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A SHIFT TOWARDS PRIVATE AND DEFINED - CONTRIBUTION PENSION PROGRAMS

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A Shift Towards Privately Managed Pension Programs Characterized by Defined-Contribution Schemes.

This paper describes how state-managed and unfunded pension programs are being supplemented or replaced by privately managed pension programs characterized by defined-contribution schemes. The paper outlines some of the benefits and risks associated with the institution and operation of these schemes. Finally, concluding remarks are provided at the end of the paper.

a. Background and Introduction

State-managed social security pension programs, also known as public pension funds, are increasingly projecting financial difficulties because they are generally under-funded and poorly managed. As a result, more and more countries are now encouraging the development and implementation of privately managed pension programs characterized by defined-contribution plans, wherein workers invest in a retirement account during their working lives and receive the proceeds of this account during their retirement period. Many developing countries also view privately managed and defined-contribution pension programs as useful vehicles in helping fulfill broader economic objectives including the development of local capital markets.

Public Pension Funds

In many countries, public pension funds take the form of social security pension programs which provide benefits to retired workers from the formal sector. These programs are typically defined-benefit schemes with pension benefits based on a formula which includes worker's salary and years of service, which are calculated independently of the amount of contributions the worker paid into the system. These plans tend to be under-funded. In other words, pension liabilities generally exceed the plan's assets. An important reason that social security pension programs are often under-funded is because governments often recognize prior work experience at the time social security is adopted. As a result, there is no money in the system at inception, but pensions must be paid almost immediately. Consequently, social security programs tend to be funded on a pay-as-you-go (PAYG) basis.

Under PAYG programs, active workers' payroll taxes fund retired workers' benefits. PAYG allows governments to meet pension obligations with reasonable tax rates as long as there is an adequate ratio of workers to retirees and little evasion of payroll taxes. Because current contributions are used to pay current pension benefits, a small amount of funds accumulates under state-managed social security pension programs.

In some countries, there is a tendency by state-managed social security pension programs to invest funds in hospitals, roads, and other infrastructure projects which do not usually earn investment returns comparable to those available in the capital markets. In countries with budget deficits, there is a strong temptation to divert workers' pension fund contributions to other government purposes.

However, trends such as changing demographics (aging of the population or increased longevity) or increases in benefit levels, can cause financial difficulties for PAYG systems. For example, the Organization for Economic Corporation and Development in the European Union projects the E.U. population to peak in the year 2000 at about 330 million, and then decline by 50 million over the next 50 years. This trend implies that fewer workers will be available in the future to support retirees and thus financial problems for the PAYG system will arise. When these financial problems are encountered, the short-term solution may be to raise the retirement age, increase contribution rates (payroll taxes), increase coverage (reduce evasion), or limit benefits. Improving the investment performance of assets may be another alternative if the pension fund system has reserves. If not, more ambitious reform, like the privatization of social security undertaken by Chile, may be warranted.

Private Pension Systems

Private pension systems operate at the company or individual level. At the company level, private pension systems may be either defined-benefit or defined-contribution plans. Defined-benefit programs promise to pay a specific benefit to covered workers on their retirement. Under defined-contribution plans, a worker accumulates funds in an individual account managed by a professional investment manager. The amount of the pension benefit depends on the amount in the individual account at the time of retirement. Under both types of private pension systems, funds tend to be invested in the capital markets to achieve optimal investment returns. One important difference between these two types of private pension systems is that, while defined-contribution systems are always funded, defined-benefit systems may be under-funded.

It is important to note that in some countries, such as the United States, both private and public funds coexist. That is to say, in addition to drawing on personal savings, a retiree may receive a social security pension and a company pension at retirement.

Global trends

Privately managed, defined-contribution pension programs are becoming more and more popular in countries around the world. Often, these programs are supplementing and even replacing state-managed and unfunded pension programs. Several factors have contributed to this overall trend including: (i) increased financial difficulties facing state-managed defined-benefit pension schemes; (ii) public sector mismanagement; and (iii) the need to stimulate local economies.

