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Public Pension Insurance in Countries with Different Stages of Development

I. Introduction

Some 150 years ago Germany was a country very much in development. It was the time of industrialization when a society with a rural economy turned into a society with all the chances of this new era but also all the problems of a country in transition. People moved to the cities in search for jobs in industry – like in China and in Brazil these days. The conditions at the workplace were bad; the risk to lose the job was high. Workers could easily be replaced and affordable, i.e. public protection in case of illness, invalidity and industrial accidents was not existent. Families were split up because the younger ones moved to the cities and the older ones stayed in the rural area. The traditional system of family as an organization of social protection did no longer work.

From the perspective of countries like Brazil and China this very much recalls to the current situation there…

Also during this time the worker´s movement started – just recently the German Social Democratic Party (SPD) which started as the General German Workers´ Association (Allgemeiner Deutscher Arbeiterverein) celebrated its 150th birthday. The worker's movement fought for better working and living conditions and caused social unrests, protests and general strikes. On the other side, the German states still were run by the old aristocracy – now more and more associated by the owners of the new industry. After (re-)unification of Germany in 1871 the German chancellor Bismarck tried to solve the "problem" of the Socialists and Marxists by repressive measures – like the Anti-Socialist Laws – but he also identified the lack of social protection and bad labor conditions as a source for social tensions.

So in the end Bismarck´s approach was a combination of repression and social reforms in order to solve the problem. The basic idea of the social reforms was the introduction of a contributory system of social insurance which in the first place covered only the blue-collar workers – the main source for social tensions. The system was made contributory, the benefit level being dependent on the contribution paid, so that the workers could view the benefits of the system as something in their own right.

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In the Royal Proclamation of Emperor Wilhelm I on November 17th, 1881 it is said that "*We let Our conviction be known that curing social defects will have to be pursued not only through the repression of Social Democratic excesses but also through the consistent and positive promotion of workers' welfare".*

Bismarck himself did not view this reform as especially important when writing about his political career and chancellorship in his biography. There is no chapter at all about social policy and social insurance. He focused on his foreign policy and the unification of Germany in 1871 and general politics.[1] From that it can be concluded that for him it was a matter of political tactics rather than reform emphasis.

The basic structures of this system are still existing and in practice. The idea of a contributory system is not only to be found in pension insurance but also in industrial accident insurance, health insurance, unemployment insurance and also in the new long term care insurance – established in 1995.

The idea of social insurance has spread around the world and is currently one of the main alternatives when designing social systems.

The aim of this paper is to review the development of social insurance idea in public pensions over the years in Germany and other countries and analyze the functioning of the idea and the system in countries in different stages of development.

The paper will analyze the Bismarckian approach and recall German experiences over the years since its start because the development in Germany from a newly industrialized country in the 19th century to a "post-industrialized" country in the 21st century might have certain analogies with the current and future developments of the other groups of countries using the Bismarckian approach. The paper then will analyze the development in Brazil over the last years and will also refer to the discussion and policy measures on "social management" in China and experiences of the author of the paper from his consulting work in Middle and Eastern Europe. The paper will include supplementary pensions if feasible.

It will be a comparison based on legal issues including aspects of constitutional law and the legal systems of the countries. This focus is to be seen on the background of the author of this article being a professor of law. But the article will not keep with the legalistic approach but will work interdisciplinary including data on the different countries and literature; in the end the paper will evaluate the current stage and future perspectives of countries following the Bismarckian approach – pointing out the different historical, social and political background of the countries. It will show shortcomings, will point out experiences for future development and discuss in general the present and future of the idea of social pension insurance.

Ottó Czúcz has witnessed all the developments especially in Middle and Eastern Europe and did research on it. The author of this paper therefore hopes that the thoughts laid down here will be of interest for Ottó Czúcz – his colleague and friend during decades.

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[1] BISMARCK O: *Gedanken und Erinnerungen.* Stuttgart, 1898.

II. General Observations

The overall situation has changed very much since Bismarck established social insurance – and especially public pension insurance in the 19th century. These days social policy is not just a means to stay in power and no longer an alternative to repression but in the center of politics of almost all countries.

