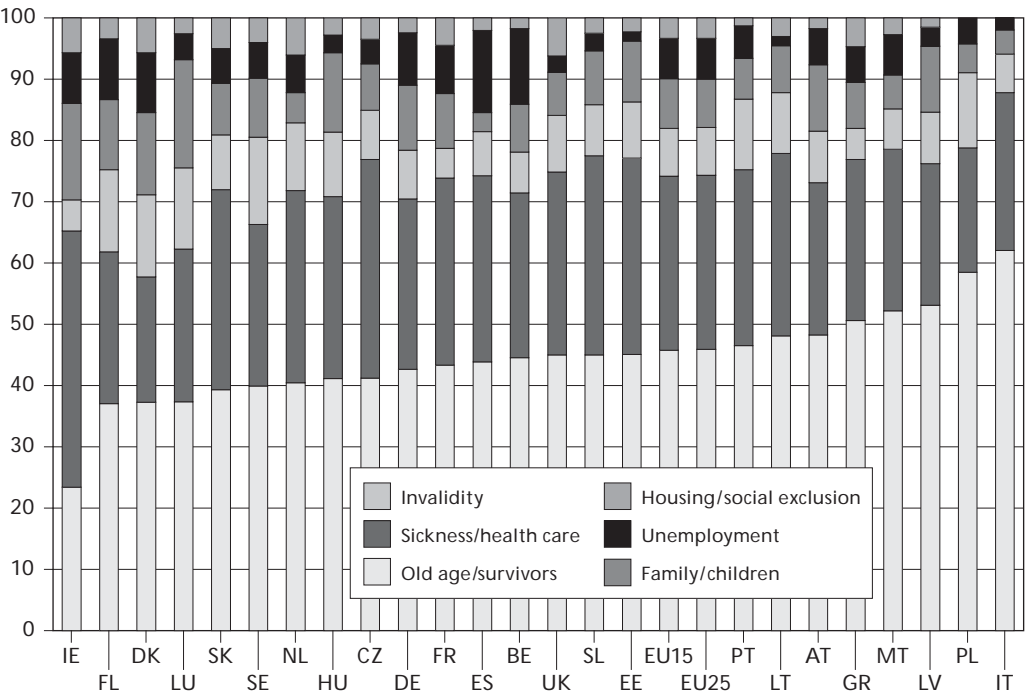
Evidence of impact of Maastricht criteria on social expenditure

Although countries do not simultaneously and at the same rate cut and increase social protection expenditure, there does seem to be some similarity among countries in this respect. It is a tendency that has led Bouget (2004) to establish the link between total social expenditure and economic growth depicted in figure 5. Developed countries display very strong and immediate links between economic growth and increase in total social spending. When a

recession occurs, with a decrease in economic growth, this is not then translated into a decrease in social spending, but rather into stabilization or even an increase (phase 1). This divergence in movements results in a budget deficit. Given the aim of adhering to the Maastricht criteria and the refusal to increase taxation, governments will be led to reduce the growth rate in social expenditure (phase 2). Once economic growth increases, this will lead to a stabilization or even slight increase in total social expenditure resulting in a decrease or stabilization of the ratio of total social spending to GDP (phases 3 and 4). Hence, EU Member States may be expected to display similar behaviour, even though the amplitude of the movements might differ greatly between countries.

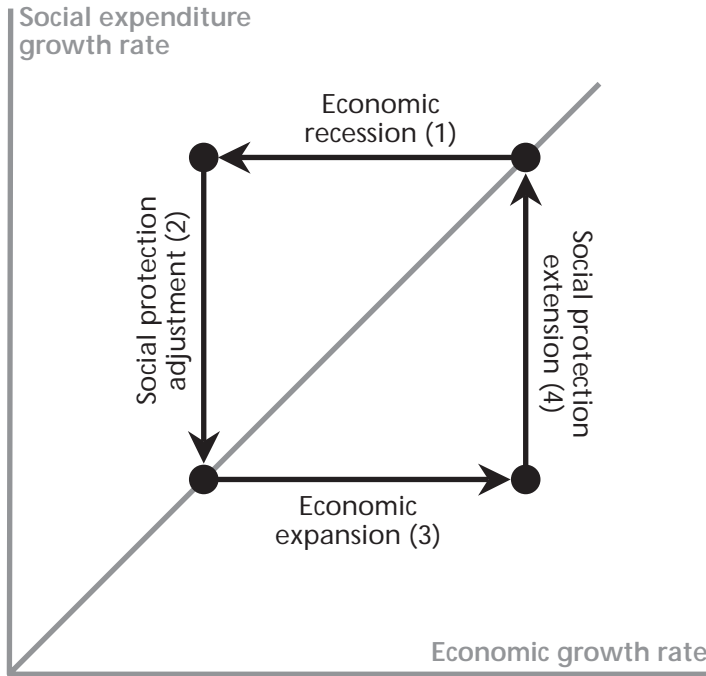
Neither the establishment of a European system of social protection nor the harmonization of the national systems has ever been a real option in European

Figure 4. Social benefits by function group in 2003 (% of total social benefits)



Source: Eurostat, ESSPROS database.

Figure 5. The cycle of social expenditure and economic growth



Source: Bouget, 2004.

policy-making. However, the notions of “catch-up” effect and convergence are often encountered in comparison of the national systems (Bouget, 2004), and the OMC and benchmarking have reinforced the notion of convergence and made it one of the aims in the modernization of social policies. The convergence of social welfare systems can be analysed from many different angles, e.g. policy-making, political, institutional, etc. One approach is to analyse the convergence of total social expenditure between countries, hence adopting a quantitative approach on the macro level, leaving the specific policy areas aside. The divergence/convergence is then affected not only by the different stages of maturity of the welfare state, but also by macroeconomic pressure and public spending constraints, i.e. the Maastricht criteria.

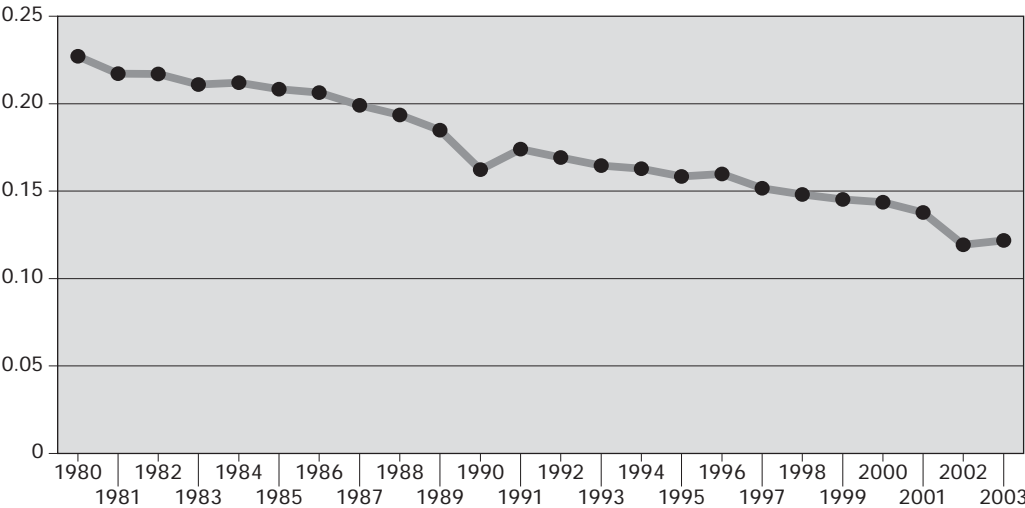
Bouget (2004) provides an analysis of the period from 1980 to 1998 for which

the results appear rather ambiguous, depending on what indicators are used for the analysis. The picture becomes clearer, however, if the analysis is based on the 1980–2003 period. For the EU15 there seems to be a steady convergence for per capita social expenditure, despite all the reforms that took place and the economic upswings and downturns that characterized this period. When approaching convergence via total social expenditure in GDP a very interesting phenomenon occurs. The period can be divided into four parts: first, a period of steady and relatively strong convergence from 1980 to 1989, secondly, a strong period of divergence from 1990 to 1992, followed, thirdly, by a strong convergence period from 1993 to 1995 and, finally, a fourth period from 1996 to 2002 which displays a steady trend of convergence, with a slight divergence for 2003. Hence, while there is no strong overall convergence, there has

been a change in the way Member States use social protection to react to economic recession. During the recession at the beginning of the 1990s there was a peak in divergence; during the latest recession, however, no such phenomenon can be observed. The question is to what extent this

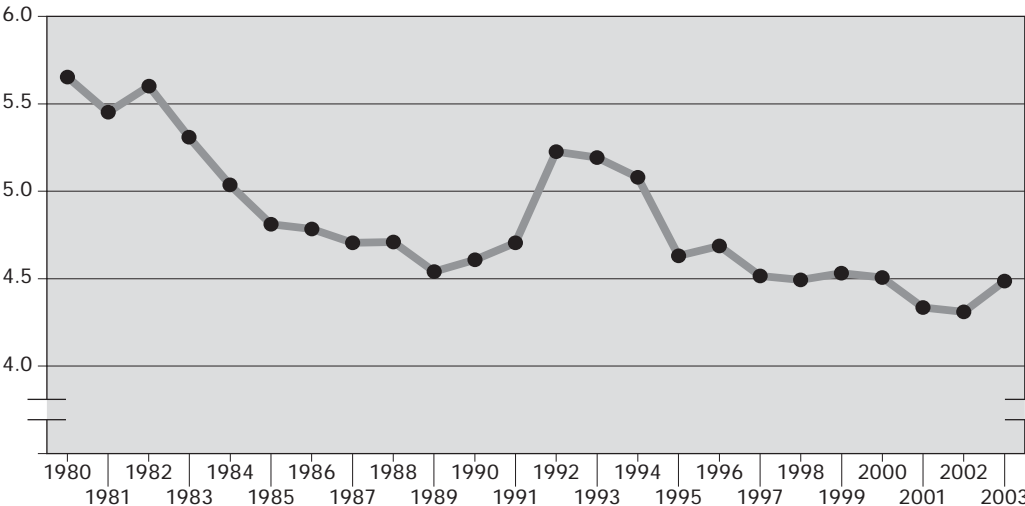
is due to the effects of the Maastricht criteria and the OMCs. Figures 6 and 7 seem to offer hints in this direction, providing some support for the idea that European-level initiatives are having a convergence effect on expenditure. However, this evidence must be treated with caution, and

Figure 6. Standard deviation of per capita social expenditure in PPS for two EU countries between 1980 and 2003



Source: Eurostat, ESSPROS database. The data refers to EU12 until 1989 and thereafter to the EU15 countries.

Figure 7. Standard deviation of the percentage of social expenditure in GDP in two EU countries between 1980 and 2003



Source: Eurostat, ESSPROS database. The data refers to EU12 until 1989 and thereafter to the EU15 countries.

further in-depth research is required to see whether the results are robust and to reveal the underlying mechanisms. The good news is that, despite the slowdown in the growth in social expenditure relative to GDP, it does not seem to constitute a race to the bottom, since there appear to be no signs of radical change but, rather, evidence of a need for “adjustment”. These conclusions are based, however, on evidence from EU15 and an important question relates to the conclusions that might be drawn if the 10 New Member States were to be included in the analysis.

Convergence of financing systems

In 2003 the main source of funding social protection was social contributions. These made up about 60 per cent of all receipts, while general government contributions derived from taxes amounted to 37 per cent (Eurostat, 2006b). In most countries the employers’ share in social contributions is considerably larger than the employees’ share. There are great country differences in the structure of social protection funding and, while social contributions make up more than 70 per cent in Belgium, the Czech Republic, Estonia and Latvia, more than 60 per cent of total receipts in Denmark and Ireland are from tax revenue (Eurostat, 2006b).

Social benefits can pursue two fundamentally different allocative aims: either protecting accustomed living standards and therefore ensuring contributory justice, or preventing and mitigating poverty (Rolf, 1988). The first aim is more pronounced in insurance schemes which are based on the equivalence principle (predominance of contribution financing – the Bismarckian tradition); the second function is more evident in schemes that are in close accordance with the welfare principle (predominance of tax financing – the Beveridgian tradition).

Divergences between European countries regarding the different financing systems are gradually diminishing. The countries with initially low tax financing

(Bismarckian tradition) now use more tax revenues for social protection funding (France, Germany, Italy, Portugal for example), whereas countries with initially high levels of government funding (Beveridgian tradition) increasingly use contribution financing (Denmark, Luxembourg and Sweden for example) (Eurostat, 2006b).

The European instruments and their effects

Although, as mentioned in the introduction, there can be no doubt that the European agenda on social issues has expanded greatly since the late 1990s, this has been achieved at the cost of two types of implicit trade-off (Goetschy, 2006). Firstly, within the social sphere itself, the achievement of the Maastricht Social Policy Agreement was offset by the incorporation of the subsidiarity principle into the Treaty, thereby emphasizing the importance of the national level; similarly, at the end of the 1990s, the introduction of the OMC and the fairly broad array of topics covered was counterbalanced by the non-binding nature of these measures. Secondly, in the 1980s and 1990s, the social progress contained in the treaties or promoted by large-scale projects (1994 White Paper; Lisbon strategy of 2000) was clearly part of a trade-off for backing the onward march of economic integration, i.e. for accepting the large internal market and EMU. These initiatives or trade-offs represent a clear break with previous social measures, undertaken in the 1960s and 1970s, which had merely been constituent elements in the workings of the markets themselves. Community social legislation was in practice created largely “by default”, i.e. based above all on an extensive and judicious reading of the successive treaty articles and with a view to bypassing their limitations.

This evolution has been analysed by several scholars in an effort to understand whether the social dimensions that have been introduced have been able to balance the economic integration and increase in

competition. The conclusions (Saari, 2006; Scharpf, 1999; Streeck, 1995) seem to indicate that the market-correcting “positive integration”, i.e. social measures/initiatives, has failed to keep up with the economic integration, or “negative integration”, thereby putting the European welfare states under strain. This situation has created a “double-bind” for governments who, in the light of increased economic integration, may be expected to shed some of their welfare-state obligations – which they cannot do, as this would jeopardize the political basis of their legitimacy – while remaining at the same time committed to deepen the economic integration and thereby expose their welfare states to regulatory competition (Hemerijk, 2006). Hence there seems to be a genuine need for a fully fledged commitment to the social dimensions from the European level as this is one of the main elements in gaining legitimacy from the European population and responding to their concerns (Jepsen and Serrano, 2005; 2006).