The remainder of this paper will focus on privately managed and defined-contribution schemes. The paper will: (i) show that these schemes are becoming more and more popular in countries around the world; and (ii) outline some of the benefits and risks associated with instituting such schemes. Finally, concluding remarks are provided at the end.

b. Trends in Selected Countries

A trend towards instituting and operating privately managed pension plans characterized by funded defined-contribution schemes is taking place in countries around the world (see attached table). From the U.S. and Chile, to China and Australia, nations are being forced, by the twin pressures of relieving hard-pressed social security pension systems and stimulating local economies, to adopt privately managed and/or funded pension programs.

In the U.S., the state-managed social security pension program is projecting financial difficulties and insolvency by year 2036. The U.S. private pension system, on the other hand, is undergoing a gradual change in the type of plan commonly offered. While the number of pension participants in privately managed defined-benefit plans has dropped, a substantial growth has occurred among privately managed and funded defined-contribution plans.

In Chile, a privately managed and defined-contribution pension scheme replaced the state-managed social security pension program. Already, the accumulated pension savings of US$ 12.5 billion has satisfied much of Chile's demand for capital. Local corporations, for example, have so far sold the pension system upwards of US$ 5 billion in bonds with maturity as long as 27 years creating one of the few long-term debt markets in Latin America. Since then, many countries in Latin America, including Peru, Bolivia, and Mexico, have followed Chile's lead in developing privately managed defined-contribution plans financed entirely or in large part by individuals.

In the Far East, many countries are encouraging the development of private and funded pension schemes. While Thailand is providing tax incentives for only the contributions made to privately managed defined-contribution schemes, Singapore has just introduced enabling legislation for the creation of private plans. Hong Kong is considering whether to adopt funding requirements for its private pension industry, and China is studying whether and how private sector plans should be funded.

The shift towards private and/or funded pension schemes in selected countries is illustrated below:

United States of America

In the U.S., both public and private pension systems coexist. While the public system is in the form of a mandatory social security pension program characterized by a defined-benefit scheme, private pension programs are voluntary and involve defined-benefit or defined-contribution schemes.

The U.S. social security pension program is projecting financial difficulties given that fewer workers will be available to support a larger number of retired people in the future. It is currently projected that the social security pension program will reach insolvency by the year 2036.

The private pension system, on the other hand, is undergoing a gradual change in the type of plan commonly offered. While the number of pension participants in defined-benefit plans has dropped, a substantial growth has occurred among defined-contribution plans.

Social Security Pension Program

Almost everyone who is employed or self-employed in the U.S. is covered by the country's social security pension program. The major exceptions include some state and local government employees, and railroad workers who are covered by other pension systems.

The U.S. system derives its funds from mandatory social security taxes levied on wages of employees at a rate of 7.65 percent. A matching amount is paid by their employer. Self-employed workers pay comparable taxes at 15.3 percent.

The Original Social Security Act of 1935 set the minimum age at which workers receive social security retirement benefits at 65. In 1956, Congress lowered the minimum age to age 62 for women, but also provided that benefits taken before age 65 would be permanently reduced to account for the longer period over which benefits would be paid.

To qualify for pension benefits, individuals must be fully insured: that is, an individual must have the required number of *quarters of coverage* under social security. Most workers need 40 quarters of coverage to qualify for retirement benefits--or about 10 years of work.

Pension benefits are based on a defined-benefit formula. This formula takes into account the individual's salary and years of work. Full pension benefits are paid at the normal retirement age of 65 for men and 62 for women. Individuals retiring prior to the normal retirement age receive lower pensions and individuals retiring after the normal retirement age receive higher pensions.

The Social Security pension program in the United States utilizes active workers' payroll taxes to pay for retirees' benefits. Any excess social security tax receipts are deposited in the U.S. Treasury along with other taxes and are accounted for by crediting federal bonds and related securities to the social security pension program. Because current contributions are used to pay pension benefits, small amounts of funds accumulate under the Social Security program.

Consistent with worldwide trends, the U.S. faces worsening ratios of workers to retirees. As a result, financial difficulties are projected for the social security pension program. While the system is not expected to face cash flow problems in the short term, the system is currently projected to become insolvent by the year 2036.

The following table summarizes the long-range projected condition of the Social Security trust funds:

		Average 75-year surplus (+) or deficit (-) as a percentage of program total cost
Optimistic forecast	:	+ 9.7 %
Intermediate forecast	:	-10.0 %
Pessimistic Forecast	:	-27.1 %
Estimated year of insolvency for the intermediate forecast :		2036

Private Pension Systems

Privately managed pension funds have been in existence for many years. These funds are sponsored by employers and supplement the pension received from the U.S. Social Security pension program.