The new-industrialized countries of the 19th century are now sometimes called "post-industrialized" countries having turned from producing industry to service industry which is to some extent the case in the United Kingdom. The now newly industrializing countries – the emerging markets – do the development much faster than the countries did in the old days.

All these countries – the "old" and the "young" – are faced with a globalized economy which means global competition.[2] In a globalized economy competitiveness depends on effectiveness, innovativeness and overall costs. An important factor therefore is cost of labor and major part of labor costs are direct taxes and social security contributions.

Public pension insurance is faced with an ageing society – not only in the "old" industrialized countries but also in the threshold countries. They may not be faced with that problem within the next 10 or 20 years – like Europe and Japan – but the time will come.[3] China already has identified its one-child-policy as a main factor for an ageing society in China and decided in December 2013 to ease that policy.[4] As a matter of fact the situation in China is already rather severe and shows a dramatic aging of the country. Countries like Brazil may be better off but will move in that direction as well.[5]

When Bismarck introduced social insurance in Germany, factors like Globalization and an ageing society didn't play a role yet. However, without facing those challenges today the system would perish; every system has to be adaptable to a certain degree.

III. Good and Bad Experiences with the insurance idea in Germany

Without any doubt Bismarck´s initiative was path-breaking – as it is the case with the Beveridge Report of 1942 and Norway´s SWF approach. Nevertheless all these initiatives have certain advantages but also certain shortcomings that should be identified. Also over the years the different approaches have been improved taking into account experiences and problems and may have converged to a certain extent.

From a German perspective one can say that the main advantage of a system of pension insurance lies in the insurance principle. This means that contributors in principle receive what they paid for; what is paid in decides on what is paid out as benefits when retiring.

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2 PIETERS D, SCHOUKENS P.: *Social Security in the BRIC Countries*, IBM Center for the Business of Government. International Series: Washington D.C 2012.

3 GUZMAN JM, PAWLICZKO A, BEALES S, TILL C, VOELCKER I:, *Ageing in the Twenty-First Century: A celebration and a Challenge.* United Nations Populations Fund (UNFPA) and HelpAge International: New York and London 2012

4 http://www.npc.gov.cn/englishnpc/news/2013-12/24/content_1819669.htm, 31 January 2014

5 *International Labour Office*, World Social Security Report 2010/2011, Providing coverage in times of crisis and beyond. ILO Publications: Geneva, p. 142.

People do not just view their pension as a benefit by the state but as their own right, their own legal position earned by contributions. This idea is especially prevalent in Germany and to a lesser extent in a number of other countries – like the US where the contribution is called "payroll tax" and by most Americans is viewed as tax. Actually this has a psychological aspect as well as a political aspect since if people consider benefits as acquired by contributions they refer to more stability and (planning) reliability and thus political changes of the system are less likely.

To better understand this thesis and the German idea of own rights acquired by paying contributions, one has to take a glance at the underlying German legal system and especially the jurisdiction of the German Federal Constitutional Court. In Germany, in exchange for paying contributions, the contributor receives a legal position including prospective pension entitlements under condition.[6] In other words, the payment of pension contributions establishes a right to future pension payments. The pension payment is promised and pensions are being paid when the retirement age is reached.

This legal position is regarded as personal property which is protected by the German Constitution, Article 14.[7] The protection by the constitutional property guarantee is justified by the fact that this right is the result of personal contributions and is classified as belonging to the individual person. The key consequence is that – as the pension benefits result out of contributions – they have to have a certain value so that they are in proportion to the contributions. However, this does not mean that what is paid out does have to be exactly the same amount as what has been paid in (or more) like in a funded system. Protected by the property clause is not the money itself but the legal position which is acquired by paying contributions. Coverage by the property clause of the constitution means that cuts in benefits and entitlements exceeding a certain level might be unconstitutional – something German lawmakers have to experience from time to time. Cuts and changes in benefits and entitlements have to stay within certain limits. However, there is still a quite vast scope for the legislator to act in everyone's interest – above all, the legislator is able to secure the functioning and the effectiveness of the system, to improve it and to adjust it to changing economic conditions.[8] In so far, the legislator is allowed to restrict pension rights as long as changes are in public interest, appropriate, necessary and their impact does not exceed their purpose.