However, the main question remains, namely, how this commitment should be carried out and, secondly, what social commitment should be put forward in the light of the institutional and cultural differences across Europe. These two key questions are intertwined and are strongly related to the belief that Europe needs to turn away from solidarity as expressed by redistributive policies towards a form of solidarity consisting of policies that would effectively enable individuals, regions and countries to operate successfully in an international market. This current trend in public policy-making on a European as well as national level seems to point up the absence of any belief in Europe’s ability to sustain the national welfare states as currently configured. This is tantamount to a questioning of its capacity to insulate social entitlements from economic pressure and to take social and labour standards “out of competition”.

This paradigm shift is rooted in the belief that European integration has intensified competition rather than suspended it. This is true not only of competition in

goods and services, but also very much with regard to capital and labour. And this intensified competition calls for new types of solidarity. Accordingly, it has increased the responsibilities of national politics, especially in relation to the matter of upholding social standards, while simultaneously transferring other policies to the supranational level. Though a substantial share of economic policy has been transferred to the European level, nation-states continue to be the principal sites of political action in Europe with respect to social issues (Goetschy, 2006).

This paradigm shift about how solidarity should be organized – with respect both to types of policy and where the responsibility should be anchored – is, in a sense, shared by many different actors on the European level and in the nation states (Pochet, 2006). All are therefore, to a certain extent, working towards the same goal. However, the question remains as to whether this is the right strategy, and whether, furthermore, it is an appropriate response to citizens’ demands for a Europe that takes the high road and not the low road. Events of the past year have provided enough evidence to claim that this perception of European integration is not sustainable, and that to uncouple the economic Europe and the social Europe is in certain respects highly naïve and at odds with reality, now that the practice of regime competition is knocking ever more loudly at the door.

In taking stock of developments in recent years, as well as of the foundations, progress and viability of Social Europe, evidence seems to point towards a trend of sidetracking social concerns, and emphasizing competitiveness as the main item on the agenda. The current lack of genuine European-level initiatives with regard to establishing a Social Europe, and the firm belief that competitiveness is the only key to solidarity, point in the direction of the trends and mechanisms of a break with the emphasis on the need for redistributive solidarity and towards what Wolfgang Streeck calls “competitive solidarity”.

What is meant by competitive solidarity? This term is used to describe a “new”

solidarity that is based on accepting that, given the need to “adapt to the new economic circumstances, national communities seek to defend their solidarity, less through protection and redistribution than through *joint competitive and productive success* – through politics, not *against* markets, but *within* and *with* them, gradually replacing *protective* and *redistributive* with *competitive* and *productive* solidarity” Streeck (1999). And it is at the national level that these policies are conducted.

This paragraph summarizes to a certain extent the perception of what form solidarity among many political actors should take, and may explain why, on a European level, very few binding social policy initiatives are being taken, and also why certain so-called “social initiatives” do not seem in the least bit social in the eyes of a large section of European citizenship (Jepsen and Serrano, 2006). On the contrary, some social actors perceive these initiatives – for example, the attempted revision of the working time directive – as a dismantling of social Europe. The question that is being asked, accordingly, is whether the future of Europe is to be only as a place where goods and services may be swapped freely, or whether Europe is also to be a political – and hence a social – project.

Many of the initiatives that emerge from the institutional European level are formulated in terms of competitive solidarity, e.g. flexibility and security, social policy as a productive factor, activation, growth and jobs. However, these concepts are “open” concepts that leave room for interpretation and design of the requisite implementing actions. As such, political actors have the opportunity to take up these concepts and formulate them in ways that fit the diverse social landscape of Europe.

The way in which social issues are dealt with on the European level has changed substantially. It is apparent that the expansion of the social question on the European level has been at the cost of the non-binding nature of today’s initiatives. Since the 1990s the number of social policy regulations issued at European level has

actually decreased rather than increased, in spite of the growing number of problems and the inclusion of the social question in the Maastricht Treaty, a step originally intended to accelerate the pace of social policy-making. Moreover, and more importantly, the nature of regulatory acts has also changed. The 1970s were characterized by binding regulations, imposing common standards on the Member States and their citizens; today’s social policy directives – insofar as they exist at all – typically allow for wide discretion in their implementation. Furthermore, an increasing number of social policy initiatives are restricted to issuing non-legally-binding recommendations. This approach places the will of those affected by a rule, and the “voluntary” agreements negotiated between them, above the will, or potential will, of the European legislature, thereby reflecting the principle of subsidiarity (Goetschy, 2006).

Hence, at a time when economic and monetary policy is being raised to the supra-national level, social policy is being relegated once again to the national level. However, any conclusion that there is no interconnection between these two policy spheres, insofar as they are performed on different subjects and at different levels, would be mistaken, for there are indeed clear and well-established links and spillover effects between the two policy areas, for example, excessive wage moderation, tax and regime competition, etc. The question then arises of whether this development represents an ideal situation or whether there may be a need to centralize, at least to an extent greater than is the case today, the question of solidarity on the European level.

Conclusion

The national social security systems of the European Union countries are under strong pressure from a range of common factors: changing family structures through a diversification of lifestyles; demographic shifts as a result of increased

life expectancy and low birth rates; and enhanced economic competition driven by globalization. In addition, European Union initiatives such as the Growth and Stability Pact, the Open Method of Coordination used in the fields of employment, social inclusion and pensions, and judgments issued by the European Court of Justice, limit national governments' scope for action in the face of economic crisis. These developments call into question not only the financial sustainability of social security systems but also their ability to cater to the needs of diversifying careers and household patterns.

Though one argument is that common pressure should lead to at least a political convergence (Taylor-Gooby, 2004), the still growing literature on the convergence/divergence of European welfare states provides no clear answer to this complex question. Despite the common pressures and common policy solutions proposed by the non-binding European-level initiatives, the evolution of national social protection systems remains path-dependent. On a macro level, however, the binding Growth and Stability Pact appears to have had some impact, since there is evidence of convergence in total social expenditure. Welfare states are not static entities, but in a constant process of evolution; reforms have always taken place and will continue to take place in order to adapt and respond to the new and changing needs of populations. The cognitive and normative framework shapes these changes within each national context, bringing the welfare state to new forms of equilibrium. As such, there would seem to be no doubt that national diversity within social policy will persist, and perhaps even increase (Ferrer, Hemerijck and Rhodes, 2000), despite the increasing Europeanization of social policy witnessed since the 1990s. The question is what specific forms of diversity will persist.

Notes

¹ The first two sections are heavily based on *Benchmarking Working Europe 2006*, chapter 6 and *Benchmarking Working Europe 2005*, chapter 5.

² Belgium, Denmark, Finland, France, Greece, Ireland, Italy, Luxembourg, the Netherlands and Spain.

³ The EU25 average was 22.8 per cent in January 2003.

References

- Bouget, D. (2004) "Convergence in the social welfare systems in Europe: From goal to reality" in Taylor-Gooby, P. (ed.) *Making a European welfare state?*, Oxford: Blackwell Publishing, pp. 131-150.
- COM(1994)333, A White Paper: European Social Policy – A way forward for the Union, Brussels 27 April.
- Commission of the European Communities (23.3.2006) Commission Staff Working Document: "Implementation and update reports on 2003-2005 NAPS/inclusion and update reports on 2004-2006 NAPS/inclusion," SEC(2006)410, Brussels.
- ETUI-REHS (eds.) (2005) *Benchmarking working Europe 2005*, Brussels: ETUI.
- ETUI-REHS (eds.) (2006) *Benchmarking working Europe 2006*, Brussels: ETUI.
- European Commission (2006) *Joint Report on Social Protection and Social Inclusion 2006*, Luxembourg: Office for Official Publications of the European Communities.
- Eurostat (2006a) *European social statistics. Social protection. Expenditure and receipts* Luxembourg: Office for Official Publications of the European Communities.
- Eurostat (2006b) "Social Protection in the European Union", *Statistics in Focus*. Population and social conditions No. 14/2006.
- Eurostat, ESSPROS database, extraction 2005 and 2006.
- Ferrera, M., Hemerijck, A. and Rhodes, M. (2000), *The Future of Social Europe*. Lisbon: Celta Editora.
- Goetschy, J. (2006) "Taking stock of social Europe: is there such a thing as a community social model?", in M. Jepsen and A. Serrano Pascual (eds.) *Unwrapping the European Social Model*, Bristol: Policy Press, pp. 47-72.
- Hemerijk (2006) *Recalibrating Europe's Semi-Sovereign Welfare States*, WZB discussion paper No. SP I 2006-103, Berlin, WZB.
- Jepsen, M. and Serrano Pascual, A. (eds.) (2006) *Unwrapping the European Social Model*, Bristol: Policy Press.

- . (2005), "The European Social Model: an exercise in deconstruction", *Journal of European Social Policy*, Vol. 15, No. 3, pp. 231-245.
- Pochet, P. (2006) "Debate around the social model: Evolving players, strategies and dynamics", in Degryse, C. and Pochet, Ph. (eds.) *Social developments in the European Union 2005*, Brussels: ETUI-REHS, pp. 79-100.
- Rolf, G. (1988) "Kontroversen über Begründung und Ausgestaltung staatlicher Versicherungs- und Umverteilungspolitik", in Rolf, G. et al. (ed.) *Sozialvertrag und Sicherung. Zur ökonomischen Theorie staatlicher Versicherungs- und Umverteilungssysteme*, Frankfurt/New York: Campus.
- Saari, J. (2006) "The Europeanization of social protection", in Saari, J. (ed.) *The Europeanization of social protection*, Ministry of Social Affairs and Health, pp. 7-46.
- Scharpf, F. W. (1999) *Governing in Europe: effective and democratic?* Oxford, UK: Oxford University Press.
- Streeck, W. (1999) "Competitive solidarity: Rethinking the European social model", MPI working paper 99/8, Cologne.
- (1995) "From market making to state building? Reflections on the Political Economy of European Social Policy", in Leibfried, S. and Pierson, P. (eds.), *European social policy. Between fragmentation and integration*, Washington, DC: The Brookings Institution, pp. 389-431.
- Taylor-Gooby, P. (2004) "Introduction. Open markets versus welfare citizenship: Conflicting approaches to policy convergence in Europe", in Taylor-Gooby, P. (ed.) *Making a European welfare state?*, Oxford: Blackwell Publishing, pp. 1-16.
- Välimäki, K. (2006) "Seeking a new balance", in Saari, J. (ed.) *The Europeanization of social protection*, Ministry of Social Affairs and Health, pp. 261-277.
- Zeitlin, J. and Pochet, P. (eds.) (2005) *The open method of coordination in action: The European employment and social inclusion strategies*, Brussels: SALTSA, P.I.E. Peter Lang.
-

Pension reform in Austria and the role of trade unions

The Austrian pension system is a case study of the process which seeks to reverse the historical consensus in many European countries about the participation of all in the decisions and the wealth of society and the role of trade unions in balancing reforms and preparing social protection for new challenges.

Eva Belabed
Chamber of Labour
Austria

A history of the pension system and the role of trade unions

In Austria the first pension system for civil servants goes back to Maria Theresia¹ (1740–80). In the nineteenth century the labour movement played an important role in the development of social protection in Austria. In the mid-1880s trade unions started their first broad attempts to organize workers with a view to improving working conditions. Private sector employees created their first pension system (*Pensionskasse*) in 1902. In 1909 the first law on pensions for private sector white-collar workers entered into force. The first pension for blue-collar workers was created in 1939.

After the Second World War, political leaders in Austria decided to build on co-operation rather than confrontation. The system of social partnership was developed which gave social partners – and thus trade unions – a big stake in the political decision-making process and in running social protection systems.

The benefits of the Austrian pension system were continuously improved. This was doubly important because the pension system also served as a substitute for other policy areas, e.g. employment policy. In the 1980s and early 1990s the unemployment effects of economic restructuring were cushioned by early retirement. This is why the real retirement age (after

a massive decrease in the 1970s) continued to decrease in the 1980s (for women even in the 1990s).

The neoliberal backlash which started around the world in the 1970s and 1980s threatened the progress in the development of pension systems and the overall social achievements of the twentieth century. Social protection, social market economy, social dialogue and co-determination were declared to be no longer affordable in a globalized world. In order to become or stay competitive it was argued that Europe had to strengthen its economy and scale down its social protection systems.

The attacks on pensions are simply part of a wider attack on living and working conditions and on the European model of society.

From the 1980s on, reforms of the Austrian pension system were aimed at adapting the system and its financial viability to economic and social changes. But there were fundamental differences between the reforms up to 1999 and those after 2000 when a right wing coalition government took power. Up until the 1997 reforms one could argue that pension reforms tried to make the existing system sustainable without attacking the achievements of the past. From 2000 on, pension reforms were part of a reform agenda aimed at reversing the existing scheme of the distribution of income, wealth and participation.

Although at the end of the 1980s it was widely accepted that additional pension reforms were necessary there was a broad disagreement on how and to what extent. The new Government in 2000 had a clear agenda of strengthening the second and third pillar of pension systems. In an attempt to keep public and political opposition as small as possible, the government tried to bypass trade unions and other political and social groups by rushing a series of reform proposals through parliament, based on the principle that “speed kills”. The result of their work was partly so poorly executed that the political opposition and the social partners successfully challenged some of the new laws in court.

With this experience and in the light of increasing public opposition, the Government changed their attitude and started to consult social partners again – in part because some of the issues were politically challenging and they preferred to share the risk with the social partners.

The axis between the social partners, which had been legendary over decades, experienced a more uneven period in the early years of the right wing government, but in the last few years there has been more cooperation. A recent conference on the future of social partnership in Austria has confirmed the conviction that social partnership is an important element in Austrian politics.²

The pension system in Austria

The central element of Austria's pension system is its first pillar, the public pay-as-you-go (PAYG) pension system. Occupational and private pensions (second and third pillars) do not have a significant presence (yet).

The public pension system – The first pillar and the central element

The Austrian public pension system is a comprehensive PAYG, defined-benefit Bismarck-type system. The system has a very

high coverage (93 per cent).³ It is mandatory for every worker except a small group of self-employed persons and those with very low earnings (such as atypical and precarious types of employment).

The separate systems for workers (white-collar and blue-collar), farmers, self-employed and civil servants were harmonized in 2005, although with long transition periods which resulted in a complicated system.

