

УДК 342(4/9)

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PENSION SYSTEM IN THE US: THE LESSONS FOR KAZAKHSTAN

Abstract

This paper overviews the experiences of the pension systems in Chile and U.S. It also overviews some problems occurred of the pension system and the ways of resolving them during the reforms in these countries. The paper also reviews current dilemmas of the pension system in Kazakhstan, and the modern ways in reforming them. There were analyzed different models of pension systems taking into account the World Bank recommendations. Moreover, potential threats to the pensions funds, and an impact of the threats on social and economic development of the country were considered as well. According to the conducted research, author suggests in order to resolve the problem with pension system it needs to formulate the integral national policy in area of pension funds of population, and to take steps toward stabilization of current situation.

Keywords: *pensions, retirement defined benefit plans and defined contribution pension funds, management of pension funds, individual retirement account, the problem of pensions, state pension system.*

Аңдатпа

Ұсынылған мақалада Чили және АҚШ зейнетақы жүйесінің тәжірибиесі зерттеліп, зейнетақылық қамсыздандырудың мәселелері мен оның осы елдерде реформалау жолдары қаралған. Қазақстан зейнетақы жүйесінің өзекті мәселелері және оны реформалаудың жаңа жолдары қаралды. Дүниежүзілік банк ұсыныстарын ескере отырып зейнетақы жүйесінің әртүрлі моделдері сарапталды. Зейнетақы қамсыздандыру жүйесінің әлеуетті қауіптері және олардың елдің әлеуметтік-экономикалық дамуына ықпалы қаралды. Жүргізілген зерттеулер негізінде автормен зейнетақы жүйесінің мәселелерін шешу үшін осы салада жағдайды тұрақтандыратын біртұтас мемлекеттік саясатты қалыптастыру ұсынылған.

Тірек сөздер: *зейнетақылық қамсыздандыру, белгіленген төлемдері және белгіленген жарналары бар зейнетақылық жоспарлар, зейнетақылық активтерді басқару, жеке зейнетақылық есепшот, зейнетақылық қамту мәселелері, мемлекеттік зейнетақылы жүйелері.*

Аннотация

В данной статье изучен опыт пенсионных систем Чили и США, рассмотрены проблемы пенсионного обеспечения, а также пути реформирования в этих странах. Рассмотрены проблемы пенсионной системы Казахстана и новые пути ее реформирования. Проанализированы различные модели пенсионных систем, с учетом рекомендаций Всемирного Банка. Рассмотрены потенциальные угрозы пенсионного обеспечения и их влияние на социально-экономическое развитие страны. На основе проведенного исследования автором предлагается в целом для решения проблем пенсионного обеспечения сформировать целостную государственную политику в области пенсионного обеспечения граждан, стабилизирующую сложившуюся ситуацию.

Ключевые слова: *пенсионное обеспечение, пенсионные планы с установленными выплатами и установленными взносами, накопительные пенсионные фонды, управление пенсионными активами, индивидуальный пенсионный счет, проблемы пенсионного обеспечения, государственные пенсионные системы.*

Introduction

Pension issues are central to the economic and social policy of many states.

Pension systems generally use two financial mechanisms – distribution and storage. The distribution system is based on the contract of generations: Disability pension is paid for by contributions from employees, and when the current workers become unable to work, they will be paid pension contributions by the next generations. The calculation of future pensions can be varied, as it is directly dependent on the contributions that were made during the operation.

Over time, the outlook has changed significantly toward reforming the world's pension system. One of the most recent analyses of the ongoing global financial crisis and its consequences for Kazakhstan highlights the following problems:

- An increase in life expectancy and more rapid growth in the elderly compared to the working population;
- Predicted further aging of the population;

- Continuous increase of social standards and quality of life;
- Accelerating the development of the financial market to raise economic growth to co-finance some of the costs of transition.

In view of these factors, all countries with institutions of social protection and social security, have to sooner or later reform their pension systems.

Kazakhstan is no exception, as reforming the pension system is a multi-factored problem. Today, Kazakhstan is working to create a single pension fund (ENPF) to consolidate assets spread out over 11 pension funds. This will preserve the principles funded system (preserving and increasing the pension assets in individual retirement accounts, custody of pension assets in the custodian bank (the National Bank of Kazakhstan)).

This paper will examine the existing problems of the pension system of Kazakhstan to conduct its analysis, examine the experience of reforming the pension system in the United States, and consider the application of certain elements of the pension system of the United States as an alternative solution to the existing problems of the pension system of Kazakhstan

Analysis problems of pension system of Kazakhstan

In 1998, Kazakhstan began the transition from a planned distribution system based on solidarity between generations, to the pension system, which provides individual retirement savings in pension funds.¹

As a result of reforms in the Republic, a multi-pillar pension system was established, based on the optimal balance of responsibility between the state, the employer and the employee.

The participants in the shared pension system in 2012 (including retired law enforcement agents) number 1.76 million. This number has fallen by almost 227 thousand since 1998.²

Sex and age structure is characterized by a predominance of female pensioners (67.5% – in 2003 and 71% in 2012).

