Executive Summary

The recommendations presented in the context of this report are presented below. They reflect in part proposals presented in the 1994 White Paper on Social Security Reform. They are based on the results of this actuarial valuation of the pension and short-term benefits schemes as of the valuation date of 31 December 1994.

Benefit provisions

(a) Increase of the normal retirement age and equalization of the normal retirement ages for women and men: the normal retirement age for women should first increase from age 55 to 60 over an initial 100 year period and then it should be raised to 63 to be in line with the retirement age of men for whom gradual increases should start immediately, i.e. from age 60 to 63.
(b) Revaluation of reference earnings: reference earnings of working years prior to retirement that are used for the purpose of calculating benefits should be adjusted for inflation as of the time of pension entitlement.
(c) Modification to the accrual rate of the old-age benefit formula to 1.7 per cent of reference earnings per year of service, as suggested in the White Paper.
(d) Modification to the definition of the minimum and maximum pensions: initially, they should be defined as a percentage of the national minimum wage; thereafter, they should increase on a systematic basis linked to increases in the national average wage.
(e) Modification to the provisions for invalidity pensions: the calculation of benefits should be modified and the method of calculation should be simplified.
(f) Modifications to the provisions for short-term benefits:
- Net earnings should be used for the purpose of calculating benefits.
- Employers should be required to finance the first 3 days of sickness.
- The reduction of the duration of maternity benefits.
- The exclusion of grand-parents as eligible dependants for parental benefits.

Financing issues

(g) Maintenance of the PAYG method of financing: given the current circumstances, this represents the only appropriate method of financing pensions at this stage. There are strong justifications in favour of this: the pension scheme is in a mature stage; the coverage of the insured population is quasi-universal; and the prevailing inflationary environment combined with under-developed financial markets render the accumulation of large reserves and risky strategy.
(h) Need for improvement of the compliance rate: measures to improve the current low rate of compliance for employers to pay social insurance contributions in full and to register all workers are necessary.
(i) Separate financing of social assistance benefits: it is recommended that family benefits and other benefits of a social assistance nature be financed from the State budget and not from contributions to the social insurance pension scheme. These benefits should not be subsidized exclusively by insured workers. When excluding the cost of family benefits, it appears that the Government subsidy for pensions and short-term benefits could be lowered significantly (by 45 per cent in 1993 and 1994 and by 82 per cent in 1995).
(j) Introduction of employees' contributions: employee contributions should provide a supplementary source of revenue in addition to employers' contributions. In parallel, compensatory measures applicable to gross earnings should be applied to maintain the same level of take-home pay. The State subsidy could be reduced as a consequence and it should increase employees' awareness of the financial cost of benefits. National consensus with all the interested Parties is
necessary. The PAYG contribution would then be lower, i.e. from 35 per cent to 30 per cent of gross earnings.

(k) The projected cost of benefits under the reform proposals is higher than under status quo provisions. Thus, the cost of the measures to improve benefit protection more than offsets the savings from the measures to reduce the financial burden. The Government should pay careful attention to this situation and maybe consider more conservative benefit provisions.

(l) Regular actuarial valuations: it is imperative to conduct annual actuarial reviews. Since the behavioural factors (e.g. retirement patterns) which impact on the financial situation of the social security schemes are expected to show atypical patterns during transmission. Less frequent assessments should only be considered once the economic situation reaches stable levels. Given the mature state of the social insurance pension scheme, a 15-year projection horizon is recommended as a minimum.

**Maintenance of statistics and the set-up of an actuarial/quantitative unit**

(m) It is recommended that training of social security officials be provided in order to develop internal capacities to maintain the necessary statistical base to conduct future actuarial reviews and to provide continuous monitoring of the financial status of the scheme. This should provide support to the GDSS in taking necessary action, e.g. increasing the contribution rate or reducing benefits or restricting the access to benefits, when the actual circumstances are different than expected. Section 4.1 addresses possible improvements to be brought to the statistical base.

(n) It is proposed to centralize the actuarial/quantitative expertise which is necessary for the future financial management of the social protection system. A quantitative unit could be located in the Government or the new Social Security Institute. In both cases the unit should serve all subsystems of the national social protection system.