The German view of protected property and own rights in regards to pension insurance might appear quite complicated and circuitous but what matters in the end is that people – and also the government – feel and know that they have a right to get out what they paid in for. Other countries may have different understandings concerning property but as long as the contributions paid in are linked with the benefits received later, which is typically the case in an insurance system, people regard receiving benefits as a right acquired by paying contributions.

Altogether, this leads to a greater legal stability of such a system without losing too much flexibility. It is also more difficult to reform the system and requires usually a broad political

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6 German Constitutional Court (Bundesverfassungsgericht) Official Report BVerfGE Vol. 117, pp. 272, p. 292 (BVerfGE 117, 272, 292)

7 BVerfGE 58, 81/109

8 BVerfGE 53, 257.

coalition. This also means for Germany that it is almost impossible in practice to change the system totally from PAYG to a funded system or even to a tax-based system.

As already mentioned above one main challenge the German system had and still has to face is the demographic change towards an ageing population. Here obviously lies one of the main weaknesses of a PAYG system; such a development causes financial problems. However, there are mainly three possibilities how to react to such a development: reducing pension benefits, increasing contributions and/or postponing the retirement age.[9] Besides reducing the benefits and introducing supplementary pension schemes to fill the gap, Germany decided to postpone the retirement age which can be seen as an inevitable means to take in response to demographic ageing and is a general advice by political and scientific bodies.[10]

One of the major aims in social security is to achieve universal coverage. In a system following the insurance principle this is more difficult to achieve than in countries following the Beveridge approach. In order to be workable a system of public pension insurance requires pecuniary income and the legal obligation to insure has to be linked with a legal relation like a labor contract. Therefore it is difficult to achieve universal coverage which in Germany in the first place led to gaps in coverage for self-employed but also for people not working. As an answer in Germany coverage was extended for example by linking it in the case of self-employed to their professional status (certain professions were included, for example craftsmen, publicists, artists…) and recently generally to all "small" self-employed.

Another disadvantage is that people have to be able to afford paying contributions. This may be difficult in case of low-income people but in those cases and generally a social insurance system works with income-related and not risk-related contributions. It is also of help that the employer in case of mandatory insurance pays at least one-half of the contributions, like in Germany – or even more as in a number of countries. This approach comes to a serious limit in case of self-employed who have to bear the full amount by themselves and to even a more serious limit in case of persons who can only be included on a voluntary basis; the experience shows that those most in need of protection will not participate due to their low income if on a voluntary basis.[11]

A specific problem of countries in transition is the lack or gap in contribution compliance.[12] According to experiences of the author of this article up to 30 % of contributions to be paid will not be paid in the end. This is very often due to a less effective administrative system or problems in registering people to be covered. These countries are trying to improve but still this problem is there – in Brazil as well as for example in China. But on the other hand this is also a problem of tax-financed systems;

[9] JOUSTEN A, PESTIEAU P.: *Labor Mobility, Redistribution, and Pension Reform in Europe*. In: Social Security Pension Reform in Europe, pp. 85-100. National Bureau of Economic Research. Publisher: University of Chicago Press. 2002

[10] *World Bank*, Averting the Old Age Crisis – Policies to Protect the Old and Promote Growth, World Bank Policy Research Report. Washington D.C. 1994

[11] *Auerbach P, Genoni ME, Pagés C.* Social Security Coverage and the Labor Market in Developing Countries, Discussion Paper No. 2979. IZA: Bonn. 2007

[12] STEINMEYER H-D., *Was bleibt übrig? Erfahrungen aus Beratungstätigkeiten in Mittel-, Ost-und Südosteuropa.* In: Festschrift für Klaus Adomeit, pp. 737-746. Cologne 2008

they only avoid the tricky issue of whether to provide benefits to all people insured or only to those where contributions have been paid. But in the end a social insurance system requires a more sophisticated administrative structure than a system which for example follows the Beveridge approach.