Participants in the solidarity pension system have seen an increase in pension payments. The reform of the pension system increased the minimum pension payments from 2440 to 26,211 tenge, average payments from 3964 to 38 767 tenge, and maximum payments from 7256 to 56 047 tenge. On the other hand, replacement rate have dropped from 46.4% in 1998. to 33.3% in 2002, before increasing to 33.9% in 2007 and 43.1% in 2011.³

From 1999 to 2012, the cost of pension plan, taking into account the basic pension payments, increased by 8.4 times and made this year – 830 billion tenge (\$ 5.53 billion).⁴

Problems in the mechanisms of various pension plans are reflected at several levels:

1. At a basic level, the lack of criteria for appointment or a fair and reasonable assessment of the relevance and benefits to the needs of the recipients leads to the fact that the basic pension benefit covers wide range of individuals, non-uniform in age and prosperity.

2. Solidarity-level:

- Imbalances in the Pension Benefits Act for people who retired at different times (during the Soviet period, the transitional period of the reform and post-reform period in the development of the country);

- The presence of imbalances in the pension system, associated with the current income limit imposed on the pension calculation, the system behind the rate of increase in pensions from wage growth, leads to inadequate pension payments and pension replacement rate for all major categories of pensioners.

3. On the storage level

- Low amount of contributions related to the low level of pay;

- Low coverage of the economically active population under the funded pension system, irregular payment of contributions;

- The low return on pension savings due to insufficient development of the domestic stock market and poor management of pension assets;

- Lack of mandatory pension savings for citizens approaching retirement age;

- Unstable funding for pension system in times of recession and the crisis in the economy;

- Imperfect voluntary retirement savings schemes;

¹ RK Law of 20 June 1997 "On pensions in the Republic of Kazakhstan"

² Data of the Statistics Agency

³ Data from the State Center for Pension Payments RK

⁴ Data of the Statistics Agency

- Lack of effective promotion for the voluntary pension savings program;
- Inadequate parameters of formation and investment of voluntary pension savings.

Thus, from the perspective of improving the pension system of Kazakhstan, the issue of optimization mechanisms for various pension plans and pension annuities as a flexible tool remains one of the most pressing.

The USA pension system: problems and ways of reforming

Currently, a reliable source of pensions is the U.S. government social insurance (social security).

Every working citizen who pays his taxes and has worked in the U.S. more than 10 years (with a few exceptions) is entitled to a basic pension from the federal fund. The amount of payment depends on the average salary and years of service, but it is limited.¹

During the work, a citizen earns «credits» for entitlement to a basic pension. All persons born after 1929 need 40 credits (10 years) before receiving their pension. Upon termination of employment until a significant number of points, all credits are retained on the individual pension account. Thus, in the event of a resumption of work, points accumulation continues. However, the worker will not be paid a basic pension with less than 40 credits.

In addition, the amount received is affected by the age of retirement. For example, the earliest possible retirement age is 62. However, the basic pension will be less (about 25%) than retiring at the generally established retirement age. Also, in the basic pension will increase by 1% for each year.

Feature of the U.S. pension system is the establishment of the retirement age. The following table contains the full retirement age, depending on the year of birth.

Table 1

The retirement age in the U.S.

| Birth year | Retirement age, years |
|---------------|-----------------------|
| 1943–1954 | 66 |
| 1955 | 66,2 |
| 1956 | 66,4 |
| 1957 | 66,6 |
| 1958 | 66,8 |
| 1959 | 66,10 |
| 1960 and more | 67 |

Source: <http://www.ssa.gov/pubs/10035.html#a0=1>

In addition to the basic pension, the Americans have the right to pension benefits from private pension plans.

An integral part of the pension plans are pension from an employer. In the U.S., there is a federal law (ERISA), which sets standards for the majority of employers and unions that sponsor pension plans, and the responsibilities of workers.

There are two main types of pension plans with defined benefits and defined contribution plans, which are described in Table 2.

Table 2

Characteristics of Pension Plans

| | Defined benefit plan (guaranteed a specific amount of the monthly pension at retirement) | A defined contribution plan (adding a specific amount for an individual retirement account (IRAs)) |
|------------------------|---|---|
| Employer contributions | Federal law limits the amount of payments for the achievement of full payment of occupational pensions on time. There are penalties for non-compliance. | Legal requirements for the minimum size has been established. This fee depends on the pension plan. In some plans, employer contributions may be in the form of shares of the employer. |

¹ <http://www.ssa.gov/>

| | | |
|---|--|---|
| Employee contributions. | Have been made. | Many plans require that you make a contribution to the employee IRA. |
| Investing. | Investment management of pension assets is the responsibility of the employer to ensure the adequacy of pensions. | The employee manages its pension assets, based on the options offered by the financial manager. |
| The amount of pension at retirement. | Depends on the worker's labor contribution for a specific employer. | Pension depends on contributions from the employee and / or employer, the amount of investment. |
| Types of pension benefits. | Traditionally pensions are paid in monthly annuity payments for the duration of life. | Retired can pass savings on an individual retirement account (IRA), or can get it at a time. Some plans also offer monthly payments through an annuity. |
| Warranty. | The federal government guarantees certain payments from corporate benefits. | no |
| In case of termination of labor activity up to pension age achievement. | If employee leaves before reaching pension age of accumulation of are saved prior to the filing employee of lawsuit. | The worker can translate assets on the an individual retirement account (IRA) or, and to another to the employer. |

Source: <http://www.dol.gov/ebsa/publications/wyskapr.html#DefinedBenefitPlan>

There are many different features of pension plans.