The public pension scheme provides old-age pensions, disability and survivor's benefits. The statutory retirement age for a standard old-age pension is 60 for women and 65 for men. In 1992 it was decided to raise women's statutory retirement age gradually until it reaches that of men. Persons are entitled to an old-age pension if they have accumulated at least 15 years of contribution.

Replacement rates in Austria are relatively high compared to other countries: gross replacement rates for lower and average incomes are around 78 per cent (OECD: 57 per cent).⁴ This is expected to decrease after the reforms. Figures on net replacement rates differ: while the EU sees them as being around 80 per cent (2005), the OECD sees them around 90-93 per cent (2005).

The Austrian pension system has no provision for a minimum pension. However, a means-tested support is incorporated in the system for persons who do not reach a minimum income level.

When the system for workers was created, the finance structure agreed upon was one-third by contributions of workers, one-third by contributions of employers and one-third by government. In the meantime the government's contribution has been cut to 24 per cent (Knell, 2005).

The pension insurance contribution rate is 22.8 per cent of the contributory wage (which is only that part of the wage which is below a defined upper earnings threshold) of which 10.25 per cent is paid by the worker and 12.55 by the employer.

The contribution rate for self-employed persons in commerce, industry and trade and for farmers is currently 15 and 14.5 per cent, respectively. When the pub-

lic pension system was extended to farmers and other self-employed persons contributions were fixed at a rate similar to the employees' contribution rate, with the government taking over a "fictitious employer share". Some groups of freelance professionals pay 20 per cent.⁵

As a result of this the Government's share in financing pensions is higher for farmers and the self-employed than for workers. This preferential treatment for different parts of the workforce constitutes one of the major criticisms raised by trade unions.

Numbers given on the share of pension expenditure in GDP vary according to the ideological position of the authors. While the World Bank sees the share of pension expenditure in Austria at 14.5 per cent,⁶ other sources calculate it at 10-11 per cent, depending on the year.⁷ When comparing these numbers with other countries one must compare apples with apples, i.e. compare the respective pillars and take into account that benefits are higher in the Austrian system.

Occupational pensions in Austria

Occupational pensions do not play an important role in Austria. Only 7 per cent of the pensions paid come from occupational pensions; 93 per cent come from the public PAYG system.⁸

In 1990 the government created the legal framework for establishing occupational pension funds (*Pensionskassen*) on the basis of which a number of single-company or multi-company pension funds were created. This created the possibility for workers of maintaining their entitlements when they changed employer.

In 2003 the Government, in an attempt to broaden the occupational pillar, started reform of the severance payment (*Abfertigung*). The result, however, based on a model suggested by the social partners, only changed the conditions for eligibility and entitlement.

There are two types of pension fund: single and multi-employer. Currently,

there are 14 single and seven multi-employer pension funds.⁹ Twenty per cent of the market volume is managed by single-employer pension funds and 80 per cent by multi-employer pension funds; 90 per cent of the latter is managed by the four biggest funds.

An employer and a pension fund sign a contract which is based upon an agreement (*Betriebsvereinbarung*) between the works council and the employer, and which determines the size of contributions by an employee and the employer, as well as the types of investments accepted.

The legal structure of the fund includes a general assembly (all shareholders¹⁰ and beneficiaries have the option to participate). Trade unions and/or shop stewards are represented in the supervisory board (four representatives of shareholders and two of beneficiaries)¹¹ as well as in different advisory committees.¹²

The contribution of trade unions

The Government's reform of severance payments was a contentious issue.

Based on a model proposed by the ÖGB¹³ which was supported by 88 per cent of the members who answered the ÖGB's questions on the reform, the social partners reached an agreement with the Government on the conditions for payment. While the Government wanted to establish this as an element of occupational pensions, the reform in fact was limited to changing the eligibility and entitlement to payments.

During the reform process GPA,¹⁴ the white-collar workers union, focused on socially responsible and sustainable investment (SRI). Although there is no legal obligation, most pension funds (*Pensionskassen*) have committed voluntarily to SRI and some of them have agreed to be subject to an independent evaluation.¹⁵ The Institute for Social Science and Economics (ISW)¹⁶ and the GPA jointly organized conferences and published a book on SRI.¹⁷

Private pensions in Austria

Private pensions do not play an important role in Austria. Traditionally they take the form of life insurance.

Since 2003 the Government, in an attempt to develop a third pillar of pensions, has supported and subsidized a new instrument (*prämienbegünstigte Zukunftsvorsorge*) to which currently 470,000 persons have subscribed.¹⁸

In addition, the Government is publicizing the view that people will not receive sufficient pensions from the public system and they therefore need to prepare individually for their retirement. These campaigns are already showing effects.¹⁹

Pension reform in Austria since 2000

The Austrian pension system has been subject to numerous reforms, which until 1997 were primarily aimed at improving the system and making it sustainable. The post-2000 reforms, however, focused not only on the sustainability of the system but also at fundamentally changing its structure and benefit levels. These changes aimed at decreasing the relative importance of the public pension by introducing and promoting occupational and private pensions. There were two major reforms in 2003 and 2004, which are briefly outlined below.

The 2003 pension reforms

The original plans of the Government included the following elements:

1. Immediate reduction of the value of new pensions by at least 20 per cent, in some cases by up to 50 per cent;
2. Reduction of pensions for younger people by up to 40 per cent; and
3. Immediate abolition of early retirement.

Although the social partners jointly asked the Government to withdraw the plans, the Government pushed ahead. This led

to the first nationwide strikes in Austria in more than 50 years.

As a result of these massive protests, the Government watered down their proposals:

- Cuts to pension benefits were limited to 10 per cent;
- Transition periods were introduced for the abolition of early retirement; and
- An alternative was created that allowed for early retirement via long-term insurance (*Hackler-Regelung*).

This outcome clearly shows the importance of strong worker organizations. Trade unions and the Chamber of Labour in a combined effort analysed the effects of the government proposals and successfully mobilized resistance.

The 2004 pension reforms

As a result of the unions' campaign in 2003 the Government, when it started a process of reform in 2004, involved the social partners from the beginning. Although it was not possible to reach agreement during the process of negotiations, the trade unions developed a model for pension reform – the “Austria Pension” (*Österreich-Pension*) – which the Government could not ignore.

The unions were successful in having their own reform agenda reflected in the government's final package:

- The newly created personal pension account is a defined benefit scheme: the Government had wanted a defined contributions (DC) account with undefined benefits;
- Fair revalorization of former employment periods;
- Federal payments remain an essential element of the pension system;
- Improved (although still inadequate) revalorization of child care periods; and
- Early retirement remains an option through a “corridor pension” – a pension can be claimed in an age corridor between

62 and 65 with a reduction and between 65 and 68 with an addition – although this corridor disadvantages women, as it is available only from age 62 and the statutory retirement age of women is 60.

Some points were simply not acceptable, but the Government insisted:

- Double reductions for the corridor pension (lower benefits through shorter periods of contributions plus an additional reduction to discourage early retirement), exclusion of women from the corridor pension and an increase in retirement age for long term insured (*Hackler-Regelung*);
- There will be three parallel systems of pensions for decades to come;
- Harmonization has not been achieved;
- An erosion of public confidence in the public pension system;
- Increasing unemployment amongst older workers is not reflected in the pension reforms; and
- Devaluation of the guaranteed minimum interest rate on the capital in the occupational pillar.

Pension Reform in Austria – Internal and external views

In a survey carried out by the WIFO,²⁰ 59 per cent of respondents were concerned about the financing of the public pension, 40 per cent thought occupational pensions were very important and a further 35 per cent thought they were very important, and 58 per cent were concerned about the effects the financial markets were likely to have on occupational schemes.²¹

Evaluations of the pension reforms differ depending on the interests and political agenda of the actors.

The Austrian government is convinced they have secured pensions “until 2050” and that “for future generations” there will be increased pensions (indexed to inflation) and the benefits of occupational and private

pensions. The opposition parties say that pensions have not been made safe, but have been cut, with decreased purchasing power for retirees, especially women’s pensions which are barely at a subsistence level.

The IMF in its Article IV Consultations with Austria in 2005 concluded that:

... pension reform is well advanced, including through the recent harmonization of pension schemes. Additional tasks remain regarding the need to also include pensions of civil servants at the subnational level in the unified system.²²

Some authors point out that Austria has one of the world’s highest pension expenditures relative to GDP, largely because of the generosity of its pension system.²³ The OECD welcomes the reforms but is critical about the remaining possibilities for early retirement and part-time employment for older workers.²⁴

The Council of the European Union stated that:

... the pension reforms of 2003 and 2004 are set to provide substantial budgetary relief in the long term. After the pension reform of 2003, Austria passed a further pension reform in 2004 (*Pensionsharmonisierung*), with the aim of bringing all groups of private and public sector employees into a harmonized pension system. The significant contribution of the 2004 law to long-term financial sustainability is being back-loaded to take effect only after 2030, while the medium-term savings from the 2003 law are partly reduced.²⁵

Trade unions are aware of the need for reform of pension systems to meet the challenges of demography and changes in the economy and society. This does not include, however, the aim of replacing existing and well-functioning PAYG systems by funded systems just for the sake of privatizing existing systems, developing the capital markets and creating business opportunities for financial actors.

At the same time reforms within the system – such as increasing the statutory and early retirement age – have to be accompanied by complementary policies in

the labour market and economic policies to create the necessary jobs.

The financial basis of pension systems needs to be adapted to changes in the creation of value added. This means instead of shifting the burden more and more on to the shoulders of workers alone there needs to be a broader financial base, including contributions by workers and employers, value added elements (e.g. the contributions of employers to be based on the value added and not just on salaries) and eventually tax elements. Furthermore, funded systems face demographic challenges as much as do PAYG systems, albeit in a different way.

In addition to this, the short-termism of capital markets has negative effects on the real economy and the increasing creativity of financial actors (hedge funds and the like) even worries the European Central Bank, which is concerned that hedge funds increase the systemic risk for the world economy.

The influence of trade unions on pension policy and governance

Trade unions in Austria are part of the social partnership and thus involved in political decision-making. Social policy in Austria has long been shaped by the social partners whose proposals have then been debated by parliament. The Minister for Social Affairs has for decades been a representative of the trade unions. The social partners have managed the pension system, which is a self-governing body.²⁶

Austria together with Denmark, Ireland and the Netherlands, are the four small countries in Europe which the ILO identified as having been particularly successful in coping with their economic problems. This had mainly been due to a process of concertation or consensus-building which resulted in political success. The result was better economic performance, higher labour market participation rates for men and women and lower unemployment.²⁷

In Austria, when the right wing coalition government took power in 2000 there

was considerable change. In contrast to Austria's long tradition of tripartism on social security policy, the government launched far-reaching reform without such consultation, thus challenging the system of social partnership.

However, May and June 2003 marked a turning point. Pension reform in 2003 provoked the largest strike action in Austria for 50 years.²⁸ For the first time in decades the ÖGB called for a national day of action, including strikes. About 500 000 workers participated all over Austria in about 10 000 activities, such as workplace meetings, rallies, strikes, blockades and demonstrations. This was followed a week later with a major manifestation on Heldenplatz in Vienna's inner city. On 3 June more than one million workers, which is around a third of the country's total workforce, from 18 000 workplaces all over Austria, heeded the strike call and took industrial action.

The main challenges to reforming pension systems

The challenges to pension systems are the vested interests which lay behind the most recent reform agenda. Pension reform is not just about securing pensions; it is part of a broader attack on living and working conditions which aims at dismantling the achievements of the twentieth century.

For several years now there has been a general attack on the levels of social protection. Cohesion and solidarity within society are values losing weight as philosophies of individualism gain importance and the role of the State is questioned increasingly. Public services and social protection systems are reduced and/or privatized and the participation of social partners in political decision-making is cut back.

The driving forces behind these developments are those who benefit from a deregulated world – among them the financial institutions and investors – where the strong get their way and the weak are left behind.

We are moving from a society based on economic and social cohesion, oriented

around the principles of consensus and social and civil dialogue, towards a society with increasing inequality of income and wealth, decreasing influence of some groups of citizens on the decisions taken in society and an increasing orientation towards conflict.

Is the welfare state truly no longer affordable? Or is the debate instead about privatizing social protection – and pension – systems? What models of society underpin the reform options? Do countries with an active labour market policy and social dialogue cope better with the problems?

Against the background of globalization, liberalization, privatization and deregulation, we face an increasing competition between two models of society with differing sets of values and objectives: the European model of society based on the principles of economic, social and territorial cohesion on the one hand, and the Anglo-Saxon model based on individual risk and responsibility on the other.

For some time now, we find ourselves in a process which aims at reversing the historical consensus in many European countries about the participation of all in the decisions and wealth of society.

The aims are clear: Reduce the role of the State where decisions are subject to democratic participation by citizens and social partners and where the aim is a fair of overall wealth; at the same time, enlarge private systems and the space for action by private actors.

The consequences of this trend include:

1. Citizens – and workers – have less influence on decisions;
2. The distribution of income and wealth created in society becomes more uneven;
3. The financial risk, e.g. in funded pension systems, is transferred entirely to the workers;
4. The original principle in pensions of cost-sharing between employers, workers and the State is increasingly abandoned and replaced by placing the burden on workers alone;

5. The room for action by companies and especially actors on the financial markets is increased; and
6. Workers find their opportunities for participation in society's decision-making reduced and their economic situation deteriorating, with the consequence that they have less capacity to oppose unfavourable policy decisions while conversely the opportunities increase for private sector actors to influence and drive the policy agenda.

This presents a considerable challenge for all those who support a policy of consensus and economic and social cohesion. Social partners and organized civil society, along with political parties, have an important role to play in the development of democracy.

Against this background – and in a world where 80 per cent of the working-age population do not have access to basic social protection²⁹ – Europe has a crucial role to play in defending, developing and promoting its European model of society, so as to present an alternative.

The actors concerned and involved in pension systems and their reforms have different interests:

- Workers and citizens want guaranteed reliable incomes for old age;
- Employers want low contributions on wages and salaries (if they contribute);
- Governments want to stabilize their budgets and thus reduce their payments;
- The financial sector wants to increase its business possibilities; and
- International organizations (IFIs, OECD) want to drive reforms in the direction of privatization, free markets, reducing the role of the State.

The challenge for trade unions is to find ways of building political support on both the national and international level to defend and develop sustainable pension systems which secure decent old-age incomes. At the same time, unions must deal with the challenges

of the increasing impact of financial actors and markets on the real economy. Conversely, unions should attempt to exploit the new levers offered by workers' participation in funded pension systems, which see workers as the indirect owners of an increasing part of the corporate world (which was certainly not the intention of those who drove pension reforms).