A contribution-related system may also have greater difficulties in fighting poverty in old age since it does not automatically cover everyone and the benefit amount is contribution-related, so it may need other means in addition. Here it can be seen that contribution-based systems tend towards supplementary means-tested systems. Countries like Germany have dealt with this and have established certain means to solve that problem. So there is a special social assistance system for old or disabled people which is slightly more generous than the general social assistance system. The current discussion in German politics is on introducing a basic pension for people with a long working career irrespective of the exact amount of contributions paid. So it can be seen that Bismarckian system tend to add a basic system of some kind whereas systems that provide only a basic protection are supplemented by additional earnings-related systems as is the case in Canada.[13]

So it can be seen that the system has been modified, supplemented and further developed since then and still characterizes social security in Germany. Germany has realized that this approach has some shortcomings – especially in the case of universal coverage – and has found ways to manage that. On the other hand it turns out to be – especially in its specific German design – independent from day-to-day politics and thus leads to a certain stability in social policy.

It also can be seen that the challenges everywhere are almost the same and the different systems and systematic approaches come to similar results while starting from different angels.

IV. Influence of the Bismarckian Model

A considerable number of countries adopted the Bismarckian model – not only in Europe but also in other continents. France and Belgium as well as Italy and Austria as well as Hungary follow this approach. There is a considerable influence in Eastern Europe and the pension reform in Sweden shows some links with the Bismarckian ideas as it introduced a contributory PAYG system based on average annual lifetime earnings. When going abroad the U.S. social security system can be identified to be at least influenced by the ideas. Also Brazil is in general following the social insurance ideas and thus uses a considerable different approach than other Latin American countries. When it comes to China it has to be said that the system is a very special one but is also contributory.

It is one thing to follow the Bismarckian approach in highly industrialized countries with sophisticated administrations and certain traditions in social policy. The other thing has been its functioning in countries in transition - like in Middle and Eastern Europe. Again another thing is how it works in less developed countries and especially in newly industrialized countries.

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[13] *Kaplan AN,* Pension Law. Toronto 2006.

V. The Brazilian Situation

Brazil has a very detailed federal constitution which also establishes specific rules on public pension insurance.[14] This means that – other than in most other countries – all major reforms have to be accompanied by constitutional amendments which require a 3/5 majority in both houses of the Brazilian Congress, Art. 60 § 2 of the Brazilian constitution. The result is that reforms are politically difficult to achieve and also may require political bargains – not always for the benefit of the reform.

Art. 201 of the Brazilian constitution specifies explicitly that the country´s social security system shall be organized as a general scheme, of a contributory basis and mandatory participation. So the idea of social insurance is fixed by constitution. In this explicitness this is not even the case in the German constitution where "social insurance" (Sozialversicherung) is mentioned in the provisions on legislative competences but not further defined.

It is also fixed that coverage has to be provided for the events of illness, disability, death, and old age; for protection to maternity, especially to pregnant women; for protection to workers in a situation of involuntary unemployment; for family allowance and confinement allowance for the dependents of the low-income insured; for pension for death of the insured, man or woman, to the spouse or companion, and dependents.

The constitution – interestingly enough – also provides details concerning benefits and even takes care about the Christmas bonus for retirees and pensioners, Art. 201 § 6.

The constitution also requires that the law shall provide for a special system to include low-income workers in the social security system, as well as to include no-income persons who are engaged exclusively in household chores within their own homes, provided that they belong to low-income families, so that they have guaranteed access to benefits at an amount equal to one monthly minimum salary. This shows that the Brazilian constitution takes into account the limits of a contributory system when it comes to people close to poverty.

By dealing with poverty in old age the constitution provides that the benefits should not be lower than the national minimum wage.

Last but not least rural workers qualify for pensions after 180 months of work in the field rather than 180 months of contributions as the urban workers. The rural workers are not obliged to contribute to the system which leads to a strong distributive effect of the system in favor of the rural economy; the number of retirees from agriculture currently exceed the number of pensioners from urban economy by far.[15] This also shows certain limits of the contributory approach for countries in transition and with a still strong agricultural sector.

On first sight these constitutional requirements address the major issues a country like Brazil is faced with. Brazil has to fight poverty and has – like China - to deal with the rural workers who very often work in subsistence agriculture.