In order to protect the interests of the participants and beneficiaries of private pension plans, the Employee Retirement Income Security Act (ERISA) was enacted in 1974. ERISA does not require that employers provide pensions, but those who do must meet minimum standards and provide prudent management of pension funds. The standards specify who must be covered, how long a person has to work to be entitled to a pension (vested), and how much money must be set aside yearly by the employer to the pension fund. ERISA also created the Pension Benefit Guarantee Corporation (PBGC), which guarantees pension payments if the plan sponsor goes bankrupt.

Since ERISA was enacted, the PBGC has come under financial difficulties. At the same time, private pension assets have increased from US$ 295 billion in 1975 to US$ 2.9 trillion in 1992.

While most pension plans have ample funds, an estimated US$ 51 billion of underfunded defined-benefit plans exists, covering 5 million employees, primarily concentrated in the steel, airline, tire, and automobile industries. PBGC's analysis shows that about US$ 12-20 billion of "reasonably possible losses" are related to about 80 financially troubled companies. Today, although it faces a US$ 2.7 billion deficit from defunct plans, PBGC has a positive cash flow. However, the U.S. Congress is seeking legislative changes to require unfunded plans to pay higher insurance premiums and fund their plans more quickly.

Currently, PBGC charges a minimum premium of US$ 19 for each participant in a defined-benefit plan. Even though insurance charges are not risk-related, an additional premium of US$ 9 for each US$ 1,000 of "unfunded vested benefits" is assessed if the plan is not fully funded. However, the maximum total premium may not exceed US$ 72.

The US private pension system is undergoing a gradual change in the type of plans commonly offered. Between 1975 and 1987, the proportion of pension participants covered by defined-benefit plans fell from 87 percent to 68 percent, while the number of employees covered by defined-contribution plans jumped from 13 to 32 percent. This trend has been attributed to a number of reasons including: (i) the shift in the U.S. economy from unionized manufacturing firms, that typically provide defined-benefit plans, to private sector service firms, that typically provide defined-contribution plans; (ii) the risk of underfunding associated with defined-benefit schemes which, in turn, increased the stringent legal and actuarial requirements and made these plans more expensive to administer; and (iii) the establishment of numerous tax incentives for defined-contribution plans such as the deferral of current income taxation on salary foregone for contribution to a defined-contribution plan.

A number of defined-contribution plans are available in the U.S. Each type of plan was begun for a specific purpose with its own set of rules. While the different plan types shared one trait--a deferral of current income taxation on salary contributed to a pension plan--rules governing eligibility, contribution, and withdrawals varied significantly. These differences reflect the variety of practices that had developed among employers in different sectors of the economy before the Tax Reform Act of 1986 introduced a greater degree of uniformity to the rules for various plan types.

One of the most popular defined-contribution plans is the 401(k) plan. This plan was formally authorized in the Revenue Act of 1978 as a salary-reduction arrangement for employees of profit-making firms, although such plans have existed earlier under Internal Revenue Services (IRS) revenue rulings.

In 1990, 20.8 million workers were covered by 401(k) plans. This number represented 23 percent of all private sector workers. Most of the covered group (19.5 million) were active participants. Participation rates are higher for workers within the higher earnings level.

A 401(k) plan permits employees to elect a contribution of a part of wages on a tax-deferred basis to a plan that may offer several investment options. Employers usually make contributions, which also are treated as tax-deferred income for employees. In a typical plan, the employer puts in 50 cents for each dollar of employee contributions up to 6 percent of salary.

Annual individual contributions are limited to US$ 9,240 in 1994. (The limit was set at US$ 7,000, effective in 1987, and is adjusted annually for price inflation.) Further restrictions are applied to "highly compensated" participants by "nondiscrimination" rules. Total contributions from both employee and employer are also constrained by a limit on the sum of contributions to all qualified employer-sponsored plans on behalf of the employee.

The popularity of these programs has further contributed to the movement toward private, defined-contribution programs.

Chile

In 1981, Chile introduced a private pension program based on a defined-contribution scheme that replaced the previous pay-as-you-go state-managed social security system. At the time, the government was spending two percent of GDP to support the old system.