Building support includes continuous dialogue with workers and citizens on developments and challenges, and identifying potential allies and cooperating with them, thereby strengthening trade union cooperation on the supra-national level.

The strange thing in the ongoing debate on the need for reform of pension systems is the argument that the richest and most productive economies in the world are not able to finance a decent life for their decreasing population!

Notes

¹ Empress of Austria and Queen of Hungary and Bohemia (1740-80).

² Social Partner Conference in Bad Ischl, September 2006, celebrating 60 years of social partnership in Austria and issuing a Declaration of the Social Partners, <http://www.sozialpartner.at>.

³ Buzolich et al. (2003), p. 202.

⁴ OECD: *Pensions at a glance*, 2005

⁵ Buzolich et al. (2003), p. 202ff.

⁶ Robert Holzmann (2004): *Toward a Reformed and Coordinated Pension System in Europe: Rationale and Potential Structure*, The World Bank, Washington, D.C., March 2004, p. 36.

⁷ Cf. http://www.reformmonitor.org/httpd-cache/doc_reports_2-2739.html; Gerald Reiter (2005), p. 186.

⁸ Christian Böhm (2007).

⁹ Christian Böhm (2007).

¹⁰ Shareholders of *Pensionskassen* are the companies involved as well as banks and insurance companies.

¹¹ Beneficiaries are the workers involved; they are usually represented by shop stewards or trade unionists.

¹² Christian Böhm (2005).

¹³ *Österreichischer Gewerkschaftsbund* (Austrian Trade Union Federation).

¹⁴ GPA = *Gewerkschaft der Privatangestellten*, which is the private sector white-collar workers' trade union.

¹⁵ The Austrian Trade Union Federation.

¹⁶ *Institut für Sozial- und Wirtschaftswissenschaften* (ISW – Institute for Social Science and Economics), which is the research institute of the Chamber of Labour in Upper Austria.

¹⁷ Sallmutter, Freyschlag (2001).

¹⁸ Knell (2005).

¹⁹ See the section "Pension reform in Austria – internal and external views", below.

²⁰ WIFO = *Österreichisches Wirtschaftsforschungsinstitut* (Austrian Institute of Economic Research), available at: www.wifo.at

²¹ See <http://globalpensions.com/?id=me/17/news/27/31663/19>

²² See www.imf.org

²³ Manfred Koch, Christian Thimann (2004).

²⁴ See http://www.oecd.org/document/54/0,2340,en_2649_201185_34932982_1_1_1_1,00.html

²⁵ Council of the European Union, Brussels, 18 January 2005, 5498/05, UEM20, Stability Programme of Austria.

²⁶ Although there have been some changes over the past years such as trying to reduce its independence and to increase the influence of government.

²⁷ Peter Auer (2002).

²⁸ See <http://www.eiro.eurofound.eu.int/2003/05/feature/at0305202f.html>; http://www.oegb.at/servlet/ContentServer?pagename=OEGBZ/Page/OEGBZ_Index&n=OEGBZ_e_0.a&cid=1061374664784

²⁹ Juan Somavia (2001).

References

Arbeiterkammer – *Positionen und Forderungen zu den Pensionsreformen*, available at: www.arbeiterkammer.com

Arbeiterkammer (2003): *Stellungnahme der Bundesarbeitskammer an das BM für soziale Sicherheit und Generationen und Konsumentenschutz vom 24.4.2003 zum Budgetbegleitgesetz 2003*.

Arbeiterkammer (2004): *Stellungnahme der Bundesarbeitskammer an das BM für soziale Sicherheit, Generationen und Konsumentenschutz vom 7.10.2004 zum Pensionsharmonisierungsgesetz*.

Arbeiterkammer Wien (2006): *Das neue Pensionsrecht – für wen gilt was im Jahr 2006*, Vienna, 2006.

Arbeiterkammer Wien (2005): *Pensionsreform 2004 – ungerecht – unharmonisch – unverständlich*, Vienna.

Arbeiterkammer Wien (undated): *Zur Geschichte der Arbeiterkammern in Österreich*, available at: www.wien.arbeiterkammer.at

Auer, Peter (2002): *Institutionelle und politische Voraussetzungen für Arbeitsmarkterfolge in Europa*, in WISO Nr. 2, 2002, pp. 13-44, ISW, Linz, 2002.

- Böhm, Christian (2007): *Pensionskassen – die zweite Säule der Alterssicherung*, Presentation in Bad Mitterndorf, Austria, 2007.
- (2005): *Pension Fund Governance of Occupational Pension Funds in Austria*, OECD, 2005.
- Buzolic Gerhard, Bernhard Felderer, Reinhard Koman and Andreas Ulrich Schuh (2003): in: Arno Tausch (ed.): *The Three Pillars of Wisdom? A Reader on Globalization, World Bank Pension Models and Welfare Society*, Nova Science Publishers, New York, 2003.
- Die Presse (2006): *Österreichs Pensionskassen im internationalen Vergleich; Mercer untersucht Performance in neun europäischen Ländern*, available at: <http://www.presstext.at/pte.mc?pte=060228014>, visited on 28.2.2006.
- Council of the European Union (2005): *Council Opinion on the Updated Stability Programme of Austria*, Brussels, 18 January 2005, 5498/05, UEM20.
- Die sozialrechtliche Entwicklung in Österreich seit 1889, available at: www.demokratiezentrum.org
- Gewerkschaft der Privatangestellten (2004): *Pensionsreformen in der EU: Risikoprivatisierung oder notwendige Zukunftssicherung?*, Vienna, 2004.
- Gligo, Claudio (undated): *Pensionskassen in Österreich – Struktur und Funktionsweise*, Österreichische Volksbanken-AG, Vienna.
- Global Pensions, available at: www.globalpensions.com, various articles.
- Hauptverband der österreichischen Sozialversicherungsträger (2006): *Die österreichische Sozialversicherung in Zahlen*, 17th ed., Vienna, August 2006.
- Ivansits, Helmut (2006): *Warum die Pensionsreform nicht hätte scheitern müssen – eine kritische Bestandsaufnahme*, in: Sepp Wall-Strasser et al. (eds.): *Tatort Sozialstaat – Angriffe auf das Netz der Generationen*, Vienna, ÖGB-Verlag, 2006, pp. 105-125.
- IMF (2005): *IMF Executive Board Concludes 2005 Article IV Consultation with Austria*, available at: www.imf.org, visited on 25.7.2005.
- (2004): *IMF praises Austria for “courageous” pension reform*, available at: www.globalpensions.com, visited on 14.5.2004.
- Keuschnigg, Christian and Mirela Keuschnigg (2004): “Aging, Labor Market and Pension Reform in Austria”, in: *FinanzArchiv* 60 (2004), pp. 359-392, Mohr Siebeck 2004.
- Knell, Markus (2005): *Situation und Probleme der Alterssicherung in Österreich*, ZHW Winterthur, 18-20 May.
- Koch, Manfred and Christian Thimann (2004): *From Generosity to Sustainability: The Austrian Pension System and Options for its Reform*, available at: <http://www.springerlink.com/content/w580145r6v610440/>
- Leutner, Richard (2003): “Pensionsreform: Geldbeschaffung statt Pensionssicherung”, in AK Wien (ed.): *Arbeit & Wirtschaft*, 7-8/2003.
- Mum, David (2004): “Die Auseinandersetzungen zur österreichischen Pensionsreform 2003, Nachhaltige Pensionssicherung; Pensionsreformen und die Interessen der ArbeitnehmerInnen”, in: ISW (ed.): *WISO* No. 3/2004, pp. 98-118.
- OECD (2005): *Pensions at a glance: Public policies across OECD countries*, Paris, 2005.
- (2003): *OECD Economic Survey of Austria 2003: Pensions*, Paris, 2003.
- Österreichischer Gewerkschaftsbund (2003) (ed.): *Abfertigung Neu – Die praktische Info-Broschüre für ArbeitnehmerInnen*, Vienna, 2003.
- (undated): *Positionen und Forderungen zu den Pensionsreformen*, available at: www.oegb.at
- Österreichische Sozialversicherung (undated): available at www.sozialversicherung.at
- Part, Peter and Hans Stefanits (2001): *Public Pension Projections 2000 – 2050, Contribution to the Work of the EU Economic Policy Committee on the Financial Impacts of Population Ageing*, Working Paper 7/2001.
- Pensionskassen: Firmenpension wichtiger als Betriebskantine, available at: www.fondsprofessionell.at, visited on 8.11.2005.
- Reiter, Gerald (2005): Neoliberalismus und “Pensionsreformen” in: ISW (ed.): *WISO* No. 1/2005, pp. 182-193.
- Sallmutter, Hans (2004): *Nachhaltigkeitsprüfung von Mitarbeiterversorgungskassen auch ein Erfolg der GPA*, available at: http://www.oegb.at/servlet/ContentServer?pagename=OEGBZ/Page/OEGBZ_Index&n=OEGBZ_Suche.a&cid=1080806640843, visited on 2.4.2004.
- , Fritz Freyschlag (2001), (ed.): *Ethische Investments, Sind Moral und Rendite vereinbar?* ÖGB Verlag, Wien, 2001.
- Schmitz, Stefan W. (2005): “Die Governance-Struktur der Pensionskassen in Österreich und ihre polit-ökonomischen Konsequenzen”, in: AK Wien (ed.): *Wirtschaft und Gesellschaft*, 31. Jahrgang (2005), Vol. 3, pp. 407-443.
- Somavia, Juan (2001): *Decent work – A global challenge*, Speech at the European Commission Conference on the European Social Agenda and the EU’s International Partners, Brussels, November 20-21, 2001.
- Url, Thomas (2003): *Die Entwicklung der betrieblichen Altersvorsorge in Österreich*, WIFO Papers and Proceedings, Vienna, 2003.
- Wirtschaftskammer Österreich (2005), <http://portal.wko.at> and www.pensionskassen.at, various articles and information on occupational pensions, e.g. http://www.oepag.at/bilder/FV_Betriebspensionen_0623.pdf; http://www.oepag.at/bilder/FV_Zusatzpension.pdf
- Wirtschaftskammer Österreich (2005): *Pensionskassen – Jahresrückblick 2005*.
- Wöss, Josef (2006): Sozialpolitik 2000 – 2006: *Bilanz Arbeitsrecht*, in: AK Wien (ed.): *Arbeit & Wirtschaft* 7-8/2006, pp. 8-11, Vienna.

Reforming the Romanian state pension system and the role of trade unions

In post-communist Romania, the state pension was used as a de facto unemployment benefits scheme. The consequent growth in beneficiary numbers, coupled with a halving of the formal sector workforce, caused huge fiscal imbalances in the pension system. The governmental response has been to implement a three pillar system, characterized by poor benefits for workers and poor investment returns. As unions campaign for reforms they are hampered by a lack of access to technical expertise.

Petru Sorin Dandea

Vice-president

National Trade Union Confederation

“Cartel Alfa”

The pre-reform scene

Until the early 1990s, Romania had several social security systems, each of them traditional models of defined contribution/defined benefit and pay-as-you-go (PAYG) schemes.

These social security schemes were generally based on an employment relationship. In respect of all employees there was a legal obligation for both the employer and employee to contribute to the pension fund. For self-employed persons and those with atypical work contracts the system was voluntary and the level of participation low.

Regulations also existed regarding the compulsory supplementary pension system, based on contributions paid by employees. The covered risks were: old age, disability, survivorship, sickness, maternity and work-related injury and illness.

The social security system in Romania was characterized, until 1992, by a high degree of diversification, with eight independent systems related to certain sectors of activity or professions. Besides the state social security system, at that time there were pension schemes for farmers and the military, as well as smaller systems such

as for artists, the clergy, handicraft cooperatives and lawyers.

These social security systems, due to the low and generally decreasing number of contributors, could not financially meet their obligations to pay pension benefits. As a result, between 1992 and 1997 the smaller schemes were integrated into the state social security system.

The Ministry of Labor and Social Protection managed the state social security fund, the supplementary pension fund (as described above) and, from 1992, the farmers' fund. The latter was largely non-contributory, and special contributions were imposed on companies producing and/or commercializing agricultural products to finance the scheme.

In the early 1990s, the state pension system was also used as a cushion for more than 600,000 employees who lost their jobs. The Government introduced some measures to allow early retirement five years before pensionable age if a person had contributed towards insurance for 25 years for men and 30 years for women, even though it was clear that the state pension budget deficit would only continue to increase.

During the transition decade in the 1990s, the pension system was used as a

mechanism to absorb redundant labour. Although the legal retirement age was 62 for men and 57 for women, under reforms introduced in 1990 workers had the option to retire five years early, without financial penalty. The number of people receiving disability benefits also accelerated due to lax rules and due to workers claiming invalidity as a means of coping with high unemployment. The total number of beneficiaries from state and farmers' schemes rose from 3.4 million to 6.2 million between 1990 and 2001.

During the same period, the number of insured nearly halved from 8.2 million to 4.5 million in the decade from 1990 to 2000. This dramatic decline in the number of contributors was due to the combined effect of the contraction of the labour force participation rate, the rise in unemployment, the growth in the informal sector and an increased number of self-employed.

This decline in the number of contributors, coupled with the policy of absorbing redundant labour into the pension schemes, led by the end of the 1990s to a dependency ratio of around 80 per cent.

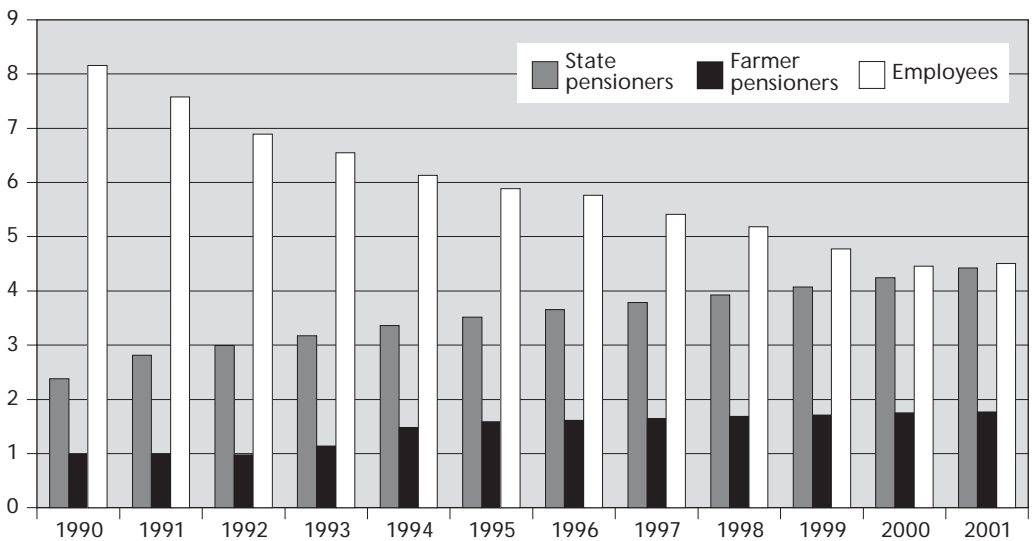
Figure 1 illustrates the decline in the sustainability of the pension system.