Brazil is a country with a vast and still mostly rural population. As in most developing countries the main cities of the country have turned into mega-cities. Especially Sao Paulo

[14] On the constitutional and comparative issues see *Steinmeyer H-D.,* Verfassungsrechtliche Rahmenbedingungen und Grenzen für Reformen der Sozialsysteme im Zeitalter der Globalisierung. In: Neue Zeitschrift für Sozialrecht 2012, pp. 721–727 (Constitutional issues and limits for reforms in social policy in the era of globalization); the paper especially focusses on Brazil and Germany.

[15] ABI-RAMIA C.: *Recent History, Perspectives and Challenges to Social Insurance: the Brazilian Case.* United Nations Research Institute for Social Development: Geneva 2009

and Rio de Janeiro have to be mentioned but also Porto Alegre, Salvador de Bahia etc. People move from the rural areas to the cities looking for jobs there. The situation is like in China with the mega-cities on the East Coast.

Like in a lot of countries in this stage of development and also those in an earlier stage there is a massive part of the population in informal labor[16] which means that they are also in need to be covered on the one hand but practically difficult to be covered on the other hand. Nevertheless Art. 201 Paragraph 12 provides: *"The law shall provide for a special system to include low-income workers in the social security system, as well as to include no-income persons who are engaged exclusively in household chores within their own homes, provided that they belong to low-income families, so that they have guaranteed access to benefits at an amount equal to one monthly minimum salary."* This may not cover all or even most being in informal labor but shows how much Brazil is concerned about the challenge of labor inclusion.[17]

This also shows what has been described above concerning Germany – a social insurance approach has problems with coverage in case of persons with no income and/or no formal labor contract. Informality is a severe issue in Brazil since it is estimated that about half of the work force belongs to this sector.[18] Informal labor is especially to be found in agriculture but also in the other areas of the economy.[19] A major reason for informal work is tax evasion and evasion from social security contributions. As a matter of fact this would not be different in a tax-financed system but nevertheless it is true that high contributions stimulate informality of labor. Approaches to solve this problem or at least reduce it are being discussed in Brazil with a special focus on small and medium-sized companies who pay a single tax according to sales – and which includes social security contributions.

As assumed above also Brazil has a problem of an ageing society but also linked with a too generous approach used these days – as to be found in a number of countries – including Germany, France, Italy etc. Countries usually tend to lower retirement age in order to fight unemployment or to meet the wishes of future retirees for an early retirement. In Brazil the average retirement age for a man was around 55 years which in the end is very expensive for the system also in a relatively young society. Facing a reduction in the birth rate which is close to the German birth rate (currently around 1.5 % in both countries) this causes severe challenges for the system in Brazil.[20] Currently the official retirement age is 65 for men and 60 for women but there are a number of exceptions so that for example under certain circumstances men may retire after 30 years of contribution and woman after 25 years of contribution irrespective of their age, Art. 202 § 2 of the Brazilian constitution. There are certain reductions of the benefit amount in those cases of a proportional retirement but nevertheless this is an expensive solution for the system and difficult to finance.

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[16] FERREIRA SAVOIA JR.: *Pension Reform in Brazil: The Challenge of Labor Inclusion.* ISSA: Geneva 2007; *International Labour Office,* World Social Security Report 2010/2011, Providing coverage in times of crisis and beyond. ILO Publications: Geneva 2010.

[17] FERREIRA SAVOIA 2007

[18] FERREIRA SAVOIA 2007

[19] on definition of informal labour /employment see HUSSMANNS R.: *Defining and measuring informal employment.* ILO: Geneva 2002

[20] cf. FERREIRA SAVOIA 2007.

The system is also rather generous in case of survivors´ benefits. Except for orphans there is no age requirement; there is also neither an income test nor a test concerning available assets nor a means test and does not cease in case of remarriage. The amount of survivor benefits in total is always 100 % of pension value of the deceased.

Like in a great number of developing countries - but also developed countries - public sector pensions are more generous in Brazil than those for the private sector[21]. In Brazil this again is generally fixed by the federal constitution which resulted in almost 100 % of salary as pension. There have been reforms in the past during the Lula period in order to reduce this which all required constitutional amendments. There has been a tendency under the Lula government to reduce this high replacement rate[22].