Under the new system, 10% of the worker's paycheck is deducted and forwarded by his or her employer to a pension manager chosen by the employee. Participation in Chile's system is compulsory. Upon retirement, the employee buys an annuity from an insurance company with the proceeds from his/her account.

The system in Chile is tightly regulated. For example, funds are required to have less than 30 percent of their assets in the stock market. In addition, both debt and equity investments must be approved by the Superintendent of Pension Fund Management Companies, and a fund cannot have more than seven percent of its assets invested in the securities of any one company.

The accumulated pension savings of US$ 12.5 billion has satisfied much of Chile's demand for capital. The Chilean private pension system significantly altered the shape of the domestic capital market. Until the late 1980s, Chilean companies, like most in Latin America, could borrow money only for very short periods at very high interest rates. As late as 1989, with Chilean sovereign debt trading at 60% on the dollar, foreign banks were not lending new money in the country. Since then, local corporations have sold the pension system upwards of US$ 5 billion in bonds with maturity as long as 27 years creating one of the few long-term debt markets in Latin America.

The pension funds have been active investors in the local capital markets. Currently, the corporate pension funds own over 10% of the total market capitalization of the Santiago Stock Exchange.

Mexico

Under a decree that was enacted in 1992, privately managed pension schemes were created to operate alongside the existing state-sponsored system. In addition to paying social security taxes to the state system, as of May 1992, employers were required to contribute a percentage of employees' wages to a new form of individual retirement savings accounts.

These new accounts are invested with the central bank, offering a guaranteed yield of two percent above inflation. Today, workers have the option of transferring their accounts to investment management operations run by banks and other entities, including stock brokers.

Unlike the Chilean system, the Mexican scheme allows the worker to maintain his/her investment in government securities. However, it is expected that many people will be lured by the potential of higher yields in other investment vehicles.

Peru

Peru has recently passed legislation to create private pension funds. This new system, which follows the Chilean model of pension fund reform, will be supervised by a government body known as the Superintendencia de Fondos de Pensiones.

In the new scheme, individual employees can contribute, on a voluntary basis, up to 10% of their salaries to a pension scheme. In addition, employees will be able to join any private pension fund and switch funds at will. Individuals participating in the government-run social security system will also be able to switch to the new private system. By doing so, these individuals will receive a bond equivalent to their previous contributions to the state system that they may choose to invest in any private pension fund. The Peruvian government has provided for a two-year transition between private and state systems.

Bolivia

Bolivia has prepared a draft law and regulations to reform its social security pension system. The legislation is expected to be presented to Congress in the first half of 1994. The impetus of the pension fund reform has two parts: to address the financing of the social security pension system and to improve pensions for Bolivians participating in social security. Under the reform, private pension fund administrators will handle investment and pension fund management. The system has prudent disclosure requirements and investment limits, and establishes fiduciary responsibilities. The new pension fund system will be supervised rigorously by a pension superintendency to be established by the Government of Bolivia (GOB).

The Government of Bolivia plans to link privatization of the six largest state-owned entities to the pension fund reform. The GOB proposes to distribute half the shares of these firms to the people via pension funds. This move has interesting implications for capital market development, although the logistics of the plan are not certain.

Eastern Europe

Many Eastern European countries are eager to institute private pension fund programs. They are trying to cut expensive social insurance costs and create an internal pool of capital. For most workers, however, the availability of private plans will be years into the future given that start-up companies are struggling to obtain operating capital in difficult economic conditions.

Even though Eastern European countries still lack legislative frameworks to create private plans, some individual companies already have established their own plans. In Russia, for example, it is estimated that more than 100 pension plans have been registered, despite the lack of adequate legislation.

Indonesia

Indonesia has a social security system in the form of a provident fund that makes a lump sum payment at retirement. In addition, private companies, state-owned enterprises, and Government entities have pension funds. In April 1992, a new law established a framework allowing a wide degree of pension arrangements and a choice in plan design. The law introduced various requirements for disclosure, trustees, investment policy, plan valuations, funding requirements, and other elements. Prior to that time, no comprehensive set of regulations regarding pension fund operations existed in Indonesia. Over the past two years, the regulations which accompany the law have gradually been issued. As a result, while some pension assets have shifted to professional investment management in the private sector in response to the law, the full impact of the law has yet to be felt.

c. Defined-Contribution Schemes: Some General Benefits

As discussed above, some countries have not only supplemented their state-managed social security pension system, but also have replaced it with privately managed and funded pension schemes. In this section, some of the general benefits behind instituting these schemes are summarized.