Having had no expertise in pension systems, the trade unions supported the measures taken by the Government. Primarily the unions' leadership believed it would be better for employees to receive a pension than to become unemployed. However, after just a few years trade unions realized that they had made a mistake: the majority of pensioners were being pushed below the poverty line.

During these years shortfalls appeared between total contributions and total benefits paid. Thus it became necessary in 1996, for the first time, to allocate funds from the Treasury, on the basis of an interest-bearing loan.

Among the difficulties facing the pension fund deficit was a significant increase in contribution evasion from the mid-1990s onwards. Many businesses, including large businesses, ceased to pay their social security liabilities due to general solvency problems. Due to this trend legislation was enacted in 1996 to strengthen the enforcement of the obligation to pay pension contributions. Between 1998 and 2001, for example, pension scheme revenue spent on debt recovery increased by nearly 1600 per cent.

Figure 1. Pension system participants, Romania, 1990-2001 (millions)



Social security reform

Due to the huge imbalances recorded by the state pension system the Government started a reform programme with two main objectives: to rebalance the state pension system and to introduce two supplementary pension pillars based on the World Bank model.

Trade unions negotiated with the Government during the development of the reforms. Unfortunately, due to a lack of pension expertise trade unions focused solely on the question of retirement age and did not focus on other important aspects such as the proposed increase of contributions by 15 per cent or the reduction of benefits from a 60 per cent replacement rate to just 35 per cent. This lack of expertise in social security matters affected the outcomes of negotiations in several ways. As an example, the trade unions accepted the Government's proposal to increase contributions by 15 per cent, mostly because of government undertakings that by the time the contributions were increased wages would have increased, preserving employees' net wages. Unfortunately, even though employees' net wages did not decrease their real wages decreased in the medium term.

The most important reform of the public pension system was the change from a

defined benefit to a defined contribution scheme, with a new pension calculation formula. Again, trade unions accepted this change, but realized after implementation that the replacement rate decreased from 60 per cent to 35 per cent.

In 2000 the first reforms took effect in the state pension system. The Ministry of Labour and Social Solidarity oversees the National House of Pensions and other Social Insurance Benefits – the agency set up by Law No. 19/2000. This legislation regulates the state system of pensions and other social insurance benefits, and took effect in April 2001 (table 1).

Following a decade of short-term policies, the new state pension scheme represented the first attempt in the post-communist era to implement more consistent parametric reforms. The main changes incorporated in the new legislative framework were:

- Enlarging the coverage of the state pension scheme to the entire formal sector labour force, including the self-employed, farmers, the unemployed¹ and civil servants;
- Increasing the required retirement age from 57 for women and 62 for men to 60 and 65 by 2014, and concomitantly raising the minimum length of service;

Table 1. The reformed state pension scheme, Romania, 2001

Contribution	Contribution rate – 2001
Social insurance – <i>employee contribution</i>	11.67 per cent
– <i>employer contribution</i>	33.33 per cent – special conditions 28.33 per cent – outstanding conditions 23.33 per cent – normal conditions
Unemployment – <i>employee contribution</i>	1 per cent
– <i>employer contribution</i>	5 per cent
Health – <i>employee contribution</i>	7 per cent
– <i>employer contribution</i>	7 per cent
Employer contribution for disability	2 per cent
Total – of which:	57 per cent (in normal conditions)
Employee	19.67 per cent
Employer	37.33 per cent

- A new benefits formula (using a points system) calculated on the entire contribution history and which penalizes early retirement on a near actuarially fair basis; and
- An increase in the contribution rate from 14 per cent to 35 per cent, 40 per cent and 45 per cent (for normal, hard or hazardous working conditions and special working conditions), calculated on the basis of gross salary.
- After the implementation of the new law in 2001, trade unions recognized the negative effects of the law on the labour market and started a strong campaign to convince the Government to introduce amendments.

The most important union demands were:

- Reducing the retirement age for men back to 62 years;
- Eliminating penalties imposed on employees working for companies that did not pay contributions on time (their pension benefit was reduced to reflect the reduced contributions);
- Maintaining the former retirement conditions for a five-year period for people working in hard or hazardous conditions;
- Extending the status of “special working conditions” to more sectors, thereby allowing earlier retirement;
- Giving trade unions the power to request on behalf of workers that the workers’ employment be recognized as hard or hazardous work, thereby winning them a higher level of employer contribution (previously only employers could make this request, which they often did not wish to do because of the higher contributions this required);
- Obliging employers to improve employees’ working conditions (often employers would choose to maintain hazardous conditions and pay higher contributions, rather than investing in health and safety improvements);
- Other measures to improve the standard of living for pensioners and employees.

The main elements of the state pension reforms related to the contribution base and the method of collecting contributions for the distinct subgroups of insured persons. However, the high rates of contribution have proved to be a factor that fosters evasion and slows down labour market recovery.

The main problem that persists with the pension system six years after implementation is the very low replacement rates, which is due to a very high dependency ratio of about 1. Low levels of employment plus a lack of political will to create a compulsory universal pension system are the principal factors which maintain the public pension system’s poor performance. Some statistics suggest there are more than two million people, such as the self-employed, military personnel, lawyers and farmers, who do not participate in the scheme, either due to refusal or through legal exemption.

The role of trade unions in pension reform

The role of trade unions before the reforms in 2001 could be summarized as follows:

- Being in a weak position in negotiations because of a lack of expertise in social security
- More concerned with maintaining existing retirement ages
- Limited appreciation of the other key issues of parametric reform, for example, the impact of changes to the benefit formula

With only one exception – the improvement of living standards for pensioners – all the other demands were finally accepted after more than four years of campaigning and after very difficult negotiations. After the new legal provisions came into effect in 2001, trade unions became members of the autonomous, tripartite National House of

Pensions and Other Social Security Rights. The power to influence pension policy is limited through this body because it has a mainly advisory rather than administrative role. That is why trade unions continue to prefer public campaigning and direct negotiations with government to promote the interests of workers.

The World Bank-backed reforms

Since 1998 the Government, assisted by the World Bank, has been trying to introduce funded, privately managed pension schemes along the World Bank's preferred three pillars model, as have been introduced in other countries in Central Europe. The main argument used by the Government in promoting the introduction of the new pension schemes was the financial imbalance confronting the state pension system. The first law introducing a second pillar scheme was passed by parliament in December 2000. In the years since there has been a series of legislation to implement the three pillar structure.

The present situation is that there is a legal framework for establishing the second and third pillars, with the intention of their taking effect in 2008. The main characteristics of the private pension schemes are:

- Compulsory; defined contribution; privately administered;
- The second pillar, 6 per cent contribution is deducted and redirected from the contributions to the state pension system;
- Compulsory for employees up to age 35 years, and optional up to 45 years;
- Administration fees – 3.5 per cent of the contribution value and 0.1 per cent from total assets each month;
- Pension companies to be regulated by the Surveillance Commission;
- Government guarantees: for actual contributions minus administration fees (and excluding interest earned).

Trade unions negotiated with the Government on the proposed supplementary pension pillars. This time, however, the trade union confederation had pension expertise as a result of technical training organized by the ILO, the World Bank and the ETUC.

The trade union confederation strongly opposed the regulations passed by parliament because they promote the interests of insurance companies at the expense of the interests of workers. The administration fees established by law are very high and will lead to administration costs of over 30 per cent. The Government's guarantee to underwrite contributions only, and not to guarantee a future pension, is completely inadequate.

Countries where the World Bank has promoted this model of reform are not normally confronted with the same population-ageing rate as OECD countries. Some of the problems in the functioning of PAYG systems worldwide are the result of poor management or political influence. In Central European countries in the early 1990s, state pension systems were used to absorb redundant workers from former state enterprises. Pension systems became unemployment mechanisms, encouraging early retirement, which engendered a powerful imbalance and a worsening of the dependency ratio. For instance, in Romania over an eight-year period the dependency ratio fell from 3.8 to 0.8.

There was a hope that funded systems would ensure a replacement ratio at least as high as the one assured by the old system, if not higher, for an equal level of contribution. But this turned out to be unrealistic. In Hungary and Poland the funds set up at the end of the 1990s have registered a negative return rate. This proves that risks associated with investing in the financial market cannot be avoided and they are going to represent a permanent threat to the real value of pensions.

In order to avoid this risk, the Hungarian pension funds have invested a significant part of their assets in government bonds. In other words, the "experts" have created a model where there is little difference

between the classical PAYG system and the privately managed investment system.

Romanian trade unions have also criticized the so-called “Chilean model”, developed in the early 1980s, which was the first funded private pension system. Research has shown that the administration costs of these funds increased to over 20 per cent of contributions. Comparing this figure with the administrative costs recorded by classical PAYG systems in Central Europe, a difference of around 15-18 per cent exists. This leads unions to the conclusion that the companies managing these funds are more focused on their own profits than in producing good pensions for workers.

The role for a future union campaign

A major criticism voiced by trade unions has been the lack of transparency in the Government’s development of the reforms. Despite the commentary in some World Bank papers that the social partners were consulted during the development of the new legal framework, this was not the case. The lack of transparency is borne out by the high degree of public confusion and ignorance about the new system, an experience shared in Croatia, Hungary and Romania. This lack of transparency has led to worker insecurity about participating in the new funds.

The new private pillar system of pensions will start to operate in 2007 for third pillar and 2008 for the second pillar.

Romanian trade unions are preparing a strong campaign in support of amendments to the proposed system, to protect workers’ interests.

The main demands of trade unions are:

- The law should promote the real goal of the reforms – better pensions for future pensioners;
- There should be separate state and private systems for making pension contributions (private contributions are currently deducted from state pension contributions);
- Occupational pension schemes to be allowed in the system;
- There should be some level of regulation of the benefits formula, otherwise workers have no capacity to predict their retirement income;
- State guarantees to be based on minimum investment returns rather than solely contributions.

This campaign will be a difficult one for trade unions because of the complexity of the issues and because of the lower level of technical expertise available to trade unions compared to government.

Note

-
- ¹ The National Authority for Employment contributes on behalf of unemployed workers.

Pension reform and trade unions in Slovakia

Slovak unions faced the questions most unions faced in post-communist States: how to preserve social tripartism, how to preserve the social protections inherent in socialist era pension systems and how to balance all this with pension system sustainability.

Mária Svoreňová

Trade Unions Confederation
of the Slovak Republic

A brief history of the pension system and the role of trade unions

The roots of the Slovak pension insurance scheme can be found in the Czechoslovak pension system, which had a shared tradition with western European countries. After the Second World War, during the communist period, the pension system was significantly altered. The statutory pension system before 1989 was, in principle, very generous, especially towards certain groups in the population. This generosity was reflected especially in the eligibility conditions rather than in the level of the benefits. All citizens were covered by the pension system preferential treatment was given to certain groups of manual workers who worked in hazardous conditions, the armed forces and high-level politicians and Communist Party leaders.

The statutory pension system in Slovakia inherited from the former Czechoslovakia covered the majority of employees and provided old-age, disability and survivor benefits. Every person reaching pensionable age (60 years for men and 53-57 for women) was entitled to an old-age pension equal to 50 per cent of his/her previous wage, but subject to certain upper limits. This pension policy was developed during the socialist era and it assumed the existence of full employment. The prime objective of the pension system was to replace income lost due to retire-

ment, disability or the death of a breadwinner. As nearly all individuals had a duty to work the pension scheme therefore provided benefits for everyone.

The value of pensions reflected wages earned prior to retirement, and with low wage differentiation in the socialist economy there was little differentiation in benefit levels. For many years pensions were rarely indexed, with the result that at the beginning of the 1990s pensioners represented a significant proportion of people living below the subsistence minimum.

The role of trade unions during the transition process of the 1990s

From the beginning of the national transition process following the collapse of the socialist state, trade unions played an important role in reforming the social security system. A newly created Trade Unions Confederation of the Slovak Republic (KOZ SR) became a powerful group representing workers and citizens, and promoting their interests under free market economy conditions. The environment in which the new, post-socialist era trade unions operated changed fundamentally during the process of comprehensive political, economic and social transformation that took place in Slovakia.¹

The most important forum for negotiations about government legislation

and policy on living standards and social security was (and is) the Council of Economic and Social Agreement of the Slovak Republic (the Council), established in 1990. The Council is an independent, tripartite body comprised of the KOZ SR, the Federation of Employers' Unions and Associations of the Slovak Republic, and the Government of Slovakia. The Council allows the parties to initiate and reach agreement on government policy and legislation. Until 1997 General Agreements were concluded annually between the social partners represented on the Council: "They provided guidance for lower-level collective bargaining on wages, health and safety, and other conditions at work, as well as containing pointers as regards policies towards employment and unemployment, and measures to reform the social security system."²

Every policy proposal or draft bill related to pensions is the subject of negotiations at the Council. The outcomes of these negotiations and any council agreement are passed to both the government and the parliament, having the nature of recommendations. The respective policy agendas formulated by each of the social partners are tabled in parliament as part of the underlying rationale of the bill or policy initiative.

In the early 1990s the KOZ SR successfully opposed the Government's attempt to increase the retirement age and to abolish the more advantageous benefits given to employees engaged in dangerous working conditions. In 1992, the Federal Czech and Slovak Parliament abolished all preferential treatment for different work categories within the pension scheme. However the KOZ SR reached agreement with the newly established Slovak Government and the employer representatives to reintroduce all these preferential benefits into the Social Security Act, where they remained until 2000. Partially these preferential benefits were replaced by supplementary insurance of workers engaged in dangerous working conditions. This supplementary old-age and disability insurance is paid for through

compulsory employer contributions, and an employee may voluntarily contribute to his/her account. Very significant was the role of the KOZ SR in promoting a better system of pensions indexation, as the link between inflation and the growth of pensions had not been clearly specified in the legislation.