It goes for granted that this leads to a rather expensive system which especially affects the employers´ side since there is a cap on the contribution of the worker but not on the employer. The contribution rate for the employee is between 8 and 11 % depending on the income – lower for low-income people and higher for the others. The contribution rate for the employer is 20 % of the full employee wage plus an additional rate depending on the firm's record of workers' injuries. The contribution rate for self-employed is about 20 %. This may lead to one-third of the wage bill which is in a country like Brazil a strong incentive to move into informality.

VI. The Chinese situation

China has a system which in the end also shows certain dilemmas of a contributory pension insurance. So it is difficult to cover informal labor as well as the rural population. Like Brazil also China is faced with an at least semi-subsistence rural economy with a limited or non-existing monetary basis for contribution and problems of registration and coverage. Whereas Brazil tries to solve the problem with a redistributive approach China is making farmer´s pension insurance voluntary and tries to stimulate farmers to join the system which leads to a considerable gap in coverage.

Another severe issue in China is the abuse of money paid into the individual account which is designed as a funded account. Obviously those funds are used for paying current beneficiaries[23] (*Sin* 2000) and general political purposes on at least a temporary basis which leads to a gap when it comes to the payment of pension benefits. There are also problems in case of mobility within China since pooling takes place on a provincial level and provinces have considerable interest not to transfer the funds to another province or may not even be able to do so due to massive underfunding.

Like Brazil also China is faced with the challenge of a rather low retirement age. This for a long time got its justification from the special situation of a developing country,

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[21] ABI-RAMIA C.: *Recent History, Perspectives and Challenges to Social Insurance: the Brazilian Case.* United Nations Research Institute for Social Development: Geneva 2009

[22] GARCÍA-ESCRIBANO M, PEREIRA J, DILTS K, MORENO BADÍA M, SEGURA-UBIERGO A, PARK J:. Brazil: Selected Issue Paper. International Monetary Fund: Washington D.C. 2012

[23] SIN Y: *Annex B2: Country Profile for China*, in: *Holzmann R, Mac Arthur IW, Sin Y,* Pension Systems in East Asia and the Pacific: Challenges and Opportunities, Social Protection Discussion Paper No. 0014. World Bank: Washington D.C. 2000.

lower life expectancy etc. The future will bring a massive demographic problem to China[24] which is even more severe due to the underfunding of the accounts. A possible solution has to be increasing the retirement age – even if this reduces the possibility to use retirement as a means to fight unemployment in times of crisis.

VII. Some observations on other countries

Reviewing contributory systems from a global perspective it can be seen that also in other stages of development than in the situation of Germany, Brazil and China there are certain points to be made that show similarities and differences.

In Europe the former socialist countries more than twenty years ago had to adjust their pension systems to the market economy[25]. They considerably changed the existing systems and were faced with similar challenges as the countries already analyzed have been faced with. In the case of the so-called CEE countries it was less a problem of integrating a large agricultural sector into the system of public insurance but moving from one social system to another. The systems of these countries during the period of socialism have been special ones with certain links toward the Bismarck approach. In a number of cases those countries anyway had followed the Bismarck idea before World War II and considered to return to that approach after 1989/1990.

This article is not the right place to analyze transition in Middle and Eastern Europe in the area of pension insurance which would be an important and wide topic in itself.

But it can be said that in case of the CEE countries the major challenge has been to organize and administer contribution compliance which for along was lacking behind and is still a problem in some succession states of former Yugoslavia. Here new institutions had to be established and new structures – dealing no longer with state-owned companies but with private enterprises – had to be established. While in the socialist period officially there has been no informal labour and no unemployment the new social system now is faced with both challenges.

Another issue has been to re-introduce the insurance principle in those social insurance systems which is also a psychological challenge since people in the socialist period had become used to receive benefits they did not pay for by contribution. The psychological effect of a contributory system might also be limited if the contributions are mainly paid by the employer and only to a much smaller percentage by the employee – as is the case in a number of countries.