Defined-contribution schemes accumulate contributions over time and can have a dramatic impact on economic and social development. In countries with limited internal savings and limited access to equity or debt capital, the schemes can help overcome these barriers and provide the capital required by both the public and private sectors for economic and social development.

The power of defined-contribution schemes to accumulate capital is demonstrated by simple arithmetic. In a country where 1 million workers, with an average income of US$ 150 per month, contribute 10% of their wages to the pension system, the total annual contribution to the pension system is US$ 180. With a nominal return on investment of 10% per annum, over US$ 1 billion would be accumulated in 4 years. The number of participating workers, average salaries, contribution rates and investment returns will vary by country, and the amounts accumulated will be higher or lower. Regardless of the exact amount, capital is generated and accumulated and can have a dramatic impact on economic and social development.

In many countries, participation in the equity markets is generally confined to a small percentage of the population. Defined-contribution schemes can democratize the capital markets and provide access to all participants in the pension system, including teachers, office workers, laborers and others.

However important to the development of internal savings, capital accumulation and democratization of capital markets pension funds may be, these are only by-products of pension programs. Their primary function is the provision of an adequate pension income to retired individuals to ensure their dignity, health and well-being after their income-generating years are over.

d. Defined-Contribution Schemes: General Risks

Risks to Workers / Contributors

A number of concerns and issues relating to privately managed pension programs characterized by defined-contribution schemes are addressed including:

(i) Interest Rate Risk. Most individuals approaching retirement will probably want to receive a pension equivalent to 65 to 75% of their latest salary level. Pension benefits under defined-contribution plans are highly sensitive to the rate of return achieved over the working life of the contributor. If returns fall below a certain return, many workers may receive unacceptably low pensions.

(ii) Density of Contribution Risk. When there are few workers per retiree, there is a danger that adequate pensions cannot be provided. For example, of the 4 million workers affiliated with the Chilean scheme in 1991, only 2.4 million were in fact paying contributions. If this proportion were to fall, the percentage of workers with low pensions would increase; and

(iii) Conversion Efficiency. The efficiency with which accumulated savings are converted into an annuity or a programmed pension at retirement affects the total funds available upon retirement. For example, insurance companies may charge for establishing an annuity. Such fees will reduce the size of the funds on which the pension can be based.

Risks to State Budgets

Not only do individual workers face potential difficulties, but also the public budget can be exposed to a number of uncertain and possibly large commitments. The state, in some schemes, is responsible for financing the cost of the change in the system and its maintenance in the future. Such financing includes: (i) the cost of providing the "recognition bonds" given to workers who transferred from the old to the new system, such as the case in Chile and Peru; (ii) the cost of liabilities arising from the state guarantee of minimum pension, such as the case in Chile; and (iii) the cost of the state guarantees covering the possible collapse of the funds.

In addition, the state, in some cases, must continue to finance deficits incurred by the old scheme as long as it continues in operation. Moreover, under certain new systems, insurance companies participating in the program must index life annuities to the rate of inflation. To meet this commitment, insurance companies must invest a percentages of their resources in government indexed bonds. Thus, the government bears a large proportion of the responsibility for the indexation of benefits.

e. General Considerations

A number of considerations also need to be borne in mind. These considerations include: (i) the ability of the local capital markets to absorb the supply of capital generated by the pension funds; (ii) the challenge of incorporating the informal sector; and (iii) pension governance.

Absorption of Funds by the Capital Markets

The magnitude of funds accumulated by the pension plans might have macro-economic effects and produce higher rates for economic growth. But they may go further than this if the supply of funds is greater than the amount that can be readily absorbed by the local capital markets and existing investment opportunities. Thus, rates of return on domestic investment may decline and/or capital outflows may increase as investors seek investment opportunities abroad.

The Informal Sector

In many developing countries, a high percentage of the population consists of low-income "casual" workers, rural workers, peasants, the unemployed and the destitute. These groups rely to a large extent on public assistance for income in retirement (and on support from the family in certain cultures). To the extent that some states may decide to subsidize the replacement of the old with the new private pension schemes, they will have fewer resources available to increase benefits for the unemployed.