The process of pension reform in Slovakia

During the 1990s there were several attempts to pass pension reform legislation, based on substantively new ideas and principles. The first reforms in the social sphere were made in 1990 when Slovakia was still part of the Czechoslovak Republic. During the ten years following the establishment of Slovakia in 1993, successive governments had all declared their intention to implement radical reform measures to the pension system, but none were successful.

Since the mid 1990s, the accession countries have made significant adjustment to such features of their public social insurance schemes as retirement age, benefit formulas, the treatment of special categories of workers, and the collection of pension contributions. Most of these are the result of political compromise, with governments having proposed larger increases initially, to be reduced through a process of negotiation with trade unions and, in some cases, with employers.³

In contrast with other accession countries, the situation in Slovakia had not been the same:

On three occasions – always during an election period – the Slovak Government has tried to implement complex pension insurance reform. In 1996 the "Social Security Transformation Programme of Slovakia" was adopted. This highlighted the need for contribution-based social insurance benefits. The programme also stressed the principle of "pay-as-you-go" financing, autonomy and unification of the compulsory social insurance system (including

old-age insurance, invalidity insurance and survivor insurance). The method of benefit calculation and the scope of social benefits remained almost the same, however.⁴

The necessity to transform pension schemes, and the solutions available to address major problems facing pensions schemes in Central and Eastern European Countries (CEEC), characterized Krzysztof Hagemeyer's keynote address to the Sub-regional Trade Union Seminar in Zagreb, October 2000:

In the upcoming decades, pension scheme financing will have to cope with growing tensions resulting from the demographic ageing process. There are only three solutions available to cope with the unfavourably changing proportion between the numbers of employed persons and pensioners: increasing the retirement age, lowering pension benefits, or increasing contributions. Contributions are already high and it is hard to imagine that a political consensus could be reached to increase them. Benefits, on the other hand, are low by international standards in most of the countries, and should be rather improved. What is left then is to encourage people to work longer and retire later.⁵

During the 1990s the KOZ SR was the main non-governmental actor actively pressuring government to develop and implement pension reform. Even though the pension scheme in Slovakia has not been sustainable and despite there having been major reforms in all neighbouring countries, no Slovak government has been able to implement major reform. In 2001, among 14 selected CEEC countries only Slovakia and Ukraine had not legislated reform of the statutory pay-as-you-go (PAYG) pension scheme.⁶

It became clear also that pension schemes developed during the socialist era could not cope with the economic and demographic conditions of the post-transformation society: the evolution of a market economy, high levels of unemployment and an expected decline in the youth dependency ratio (see figure 1). The

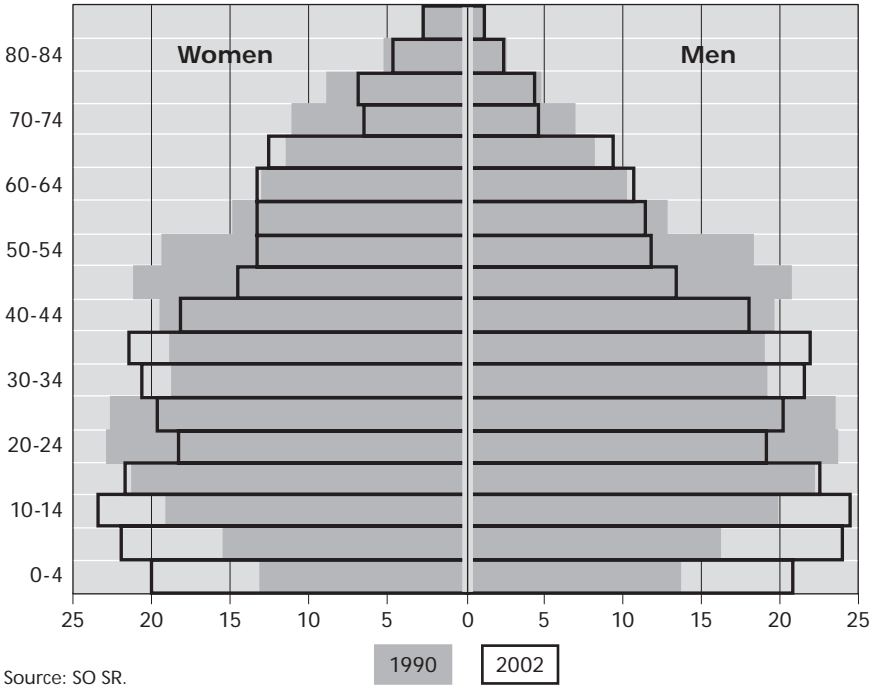
need for a substantial reform of the pension scheme was widely recognized not only by technical experts and politicians, but also by the general public.

A significant motivation for transforming the pension system was the argument about the ageing of the population and the resulting dependency ratio. However, as figure 1 shows, the population structure of Slovakia has a high proportion of people in the younger age brackets of working ages (which is a higher proportion compared to the EU 15 average) and this relativity will remain for several decades. The expected elderly dependency ratio in Slovakia will only increase from 16.5 per cent in 2000 to 29.6 in 2030, while in Western European countries it would be from 23.6 per cent to 41.6 per cent respectively.⁷

Transformation of the pension system into a pension insurance scheme commenced in 1999 when the government prepared its "Draft Concept of Social Insurance Reform" for public discussion. A survey (with 14,796 respondents) carried out by the Research Institute of Labour, Social Affairs and Family appeared to confirm Slovak citizens' willingness to participate more actively in providing for their old age and to receive benefits based on contributions. However, a survey published in *Labour and Social Policy* (No. 1-2/2000) found that citizens were not willing to renounce the existing system: two-thirds of respondents were against raising the retirement age.⁸

Another strong impulse for pension reform was the result of the autumn election in 2002, when a coalition of solely right wing parties won power. Immediately after the creation of a new government all poverty alleviation benefits were drastically reduced and a new, more individualistic policy of pension reform was adopted. This strong change in social policy resulted in the new government issuing in spring 2003 a paper "Concept of Pension Security Reform in the Slovak Republic" (the "Concept"). This paper was discussed at the Council of Economic and Social Partnership (the primary tripartite body for national discussions

Figure 1. Population structure in Slovakia, 1990 and 2002 (thousands)



Source: SO SR.

on policy and governance), where the KOZ SR strongly opposed many parts of the Government's proposals. The views of trade unions were not supported by either the employer groups or the conservative government. The Government then proceeded to endorse the concept, and it was subsequently enacted into law by parliament. The first piece of legislation, on social insurance, established a new public, PAYG pension scheme, under which pension benefits would be much more closely aligned to each individual worker's previous earnings and contributions.

The second new law, on old-age pension savings, established a mandatory, privately managed, defined contribution second pillar pension scheme with individual pension accounts, to be financed by diverting a portion of the existing contribution rate from the first pillar. Both new systems largely destroyed the solidarity and cross-subsidization of the previous scheme.

The act of parliament that created the new scheme was passed by only a slim majority and the President of Slovakia sent the act back to parliament for further debate, after which it was again passed narrowly. The act gave all workers already insured the choice to join the private savings scheme and required that all new entrants to the work force must participate in it. For each member, 9 of the 24 per cent rate of pension contribution would be diverted to an individual savings account managed by a private savings fund. This diversion of contributions would create an enormous hole in the financing of the public pension scheme, around 30 per cent of its income over the next several decades. To help balance this loss, the Government set aside 65 billion Slovakian koruna (SKK) from the total sale price of the privatized state gas enterprise and has reserved this to underwrite the transformation of the pension scheme. It also established a new Reserve Solidarity Fund in the Slovakian

Insurance Agency (SIA) which would receive 4.75 per cent of all pension contributions to create a fund for underwriting the public as well as private pension scheme.

The deficit issue

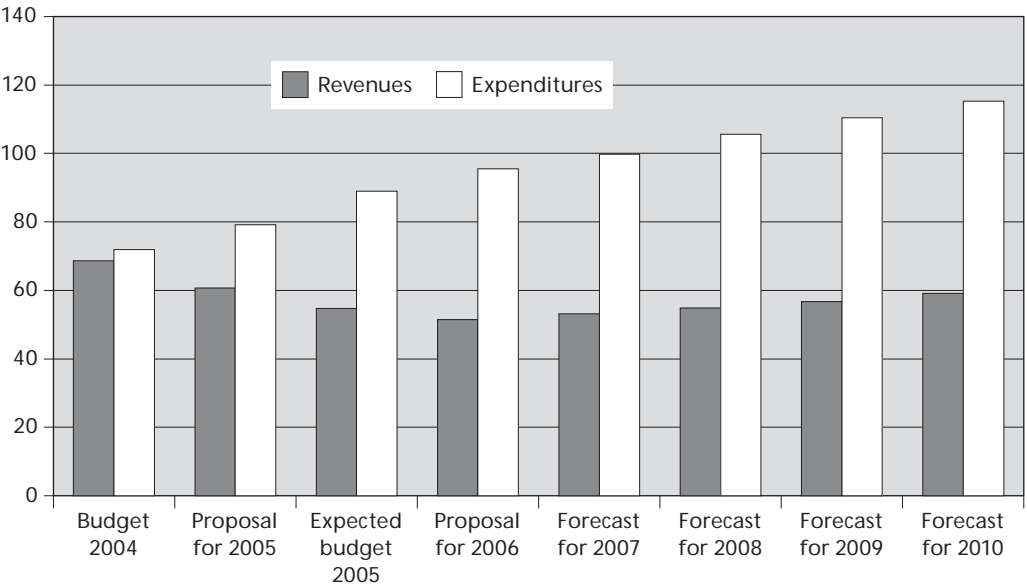
The estimated impact on the financial stability of the public pension insurance scheme has not been published. However, the following reasons demonstrate that it will be significantly.

- The financial stability of the first pillar of old-age pension insurance is undermined by the redirection of 9 per cent of the contributions rate into the second pillar of private savings and by splitting disability insurance with the diversion of another 6 per cent. The first pillar old-age pension insurance is presently financed by a contribution rate of only 9 per cent instead of the 28 per cent rate used to finance old-age and disability pensions before the reforms;
- The deficit in the PAYG pillar will grow;

- Multi-pillar reform will lead to a state fiscal deficit – under the EU stability pact a 3 per cent deficit limit should be met;
- The Slovakian financial market is not sufficiently developed and as a result pension funds have problems investing assets;
- The deficit in the public, PAYG pillar will create pressure to index pensions inadequately, and the younger generation of workers will also suffer because taxation revenue will need to be diverted to meet the deficit in the PAYG scheme;
- The second pillar scheme will not solve the expected problems of demographic change; and
- A minimum level of pension benefit is required to provide a decent standard of living for the elderly who have worked for their entire adult life.

Figure 2 shows the projected growth of the deficit in the public first pillar pension system.

Figure 2. Revenue and expenditure of the social insurance agency on old-age pensions, Slovakia, 2004-2010 (thousands of SKK)



With the redirection of a large share of contributions into the second pillar private pension system, the deficit of the first pillar PAYG pension system will continue to deepen. In 2010 the Social Insurance Agency will collect only about 50 per cent of the funds necessary to finance existing pensions. The Act states that the Reserve Fund of Solidarity has to cover the deficit, but it is already depleted after the last two years' deficit. Another option is to underwrite the deficit from the state budget, but it is not clear whether there will be a sufficient budget surplus to cover this shortfall. There is the further option of borrowing the funds to meet the shortfall, but this would create a financial liability for future generations (both those currently working and those still to enter the workforce).

The framework of the pension system and of pension benefits

Pension reform was introduced to improve the pay-as-you-go pension insurance system and to introduce a system of pension savings. This is the first mixed pension insurance system in Slovakia.

The new PAYG scheme came into effect on 1 January 2004 and introduced the following substantial changes to the pension scheme:

- A different calculation of old-age pension benefit;
- The reintroduction of early retirement, but with a restriction in the benefit level;
- The entitlement to receive an old-age pension while still earning income and without income testing;
- Equality of entitlements for widows and widowers;
- The abolition of a statutory minimum pension level which, under the previous scheme, was set at 110 per cent of the subsistence minimum;
- Increase of the retirement age to 62 for both genders.

The least popular reform introduced by the new Social Insurance Act was the increase of the retirement age. From 2004 the retirement age will gradually increase to age 62 for both males and females, from the former ages of between 53 and 57 for women (depending on the number of children raised) and age 60 for men.

The most substantial change has been to the benefit levels in the public old-age pension scheme. Instead of the previous requirement of a minimum of 25 years of insurance contributions/employment, it is now sufficient to have a minimum of 10 years (assuming the person has also reached pensionable age).

The monthly benefit is calculated on the basis of:

1. For each year of contributions during the period since 1984, a "personal earnings point" is calculated, being the ratio of that employee's gross annual income to the average annual wage across the workforce in that year, up to a maximum ratio of 3 (i.e. three times the average wage). Over the working life since 1984 an average is taken of all of an employee's annual "personal earnings points", which is called the "average personal earnings point".
2. The "average personal earnings point" is multiplied by the number of years of employment (i.e. years of insurance contributions) and by the "current pension value". The "current pension value" is set by legislation every year and in 2006 it is about 1.2 per cent of the monthly average wage (SKK214.68).

This old-age pension calculation formula is significantly austere towards low income contributors. A worker with 40 years of contributions who earned the minimum wage would receive only 50 per cent of their average pre-retirement income, whereas such a worker would have received 120.2 per cent of pre-retirement income under the old scheme.

Very popular among contributors was the retention of the early retirement pension, although it is subject to new

conditions. A person becomes eligible for an early retirement pension if they have been insured for at least 10 years and if the pension payment (as calculated at the day of applying for it) is higher than 1.2 times the official subsistence minimum income.

Pension benefits are indexed annually on 1 July, based on the growth of consumer prices and average wages.

The statutory public pension system in Slovakia is composed of two types of schemes. The general pension insurance scheme covers the majority of employees. For professional military members and members of the special state services a different pension systems exist.

In the second private savings pillar, 9 per cent of old-age pension contributions are accumulated in personal accounts within pension fund management companies (PFMCs), but the collection of contributions to PFMCs is done by the Social Insurance Agency. Eligibility to a pension from this second pillar accrues after 10 years of savings through the purchase of an annuity.