These systems also have been faced with privileges for certain groups of people who – for political reasons – received more generous pensions. So the systems in those days had been used to reward persons stabilizing the system. Major examples are the high benefits for members of the secret police.

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24 *International Labour Office*, World Social Security Report 2010/2011, Providing coverage in times of crisis and beyond. ILO Publications: Geneva 2010

25 STEINMEYER H-D: *Was bleibt übrig? Erfahrungen aus Beratungstätigkeiten*. in Mittel-, Ost-und Südosteuropa. In: Festschrift für Klaus Adomeit, pp. 737–746. Cologne, 2008.

A similar challenge as in the other countries described and analyzed here is the issue of raising the retirement age. The retirement age in the former socialist countries usually was relatively low and during transition there was no incentive to change that since early retirement also here had been a means to fight unemployment. These days now those countries need to raise the retirement age in order to meet the challenges of demography – also because the birth rate went down in these countries after 1989/1990.

VIII. Evaluation

There is always a discussion in the scene of "pension-academics" whether the social insurance approach is better or whether another like a system following the "Beveridge" idea is the better one. Also international organizations like the World Bank "sell" specific approaches as a blueprint for reform[26].

This paper is not intended to draw a conclusion like this. History tells us that any approach has its own advantages and disadvantages. This article – focusing on the public pension insurance approach – has pointed out a number of disadvantages of social insurance systems and may suggest that this approach is not a good one after all.

There are a number of problems these systems are faced with. They have difficulties in coverage especially of those being in risk of becoming old-age poor. They are faced with problems in case of informal labour. The same is the case with covering the rural population, i.e. the agricultural economy. Especially in transition countries there are still considerable gaps in contribution compliance which makes the systems financially vulnerable. The demographic challenge has to be faced in all countries observed and analyzed.

Social Insurance on the other side usually provides a politically more stable system while a tax-financed system is much more dependent on the situation of the current state budget and the Minister of Finance more easily might intervene. A special situation is to be found in Germany where pension entitlements are covered by the property clause of the constitution. A PAYG system is more vulnerable with regard to demographic issues but funded systems have suffered severe losses during the financial crisis[27]. When it comes to the issues of equity and financing in general all approaches have their pros and cons.

Social insurance systems have certain difficulties to achieve full coverage and tend to be linked to the urban working population. To cover farmers and rural workers is a challenge for these systems – especially in the case of subsistence agriculture. In China this has led to the approach to cover farmers only on a voluntary basis and in Brazil to provide them with social security benefits with no contributions required. The Brazilian approach in this case is moving away from the insurance principle and introduces some kind of social assistance; but since it is not means-tested it should not be qualified as social assistance but as social insurance nevertheless. It is also a peculiarity of *social* insurance to honor years without contributions; this is the case in a number of social

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[26] *World Bank,* Averting the Old Age Crisis – Policies to Protect the Old and Promote Growth, World Bank Policy Research Report. Washington D.C. 1994

[27] *OECD,* Pensions at a Glance 2009: Retirement-Income Systems in OECD Countries, OECD Publishing. DOI: 10.1787/pension_glance-2009-en.

insurance systems when they honor periods of military duty, of imprisonment for political reasons etc. Germany for example pays social security retirement benefits to persons with German roots who have lived in Eastern European countries including all republics of the former Soviet Union and now have settled down in Germany; this has been a matter of social policy as well as of solidarity with fellow-Germans. Contributions to the German system are not required.

Another issue is the ability to fight poverty. Since social insurance requires contributions the main issue is that the person to be covered is able to afford it. In some cases the state gives subsidies to the people to be able to afford it; in other cases this is an issue of social assistance. Brazil is using the minimum wage as a means and provides a minimum benefit amount equal to the minimum wage. This has limits when it comes to persons not covered by the social insurance system. In that case social assistance has to step in.

A general problem of social insurance is that in case the benefit level of social assistance benefits is close to that of social insurance people might not have incentives to pay contribution into the system since in that case the contributions paid practically have no effect on the benefits received.