Governance

Many of the new pension schemes will rely heavily on the efficient operations of private pension funds. This reliance will require: (i) the funds' compliance with regulations covering their operations; and (ii) competition among the funds to minimize costs and promote productivity. The first responsibility will reside with a regulatory body. Prompt and full compliance by two other groups is equally important: the workers and their employers, who are responsible for forwarding contributions; and the funds and insurance companies, who are responsible for processing claims. Another essential element concerns the government's obligation to ensure good economic management because low or negative real interest rates, a weak labor market or a decline in the relative size of the formal sector, would all rapidly make new private pension schemes unattractive.

Conclusion

The primary focus of national pension systems, and any pension system reform, should be the provision of pensions to retirees to enable them to enjoy a reasonable level of income, and subsequently health, well being and dignity in their post-work years.

If appropriately designed and administered, pension systems can successfully include public or private administrators and defined-benefit or defined-contribution plans. Nevertheless, experience appears to indicate that privately managed pension programs characterized by defined-contribution schemes may offer a higher probability of providing attractive, secure pensions to retirees.

An additional benefit of defined-contribution schemes is that they tend to accumulate high amounts of capital which can have a positive impact on economic and social development. In fact, there is a danger, discussed above, that more capital will be accumulated than can be absorbed in the domestic market.

The transition cost of moving from one pension system to another can be significant, especially when past work experience--which has not been funded by the government--is sought to be credited to workers' accounts in a defined-contribution plan.

Many developing countries that attempt to move from a pay-as-you-go system to a defined-contribution plan will require assistance from the international donor community to finance both technical assistance and transition costs.

International assistance to reform pension systems has the potential for achieving a greater impact per dollar of assistance, than many other types of assistance. Once the structural adjustments have been made, the accumulated capital in the pension funds will provide the capital required for development. The billions of dollars accumulated in pension funds dwarfs the assistance that can be provided by the international donor community and provides a sustainable source of financing for development.

COUNTRY	TYPE OF PENSION SYSTEM	SOURCE OF FUNDS	PENSION BENEFITS AT RETIREMENT	ADMINISTRATIVE ORGANIZATION	COMMENTS
Bolivia	State-Managed Social Security System based on a defined-benefit scheme.	**Insured Person:** 5% of earnings **Employer:** 2.5% of payroll.	30% of average earnings in last 6 months of contribution (24 months for workers with earnings over a specified amount), plus increment of 2 % of earnings for each 12 months of contribution beyond 180 months. Minimum and maximum pensions are set at a given rate.	Ministry of Social Security and Public Health, general supervision. Bolivian Social Security Institute, responsible for coordination, planning, control, and evaluation of program. National Social Security Fund, administration of program.	The government is currently addressing the financing of the social security system. It is considering the creation of private pension schemes to operate along-side the existing state-managed system.
Chile	State-Managed Social Security System based on a defined-benefit scheme.	**Insured Person:** 20.15% of earnings. **Employer:** none	1/35 of final base salary times years of contribution.	Ministry of Labor and Social Welfare, general supervision. Superintendent of Social Security, administration of program.	In 1981, the government instituted the mandatory private pension system in order to phase out the state-managed social security system.
	Mandatory Private Pension System based on a defined-contribution scheme	**Insured Person:** 10% of earnings **Employer:** none	Insured's contributions plus accrued interest. Minimum pension guaranteed by government. At retirement, insured may buy annuity from private insurance company.	Superintendent of Pension Fund Management Companies, general supervision; individual pension fund management companies, administration of program.	
Indonesia	Provident fund social security system (lump-sum benefits only).	**Insured Person:** 1% of earnings **Employer:** 1.5% of payroll.	Lump sum equal to total employee and employer contributions paid in, plus accrued interest.	Minister of Manpower, general supervision. Public Corporation for Employees Social Insurance, administration and operation of program.	As a result of a new law issued in 1992, a wide choice of pension arrangements is allowed. So far, some pension assets have shifted to privately managed pension schemes. However, the full impact of the Law is yet to be felt.