A supplementary, third pillar pension insurance scheme was established in Slovakia in 1996. During the 2003-4 pension reforms the legislative framework was changed, requiring all insurers providing voluntary old-age insurance to restructure themselves to conform to the new regulations. Contributions are paid on a voluntary basis and the rate of an employer's contribution can be set by collective agreements. Also eligibility to benefits from this third pillar has been strengthened.

The social insurance agency and tripartite governance

The most important changes to the pension scheme which existed in the former Slovak Federal State within Czechoslovakia occurred in Slovakia in 1993 and 1994. It was the separation of the financing of pensions from the state budget and the creation of a new organisational structure for pension administration – the Social Insurance Agency (SIA). Since its creation

the SIA has been through many changes but its tripartite way of governance still survives.

The SIA collects all contributions towards the insurance schemes (including pension, disability, sickness, occupational injury and unemployment insurance) and pays benefits from all those schemes. Since the 2004 reforms, the SIA also provides personal accounts for first pillar pension contributors. For private pension funds (second pillar), the SIA also collects contributions and produces a list of concluded agreements between insured persons and private pension funds.

The two main governing bodies of the Social Insurance Agency are its supervisory board and its board of directors. The supervisory board has 15 members, of which two are nominated by trade unions, three by community associations which represent the interests of pension beneficiaries, five by employer groups, and four by the Government. The president is the Minister of Labour, Social Affairs and Family.

The Board of Directors consists of five members. The President of the Board and two Vice-Presidents are nominated by the Ministry of Labour, Social Affairs and Family (MLSAF), one member is nominated by the trade unions and community groups, and the fifth member by the employer groups.

Pension reform in Slovakia and trade union involvement

The KOZ SR played an important role in shaping the pension scheme in Slovakia. It realized very early after the transition process began that reform to the pension system was inevitable and necessary. The KOZ SR took an active part in developing pension reform during 1990s and in the early years 2000s. In 1993 the KOZ SR prepared its own proposal for social security reform which was, in many respects, accepted by the Ministry of Labour and Social Affairs. The KOZ SR was also active in responding to each government reform

proposal and used the tripartite forums of social dialogue to promote workers' interests in social security protection. These tripartite forums were not the sole forum for debate, as meetings were also held of technical experts associated with each of the social partners to discuss pension reform documents and legislation.

KOZ SR helped the MLSAF to organize opinion-polls, and to distribute and collect questionnaires. KOZ SR valued consensus building and on many occasions was successful in reaching agreements with the social partners on cornerstone issues. One of the key tripartite agreements in the development of social security reform was on the framework of the pension scheme created by legislation in 2001.

However, as mentioned earlier, a Minister of Labour, Social Affairs and Family from the hard right was appointed after the 2002 election, and refused to cooperate with trade unions. This new Minister created a special commission for pension reform and invited employer groups, researchers and academics, policy institutes and NGOs to participate, but excluded the KOZ SR and any other union representation. In contrast with previous governments, the conservative government elected in 2002 did not seek any level of consultation with unions. However, KOZ SR continued to develop alternative policy proposals and raise its objections to the government's reform agenda.

The Trade Unions Confederation was the main if not the only opponent of most aspects of the proposed reforms. The unions were especially opposed to the proportion (40 per cent) of contributions to be redirected to the second savings pillar. Such a large deduction from the contributions towards the public scheme undermines the financial sustainability of the pay-as-you-go pillar of the pension system, which was already in debt before the proposed reforms took effect.

However, KOZ SR could not win the battle to put a more social face on the new pension scheme. The KOZ SR did not receive the same level of media coverage as the Government did in promoting its

agenda. Significantly, there was also strong public support for substantial changes to the statutory pension scheme, particularly to reduce the level of income redistribution inherent in the previous public pension system.

The Government funded a large publicity campaign on pension reform, presenting only the positive aspects of its proposals. It was the simplistic positives that the public heard and listened to, and the government was thereby successful in gaining the public's trust for its pension reforms.

For KOZ SR the results of pension reform were mixed. KOZ SR was able to influence positively some aspects of the reform process, but it was not possible to prevent the overall thrust away from a solidaristic system of pensions. During the process of reform, the KOZ SR played a key role in having the following amendments included:

- After the elections in 2002, the first Government proposal was to abolish the PAYG pension scheme and replace it with a private savings scheme. However, there was no proposal as to how to finance the entitlements of current benefits. After strong opposition from KOZ and also from some experts and left wing politicians, this proposal was abandoned. There had also been a proposal to increase the retirement age to 65 years.
- Other changes accepted by the MLSAF and later by the government were mostly minor or their complexity made them difficult to explain to the public. For example, a transition period was introduced during which the calculation formula was moderated to lessen the gap between the highest and the lowest pension benefits and to reduce the gap between benefits, especially low income pensions, under the existing and new schemes. After one year of operation this transition period was increased from 3 to 10 years, in part to protect low income pensioners, but also to protect the state budget because the

majority of low income workers would be eligible to state social assistance benefits. (Note though that the value of social assistance benefits is about one half of the subsistence minimum, due to austerity measures made at the end of 2002 and early 2003).

- Early retirement pensions for workers dismissed one year before reaching retirement age would not be reduced (normally, there is a reduction of 0.5 per cent of pension benefit for each month before reaching retirement age).
- In the second pillar scheme, unisex tables for calculating pension benefits were introduced.
- Better supervision of private funds was promoted.

But, as discussed earlier in this article, the majority of the population supported the pension reforms, having the mistaken expectation that pensions for everybody would be higher. Despite being able to win the changes listed above, it was very difficult for KOZ SR to oppose the main thrust of the Government's reforms. The performance of the new pension system since its inception has demonstrated that many of the trade unions' objections were valid and correct.

Notes

¹ For more about the pension scheme in the Slovak Republic between 1989 and 2004 see Svoreňová, M. and A. Petrášová (2005), pp. 121-185; 308-328.

² Svoreňová, Maria. 2000. The Development of Trade Unions in Slovakia during the Last Decade. In: *South East Europe Review for Labour and Social Affairs*. Vol. 3. No. 2/2000. Baden-Baden: Hans-Böckler Foundation, p. 135.

³ Fultz, Elaine. 2003. *Recent Trends in Pension Reform and Implementation in the EU Accession Countries*, paper presented at the Informal Meeting of Ministers at the International Labour Conference, Geneva, pp. 4, 5.

⁴ Bednarik, Rastislav. 2004. Pension reform finally a reality, EIRO (European Industrial Relation Observatory on-line).

⁵ Social Protection and the Informal Sector in Central and Eastern Europe, Seminar Report, Zagreb, 2000, ILO-CEET – Budapest, p. 10.

⁶ Fultz, Elaine and Markus Ruck. 2001. *Pension Reform in Central and Eastern Europe: An Update on the Restructuring of National Pension Schemes in Selected Countries*, ILO-CEET Report No. 25, p. 11.

⁷ Svoreňová, M. and A. Petrášová. 2005. *Social Protection Expenditure and Performance Review of the Slovak Republic*. Budapest: ILO-CEET, pp. 367-368.

⁸ Bednarik, Rastislav. 2004. Pension reform finally a reality, EIRO (European Industrial Relation Observatory on-line).

References

- Bednarik, Rastislav. 2004. *Pension reform finally a reality*, EIRO (European Industrial Relations Observatory on-line).
- Fultz, Elaine. 2003. *Recent Trends in Pension Reform and Implementation in the EU Accession Countries*, A paper presented at the Informal Meeting of Ministers at the International Labour Conference, Geneva,
- and Markus Ruck. 2001. *Pension Reform in Central and Eastern Europe: An Update on the Restructuring of National Pension Schemes in Selected Countries*, ILO-CEET Report No. 25.
- ILO-CEET. 2000. *Social Protection and the Informal Sector in Central and Eastern Europe*, Seminar Report, Zagreb.
- Svoreňová, Maria. 2000. The Development of Trade Unions in Slovakia during the Last Decade. In: *South East Europe Review for Labour and Social Affairs*. Vol. 3. No. 2/2000. Baden-Baden: Hans-Böckler Foundation.
- and A. Petrášová. 2005. *Social Protection Expenditure and Performance Review of Slovakia*. Budapest: ILO-CEET.

Trade union role in the Slovenian pension system

Social values rank highly within Slovene society, despite an increasing neo-liberal influence in politics. Social dialogue and tripartism also have good public support as they are seen as being fundamental to a Slovene style of democracy. Pension reform was seen as a litmus test of preserving this culture.

Metka Roksandić

Association of Free Trade Unions
of Slovenia (ZSSS)

1. Introduction

The Slovenian pension reforms of 1999 represented a major victory for trade unions. The two fundamental elements that unions succeeded in retaining were the maintenance of intergenerational solidarity in the funding of pensions and the preservation of mandatory insurance as a basic and general insurance for all.

The pension system is one of the most important pillars of the Slovenian social security system with its income protection for old age. Its fundamental status is recognized by the inclusion in the Constitution of a right to social security. Slovenes place a high value on good social policy and rights, especially social security, and so Slovenian trade unions have always been deeply involved in the pension system, including in the management of schemes. And as recent Slovenian history shows, the role of unions has at times been critical to maintaining a sound pension system.

Note: This paper presents a trade union perspective of the pension system in Slovenia: its roots and development in a newly established State, and the role of trade unions in shaping the pension debate. By "pension system" I am referring to the whole system of pensions and invalidity insurance. However, I will focus here on the aged pension system in particular.

2. Brief history of the Slovenian pension system and the role of trade unions

2.1. History of the pension system

The Slovenian pension system finds its roots in the nineteenth century social insurance systems of the Austro-Hungarian monarchy and in the compulsory workers' social insurance in Yugoslavia from 1937 onwards. After the Second World War, state social insurance became a universal right for all in Yugoslavia. As a new State, Slovenia has maintained that pension system and, since 1982, it has been administered autonomously from Government.

The new Constitution in 1991 created a constitutional right to universal social protection and, as a result, in 1992 an integrated aged and invalidity pension scheme was adopted. In 1996 minor reforms were enacted: the pay-as-you-go system was retained but supplementary, voluntary (third pillar) pension insurance was introduced, along with an amended system of valorization. After 1992 several other minor amendments were made.

2.2. Preparations for major reforms

At the request of the Slovenian Government, in 1995 and 1996 research into the pension system was conducted by special missions of the International Monetary Fund and the World Bank. In 1996, in accordance with the European Union (EU) PHARE¹ programme, the Government started developing proposals to reform the pension system. This led to the release in late 1997 of a White Paper on pension reform. This paper was preceded by an intensive government public education campaign the necessity for pension reform.

There were several factors influencing pension reform at this time. Slovenia had begun the process of preparations for accession to the EU, with the related pressures of economic modernization which focused attention on the pension system. These pressures influenced the Government's decision in 1996 to decrease employers' contributions from 15.5 per cent to 8.85 per cent of gross earnings, the argument being that it would increase the competitiveness of the Slovenian economy. It was a decisive moment. The autonomous state pension then ceased being funded entirely by contributions from the active population and became state co-financed: the Government undertook co-financing to compensate for the reduction in employer contributions. To meet the cost of co-financing the Government introduced a payroll tax to be paid by employers. This tax was politically more acceptable than the previous level of pension contributions.

2.3. The trade union perspective on the proposed pension reform

The 1997 White Paper instigated tremendous trade union activity on pensions. It was clear that the Government's agenda was to dismantle the existing pension system: the picture from the White Paper was not white but black. It proposed a three-pillar system with no intergenerational

solidarity, a compulsory second pillar, a standard retirement age of 65 years for men and women (with no associated qualifying period of contributions), significant reductions in the benefit levels of acquired pensions, and a short transitional period for equalizing retirement ages.

The proposed reforms were unacceptable to trade unions. The Association of Free Trade Unions of Slovenia (ZSSS) resolved to oppose the general direction set out in the White Paper. The main issues for the ZSSS were:

- the retention of intergenerational solidarity as the cornerstone of the pension system;
- the second pillar scheme should be voluntary, not compulsory;
- maintaining the combination of age and years of service as conditions for eligibility for a retirement benefit; and
- a longer transitional period before the retirement ages for women and men were equalized.

At the beginning of 1998 the ZSSS and other trade unions mobilized protest: weekly demonstrations against the White Paper reforms in front of the Government's headquarters; the collection of signatures in support of a referendum; and, at the time, the largest workers' demonstration ever held in Slovenia. These initiatives won unions and their campaign extensive media coverage and built up significant public support.

The ZSSS also prepared information material for the public, showing the impact on workers, particularly women, of the proposed reforms: the effect on retirement ages, benefits, eligibility, etc. This education campaign was achieved through the distribution of material via affiliate unions, at workplaces and at demonstrations, and the use of the media.

2.4. The response of Government

Despite the union campaign, and despite the fact that the Economic and Social Council of Slovenia (the national tripartite advisory body) and the National Council² (the upper chamber of Parliament with powers of review and supervision of legislation passed by the National Assembly) both demanded a social consensus before any parliamentary procedure should occur, in July 1998 the Government tabled a draft law in parliament. However, the draft law did not include the proposed compulsory second pillar and retained the existing pay-as-you-go system. One important factor which influenced Government in not pursuing this second pillar system was the unknown level of management costs of such a privatized scheme.

After intensive public debate and many academic papers on the subject, in 1999 the time was ripe for talking and negotiating. It was also the first year for negotiations for Slovenia's EU accession.

In April 1999, after the draft law's first reading in the National Assembly, the Minister of Labour initiated talks with unions on pension reform. After hard but short negotiations with trade unions, consensus was reached by the end of April 1999 and the Government signed an agreement with all four representative trade union confederations. The Economic and Social Council of Slovenia also endorsed the agreement, which Parliament then enacted into law.

2.5. Trade union outcomes

The result of the trade union campaign was the following:

- compulsory pension insurance (the pay-as-you-go system) remained the cornerstone of the pension system – the second pillar;
- voluntary second pillar contributions based on agreements reached through collective bargaining;

- full pension entitlements under the first pillar for 40 working years (38 for women) at a minimum age of 58;
- different retirement ages and years of service for women and men – women to retire at age 63-61 and men at 65-63, with the exact retirement age depending on the number of years of contributions, and specific beneficial conditions applicable to women for work before age 18; and
- a longer transitional period for increasing the retirement age for women to 58 years (to be implemented by 2014).