This also leads to the problem that contributions have to be collected and if not done by the tax authorities may need a specialized administration. Experiences from countries like Brazil and China but also certain European countries show that contribution compliance often is only around 70 % which increases the financial burden on the system.

This leads to the question if another general approach would produce less problems and/or better results.

Tax financed systems for example may provide better coverage since also those can be covered who are not able to pay contributions. But experiences show that countries using that approach usually only can provide a basic system close to social assistance level. In addition there are earnings-related supplementary schemes – either public or private and either mandatory or voluntary.

Systems not following the insurance principle might not be faced with lack of contribution compliance – by definition. But other sources of financing – like the general budget – are dependent on sufficient and efficient procedures of collecting taxes and thus may run into the same problem.

The demographic challenge is not only an issue of systems based on the insurance principle; if funded they may even have advantages in relation to other approaches. But not only a contributory PAYG system will struggle due to demography but also a tax based system, since taxes are usually paid by the working population.

There are also doubts if the issue of covering the rural population will be better solved by a tax financed system.

So in the end it can be concluded that in a complicated world and in view of the challenges all countries are faced with globally there is no perfect solution.

All countries are faced with very similar problems; there only might be some differences regarding the time when those problems emerge and are in their peak. So Japan, Germany, Italy and others are already faced with the demographic problem and the peak is close whereas in other countries there is still some time to go. The choice of the solutions is limited – irrespective of the specific approach of a country.

All transition countries have to work on contribution compliance and/or tax compliance and have to improve their administrative systems.

Covering informal labour is a challenge everywhere which is also the case with covering the rural population.

When it comes to prevention of poverty in old age the solutions are similar to a certain extent everywhere.

The author of this article has done consulting work in a number of different countries. Basic philosophy based on long experience is that every country has to find its own way and solution. Social security systems are usually elements of public awareness and imbedded into the traditions of a country. Based on that solutions have to be found and according to own experiences can be found.

The basic philosophy of any advice should be to learn about the special situation in another country in the first place. After a long experience in consulting work on behalf of the European Union and other international organizations the author has learned that using rules and procedures from other countries as blueprint for a reform in countries that have been consulted would lead to bad results. Any country has its peculiarities, its special situation, its own history and culture. Approaches that work in one country very well might fail totally in other countries. Therefore in the first place the special situation of a country has to be studied and it has to be found out what the needs are. The next step then can be to discuss a specific idea and/or proposal. This then again can only be applied to that country if maybe adjusted to the specific situation.

An insurance system may under certain promises serve as a stable basis for old age security without being too inflexible. But of course one has to see whether it can be adjusted to a country’s demographic, cultural, political and historical structures and whether its weaknesses can be alleviated for example by using supplementary systems like social assistance.

The aim has to be to try to make proposals tailor-made for that country and it requires reflecting the experiences on the background of that country and its situation.

So any comparative analysis and comparative proposal has to start with studying the country in the first place.

Doing research on pensions on a comparative and international level receives its fascination from the diversity of systems and solutions. It is interesting to see that challenges are similar globally and the answers of the different countries do not follow exactly the same track. Specific situations of a country cause specific solutions. Brazil and China – being in a similar situation as countries in transition are great examples for this. If asked what the better approach would be the author of this paper would argue that the social insurance approach brings more stability into the system which is a great advantage as such in a system dealing with long term promises. It is important that the people know what to rely upon. Its disadvantages can be compensated as shown. Nevertheless the perfect system is still to come.

HEINZ-DIETRICH STEINMEYER

PUBLIC PENSION INSURANCE IN COUNTRIES WITH DIFFERENT STAGES OF DEVELOPMENT

(Summary)

Public pension insurance is a widespread approach to be found in a number of countries around the world. These systems have to meet different – and also similar – challenges in countries of different stages of development. This article analyzes the situation in Germany, Brazil, China and CEE countries as example for challenges in different situations. The pension insurance approach has certain shortcomings especially when it comes to universal coverage but also other systems are faced with similar problems. A certain convergence of approaches can be observed. It is interesting to see that challenges are similar globally and the answers of the different countries do not follow exactly the same track. Specific situations of a country cause specific solutions. Brazil and China – being in a similar situation as countries in transition are great examples for this.