COUNTRY	TYPE OF PENSION SYSTEM	SOURCE OF FUNDS	PENSION BENEFITS AT RETIREMENT	ADMINISTRATIVE ORGANIZATION	COMMENTS
Italy	State-Managed Social Security System based on a defined-benefit scheme.	**Insured Person:** 7.29% of earnings **Employer:** 18.93% of payroll.	Based on average annual earnings in last 5 years (with earnings in first 3 years revalued for changes in the cost of living).	Ministry of Labor and Social Welfare, and Treasury, general supervision. National Social Insurance Institute, administration of program through its branch offices; managed by tripartite governing body. Separate institutes or funds administer special systems.	The government is considering to adopt a defined-contribution scheme to replace the systems existing arrangements.
Mexico	State-Managed Social Security System based on a defined-benefit scheme.	**Insured Person:** 1.75% of average earnings (rate will rise gradually each year to 2% by 1996). **Employer:** 4.9% of payroll (rate will rise gradually each year to 5.6% by 1996).	35% of average earnings during last 250 weeks of contribution, plus 1.25% of earnings/year of contribution beyond 500 weeks.	Ministry of Labor and Social Welfare, general supervision. Mexican Social Insurance Institute, administration of program through regional and local boards in areas to which coverage extended; managed by General Assembly, Technical Council, Oversight Commission, and Director-General.	The privately managed pension system was created in 1992 to operate along-side the state-managed system.
	Privately managed pension system based on a defined contribution scheme.	**Insured Person:** none **Employer:** 2% of payroll (mandatory).	Contributions plus accrued interest.		

COUNTRY	TYPE OF PENSION SYSTEM	SOURCE OF FUNDS	PENSION BENEFITS AT RETIREMENT	ADMINISTRATIVE ORGANIZATION	COMMENTS
Peru	State-Managed Social Security System based on a defined-benefit scheme.	**Insured Person:** 3% of earnings; (self-employed 9% of earnings). **Employer:** 6% of payroll.	50% of highest average earnings in last 12, 36, or 60 months (whichever is more favorable); plus 2%/year beyond 15 years (men) or 1.5% (women) for each additional year of contributions up to 5 years.	Comptroller General of the Republic, general supervision. Peruvian Social Security Institute, administration of program through 9-member tripartite governing board and executive chairman.	The privately managed pension system was created to operate along-side the state-managed system.
	Privately-managed pension system based on a defined-contribution scheme.	**Insured Person:** Up to 10% of earnings (voluntary) **Employer:** 1% of earnings.	Contributions plus accrued interest.	Superintendent of Pension Fund Management, general supervision; individual pension fund management companies, administration of program.	
U.S.A.	State-Managed Social Security System based on a defined-budget scheme.	**Insured Person:** 7.65% of earnings. Self-employed, 15.3%. **Employer:** 7.65% of payroll	Based on average earnings over period after 1950 (or age 21, if later) up to age 62 or death, excluding 5 years with the lowest earnings.	Department of Health and Human Services, general supervision. Social Security Administration, administration of program through regional program centers, district offices, and branch offices. Treasury Department, collection of Social Security taxes through its Internal Revenue Service, payment of benefits, and management of funds.	State-managed social security system is projecting financial difficulties because of its unfunded status.

	PENSION SYSTEM	FUNDS		ORGANIZATION	
U.S.A. (continued)	Private pension systems based on defined-benefit or defined-contribution schemes.	**Insured Person:** vary by type.. **Employer:** vary by type..	Vary by type.	ERISA (Employment Retirement Security Act) requires employers providing pensions to meet minimum standards and provide prudent management of pension funds. The Pension Benefit Guarantee Corporation (PBGC) guarantees pension payments if the plan sponsor goes bankrupt.	The private pension system is undergoing a gradual change in the type of plans commonly offered. While the proportion of employees covered by defined-benefit plans dropped from 87% to 68% (between 1975 and 1987), the number of employees covered by defined-contribution plans jumped from 13% to 32%.

Glossary

defined-benefit schemes	are pension schemes with pension benefits based on a formula which includes worker's salary and years of service. These schemes may or may not be fully funded.
defined-contribution schemes	are pension schemes where a worker contributes funds to an individual account. The amount of the pension benefit depends on the amount in the individual account at the time of retirement.
funded pension plans	are pension plans whose liabilities equal the plan's assets.
pay-as-you-go scheme	is a defined-benefit scheme which utilizes active workers' payroll taxes to fund retired workers' benefits.
privately-managed plan	is a plan in which funds are administered by a professional investment manager.
social security pension	is the pension that is provided by the state-run pension system.
unfunded plans	are pension plans whose liabilities exceed the plan's assets.