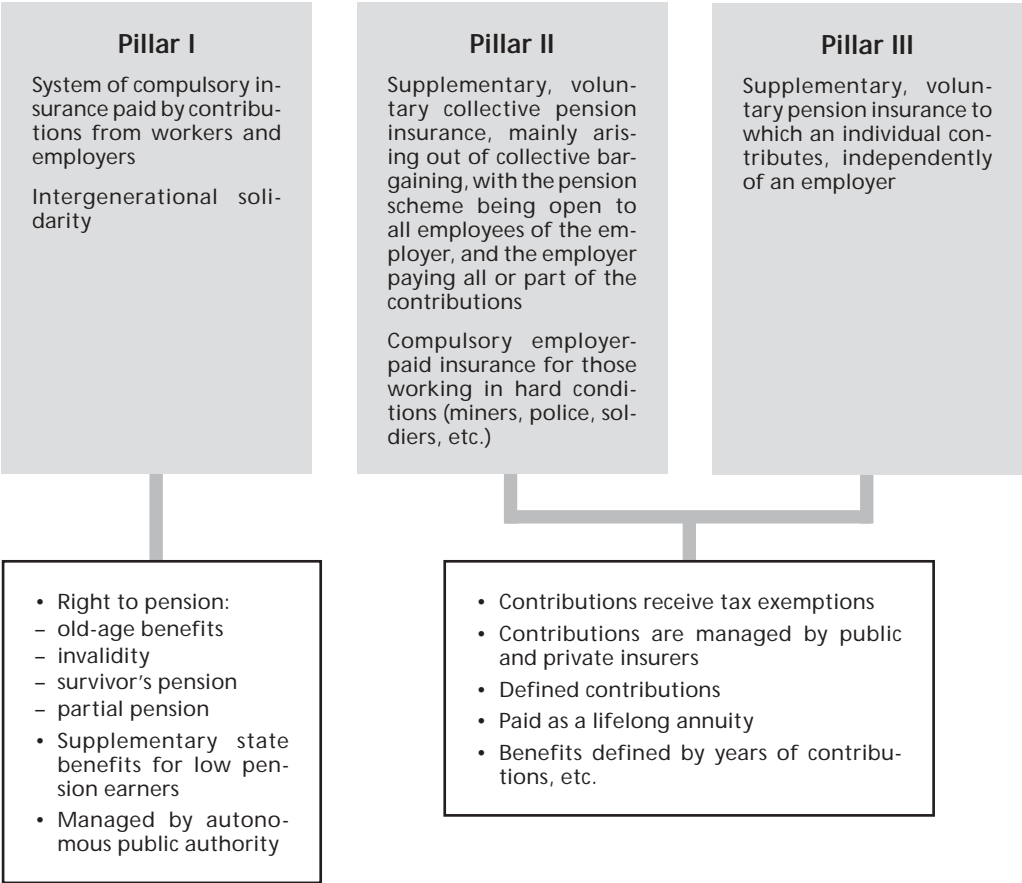
To reach an agreement with Government, trade unions had to concede on some issues: higher eligibility age; longer periods of work before qualifying for a pension; the pension benefit is calculated based on the average of the worker's best 18 consecutive years of salary instead of the previous level of 10 years (see section 3.2); and the pension benefit will be reduced on a phased-in basis from 85 per cent to 72.5 per cent of the pension base. The accord on pension reform was seen as a win-win both for government and unions, but some financial experts claimed that pension reform did not go far enough and foresaw problems of financial sustainability in the near future.

Pension reform was a turning point in Slovenian social dialogue, as it was the first significant experience in the new State of the social partners reaching consensus on social protection issues. It demonstrated that social dialogue is an effective mechanism in developing social and labour policy at the national level. And, importantly, it shows that trade unions have the capacity to participate effectively in social dialogue at the national level.

3. Overview of the legal and institutional framework of pensions

The new Pension and Invalidity Insurance Act was adopted in December 1999 with effect from 1 January 2000. The structure of the pension system is shown in figure 1.

Figure 1. Structure of the pension system adopted in 1999 in Slovenia



The Pension and Disability Insurance Institute of Slovenia (PDII) is a public body administering the compulsory first pillar insurance pension system. This system is financed by employer and employee contributions (two-thirds) and from the state budget (one-third). Contributions are: employers 8.85 per cent and employees 15.5 per cent of gross wages. This scheme covers (as at 2004) approximately 83 per cent of the total labour force with pension entitlement for old age, disability, the need for permanent assistance and care and death.

There is also a basic, safety-net means-tested pension for people not otherwise entitled to the first pillar insurance-based

pension, and this is paid from consolidated revenue. This latter pension is set at one-third of the pension base (see section 3.3).

3.1. Retirement conditions

Eligibility for a retirement pension is a product of a person's age and years of pension contribution ("qualifying period"). The final structure of the pension scheme (following a transition period during which retirement ages will increase) will be as shown in table 1.

In 2006 the eligibility for a full pension for full working years (40 for men

Table 1. Eligibility for retirement pension, men and women

	Retirement age	Qualifying period	Entitlement
Men	58	40 years of work	Full pension ^a
Women	58	38 years of work	Full pension ^a
Men	63	At least 20 years and up to 40 years of pension-qualifying period	35% of retirement pension base ^b + 1.5% for every year in excess of 15 years of pension-qualifying period, to a maximum of 72.5%.
Women	61	At least 20 years and up to 40 years of pension-qualifying period	38% of retirement pension base ^b + 1.5% for every year in excess of 15 years of pension-qualifying period, to a maximum of 72.5%.
Men	65	At least 15 years and up to 40 years of pension-qualifying period	35% + 1.5% of retirement base ^b for every year of pension-qualifying period
Women	63	At least 15 years and up to 40 years of pension-qualifying period	38% + 1.5% of retirement base ^b for every year of pension-qualifying period

Notes: ^a See section 3.2. ^b See section 3.3.

and 36 and 3 months for women) is at age 58 for men and 55 and 4 months for women. With at least 20 years of pension-qualifying period, men can retire at age 61 and 6 months and women at age 60 and 4 months. All age limits and qualifying periods will increase during a transitional period from 2000 to 2014.

In some circumstances the retirement age can be lowered but to not less than 55 for women and 58 for men. This applies where a worker is entitled to a credit for having raised a child, where a woman performed work before the age of 18, where the worker was engaged in an occupation designated as “hard work”, or where there are special personal health circumstances.

In practice the average years of service in qualifying for old-age pensions is currently 37 years for men and 32 years, 1 month for women. Between 1999 and 2005 these averages increased by 2 years, 3 months both for men and for women.

3.2. Calculating the old-age pension

An old-age pension is calculated on previous earnings. Currently it is the average of the best 16 consecutive years of salary (rising to 18 years in 2008) since 1970.

This average is then the base for pension calculations: men receive as a pension 35 per cent of this average for 15 years of service; women 40 per cent for 15 years of service; and an additional 2 per cent for each year of contributions prior to 2000. For work after 2000, 1.5 per cent is calculated for each year of service. When all years of service are performed after 2000 the values in table 1 apply. Pensions are indexed twice a year based on movements in average wages.

3.3. *Maximum and minimum payments*

Levels of pension entitlement are based on a national minimum pension standard, which was defined in 1996 at 64 per cent of monthly average wages and is valorized in the same way as pension entitlements. The minimum receivable pension is set at 35 per cent and the maximum receivable pension 400 per cent of the minimum pension basis.

For low-income pension recipients there is supplementary pension support. This is means-tested and can provide additional income of between 15.471 Slovenian tolar and 20.344 Slovenian tolar (64.55 and 84.89 euros) per month.³

The minimum pension (assuming the minimum 15 years of qualifying contributions) is currently 37.378 tolar per month (156 euros), and the highest paid-out pension is 403.303 tolar (1,683 euros). The average old-age pension (including those who receive supplementary pension support) is 126.002 tolar (526 euros).⁴

The national average for old-age pensions in 2006 was 70.3 per cent of the average national net wage. This ratio had been constantly falling: from 77.8 per cent in 1992 to 75.8 per cent in 1999, and to 69.1 per cent in 2005. However, in 2006 there was a slight increase (70.3 per cent) due to a new system of indexation introduced in 2005.

4. The influence of trade unions on pension policies and governance

4.1. *Pension policies*

The shape of pension reform in 1999 demonstrated the success of the trade unions' campaign and their capacity to influence social policy. Since 1999 pension law has been amended several times but the tripartite Economic and Social Council has on each occasion discussed the proposed changes. Where consensus cannot be reached, a joint working group is set up to attempt to reach consensus. In general, the social partners agree but, where

agreement is not reached, unions will normally start a public education and media campaign to influence public opinion.

The National Council, the Parliamentary chamber of review, has four trade union representatives in the Council, nominated directly by unions, out of a total size of 40, as well as those from employer groups. The Council has the power to veto legislation approved by the National Assembly which gives trade unions a second level of influence over legislation: if vetoed in the Council the legislation must return to the National Assembly, which must again vote on the legislation.

There had also been the facility to organize referendums either before or after a law was adopted by the National Assembly, with such referendums preventing the law from being amended or implemented for two years.⁵ Trade unions had successfully organized referendums in the past, such as in 2003 over the issue of shop opening hours. The capacity of unions to mobilize public opinion against a government initiative compels Government to give due weight to consultation with unions.

However, consultation does not always lead to consensus. In 2005 the Government proposed a new formula for indexing pensions based on average wage increases. This amendment was the result of a political compact with the pensioners' party who formed part of the ruling coalition. Trade unions did not oppose these proposals but employers and economic experts believed the proposal would harm the financial sustainability of the pension system. Trade unions were opposed to a proposal to change the governance of the PDII. Government sent the proposal to Parliament for adoption in spite of the opposition both of employers and trade unions.

In the latest reforms in 2006, the social partners and Government did not reach agreement through the Economic and Social Council about the introduction of supplementary individual insurance for workers already insured under a collective pension programme. The employer repre-

sentatives warned against changes which did not fully take account of the possibility of a decreasing number of insured persons. The social partners were not opposed to these changes but, based on the research and analysis available, were cautious about the wisdom of the proposal. In the light of the social partners' views, Government proceeded only with those changes to the law necessary for implementing European directives.

4.2. Pension scheme governance

Despite the range of changes to the Slovenian pension system since 1992 the governance structure of the PDII had remained unchanged in practice: the employer and worker representatives, along with pensioners, had continued jointly to manage it. The establishment of this structure was the first time that those contributing the funds had the power to control the funds.

However, in 2005 this bipartism was abolished. The Director-General of the PDII is now overseen by a council rather than a management board. It is comprised of 27 members: ten appointed by government, six by trade unions, four by employers, five by pensioners, one by disabled persons' organizations and one by PDII employees. Initially Government had proposed a structure of majority government control but, through consultation at the Economic and Social Council, Government was persuaded to abandon this proposal. Unions do not endorse the current structure because it does not give due representation to the funds' contributors: employees and employers now hold one-third of seats in comparison to the previous two-thirds.

Trade unions have been adept at influencing the policy debate on pensions in Slovenia. Unions have a network of external experts on which they rely for technical advice, but the ZSSS has its own internal expertise which has allowed to take the leading role among unions on pension policy. There is high public interest in pen-

sion policy and the views and opinions of trade unions are welcomed by the media. The media has been an effective tool for influencing public opinion.

Social values continue to rank highly in Slovene society, despite the increasing neo-liberal influence in politics. Social dialogue and tripartism has good public support as it is seen as being fundamental to a Slovene style of democracy.

5. Current issues for the pension system

In November 2004 a new government was elected with an agenda of improving welfare rights in Slovenia. A framework of reform was adopted a year later in November 2005, comprised of 67 specific measures.

Five of them concern the pension system:

- | | |
|------------|---|
| Measure 61 | Increasing incentives for remaining in active work longer |
| Measure 62 | Extending compulsory insurance cover to those who work rarely and receive low earnings |
| Measure 63 | Finding a suitable balance between the economic sustainability of the compulsory pension insurance and the social impact of changes to the system |
| Measure 64 | Systemic separation of collective and individual insurance |
| Measure 65 | Additional incentives for voluntary pension insurance. |

The Government also adopted in December 2005 an agenda for negotiations on a Social Agreement for 2006-2009. However, for trade unions the most important issue is the possible introduction of a flat tax rate, which has hindered progress on other aspects of the Social Agreement for 2006-2009. Consultation within the Economic and Social

Council is being undermined by the pace and breadth of changes being introduced and by the Government's strategy of tabling documents just before meetings.

In respect of pension reforms, Measure 63 of the framework of reforms, above, has been translated into government proposals to again increase the eligibility periods, revalue the benefit levels and accelerate the transition period for higher pension ages for women. At the time of writing there is no concrete reform proposal.

6. Conclusion

The pension system is one of the fundamental pillars of national social security. As such, Slovenian trade unions see pensions as a core issue for workers. The public pension system, the level of contributions, the conditions of retirement and the governance of the public pension fund, among others, are of great significance. Reforms to public social insurance and the pension system are matters for social dialogue: it is essential the Government seeks agreement with the social partners and strives for reforms which make social security sustainable. Agreement on pension reforms in 1999 was a great achievement. It showed that social dialogue should be the primary political tool for change and that social dialogue is a sign of an active, participatory democracy.

Notes

¹ The PHARE programme provides assistance for the economic and political transition of applicant countries in their preparations for joining the European Union.

² The 40-member National Council is comprised of 22 elected representatives and 18 members nominated by a range of social partners, including four union representatives.

³ 2005 figures.

⁴ June 2006 figures.

⁵ This law was amended in December 2006, allowing referendums only after national legislation is enacted and deferring the date of effect of the referendum result until one year after the legislation was enacted.

References

- Government Office for Growth, *Framework of Economic and Social Reforms for Increasing Welfare in Slovenia*, Ljubljana, August 2006.
- Prijatelj J., *Pokojninsko in invalidsko zavarovanje 2000* (Pension and invalidity insurance), Center Marketing Internationale, Ljubljana, January 2000.
- Stališča Predsedstva ZSSS (Statements of the ZSSS Presidency).
- Verbič M., Majcen B., van Nieuwkoop R., *Sustainability of the Slovenian pension system*, Working paper No. 29, Institute for Economic research, July 2005.
- Zapisniki Ekonomskega socialnega sveta (Minutes of the Economic-Social Council).
- ZPIZ, Letno poročilo 2005 (PDII, Annual Report 2005), available at: www.zpiz.si.
- ZPIZ, Mesečni statistični pregled, junij 2006 (PDII, *Monthly Statistics Overview*, June 2006).

