

Transition in the social security reform in Chile:

Effect on the fiscal deficit (as % of GDP)

<u>Year</u>	<u>Direct Deficit</u>	<u>Recognition Bonds</u>	<u>Total</u>
1981	1.47	0.01	1.48
1982	4.08	0.11	4.19
1983	4.58	0.22	4.80
1984	4.55	0.25	4.80
1985	4.27	0.30	4.57
1986	4.33	0.41	4.74
1987	4.35	0.49	4.84
1988	4.23	0.50	4.73
1995	3.10	0.80	3.90
2000	2.57	0.94	3.51
2005	1.84	0.99	2.83
2010	1.19	0.80	1.99
2015	0.80	0.40	1.20

THE CRISIS IN GERMANY'S PENSION INSURANCE SYSTEM

Up to 1992 Germany had a pension system in which the pensions were linked to the growth of gross wages. The Bundestag defined a comprehensive program of pension reforms in 1992 and 1997. It replaced tying the pension to the net wage, did away with early retirement, abolished the pension for occupational invalidity (due to decline in earning capacity) and made it more difficult to get a general disability pension. It also lowered the pension of the so-called "standard pensioner", that is, someone who has paid contributions based on average income for 45 years, will fall from 70% to 64% of the net wage. All these measures have helped make the problem seem less serious, but they only make up a policy of mere deficiency management which, whether intentionally or not, has obscured the issue of the coming crisis of the statutory pension insurance system.

The age profile of Germany's population has changed from a pyramid in the early 20~Century to a pine tree structure, with a bulge in people of middle age. This profile creates problems for a pension system that operates with Pay-as-you-go (PAYG) financing. Fewer and fewer young people must finance more and more old people. It is also quite obvious that the greatest difficulties are yet to come. It will become critical when the heavy branches now at the lower levels of the pine tree move up to the pensionable levels. This is predicted to happen in the third decade of this century.

Germany could have handled the coming demographic distortion well if its pension insurance system had been a fully capital funded system and not a contributory PAYG one, because the pensions could then have been financed by dispersing previous

savings instead of by using the contributions of the working generation. With capital funding, the contributions to pension insurance are true savings, which can be put on to the capital market and used to finance real investments. The only problem then is to create the capital stock. The accumulation process is likely to be arduous, which could have been avoided if such a stock had already existed. Today the fund is only sufficient to cover pension payments for 11 days.

The cash value of the rights already acquired, that is, the implicit government debt, is around DM 10 to 12 billion. That is more than Germany's total fixed assets and a multiple of the explicit government debt, which comes to DM 2.2 billion. At the Euro's advent, the German debt-GDP ratio was just above the Maastricht limit of 60%. If the implicit government debt of the pension insurance is added in, the total debt-GDP ratio becomes about 350%.

Pension reforms of government employees in selected countries

Pension reforms, in general, and those of the civil services in particular, have gained momentum in the nineties due to a combination of diverse economic and fiscal developments, both internal to the respective countries, and external. The pioneering Chilean pension reforms included the system for government employees as well. The East Asian economic crisis of the late nineties further underlined the importance of financial and capital market reforms, and of reducing the gap between domestic savings and investment to lower dependence on volatile, short-term capital market inflows. Civil servants generally account for a significantly large share of formal sector employment and, as a group, belong to the upper half of the income group. Civil service pension reforms are thus regarded as an important potential avenue of increasing national savings or at least to better utilize the change in the composition of savings towards long-run contractual savings made possible by the pre-funding arrangements. They have also been designed to reduce the fiscal burden of the state, improve labour market efficiency and assist in the development and improved efficiency of capital markets, while simultaneously addressing social adequacy and equity concerns.

Besides the Latin American countries mentioned in the sections above, Eastern Europe has also moved in this direction. Among neighbouring countries, Thailand reformed pension benefits of civil servants along the above lines in the mid-1990s, even before it was hit in 1997 by the economic crisis. Indonesia requires about a quarter of pension benefits for the government employees to be in the form of employee contributions. This ratio is expected to increase significantly as part of pension reforms it is considering, not only as a response to the economic crisis, but also to maintain its international competitiveness.