One of them is the Individual Retirement Account (Personal Retirement Account) (hereinafter – IRA), used for long-term savings that will ensure the individual's income after retirement.

Most employers offer their employees retirement savings plans. These savings plans can be used simultaneously with the opening of an individual retirement account IRA. Professional savings plans, also known as 401k accounts or 401a, aer similar to traditional IRA accounts. These accounts are not taxed as long as you do not start to withdraw from them. Some employers bolster each of your pension contributions with some amount from the company.¹

However, the steady increase in life expectancy of Americans, along with the increasing federal budget deficit has required changes to the pension system in the United States.

Today, Americans who use certain contribution pension savings, such as 401 (k) or 403 (b) plans or IRAs, can choose one of the following innovations in the legislation.

1. Department of the Treasury (IRS) offers new four rules requiring the purchase of pension annuities or other insurance products that guarantee lifetime income.²

The first rule involves lowering the minimum requirements for the purchase of annuity. e legislation, people have annuity or all pension assets, or do not annuity. It is now proposed annuity of pension assets. This will save a part of the pension assets to use them for other purposes.

The second rule would eliminate technical barriers to the use of many years of pension annuities that are purchased in pre-retirement age, and the payment will be made only up to the age of 85. Years of annuities allow retirees to manage their assets over a period of time up to the experienced assets.

The third rule allows a citizen to begin partial annuitization of their pension assets long before retirement age. Early annuitization allows you to buy some “juice” for more than twenty years, which allows investors to spread interest rate risk over time.

The fourth rule will be relatively rare. In the presence of an occupational pension benefit plan, employees could purchase inexpensive retirement annuity payments as specified by the employer.

2. The mandatory requirements of the employer for complete information on the amount of contributions.

This rule requires providers to provide information on all direct and indirect fees employers that

¹ [http://www.irs.gov/Retirement-Plans/401\(k\)-Plans](http://www.irs.gov/Retirement-Plans/401(k)-Plans)

² http://www.socialsecurity.gov/OP_Home/ssact/title02/0209.htm

sponsor 401 (k). The regulations shall provide necessary guidance to all charges, which will increase competition for the best results for both employers and employees.

Thus, the measures taken to stabilize the situation on pensions of U.S. citizens

Recommendations

Today, Kazakhstan is working to further reform the pension system. The main purpose and especially the modernization of the pension system is:

1. Ensuring that pension payments follow previously received revenues and the rising standard of living in the country.

2. Financial sustainability of the pension system (continuous line of current income and reserves generated by pension contributions, as well as budget and other income expenditure on pensions).

Modernization will be carried out while maintaining the tiered pension system. Necessary and related changes will occur at the basic level, necessarily – in solidarity and funded pillar, and voluntary.

Thus, the most relevant in the framework of the process, it is proposed, using the experience of the United States, the introduction in Kazakhstan of a cash balance pension plan (cash balance plan), which is a hybrid pension plan.

In terms of the balance of the money, the employer agrees to contribute a certain percentage of the salary, and thus guarantees a certain rate of return. Under the plan, you can easily calculate the exact amount of pension savings which will be available to the employee at retirement, as the employer guarantees contributions and returns.

One of the most common pension plans is a defined contribution plan, or «purchase money.» Under this plan, the employer guarantees only the amount of the annual fee, but not investment income. Unlike pension plans with defined benefit plans, where the employer keeps all the money in the only retirement account plans, defined contribution pension savings involves storage in separate accounts for each employee. Investing pension funds use a limited number of financial instruments (issuers), defined by the employer. Investment risk is entirely the responsibility of the employee.

Another common kind of hybrid plan is the so-called target retirement plan (target pension plan), which is preferred for workers close to retirement age.

For employers who want to reduce the burden of obligation, the decision is a profit-sharing plan (the profit sharing). This plan has a defined contribution, which is not formally a pension plan. There are no requirements for regular (even minimal) funding. These plans are popular in the U.S., such as the 401 (k), in which employees make regular contributions to a tax free pension. The plan is not classified as an employer's contribution as an employer may make or not make a contribution. Total contribution of the employee and the employer may not exceed 25% of the salary. Nearly two-thirds of all large U.S. employers use 401 (k) as the main pension scheme for its employees.

Based on the above, pension provision for the citizens of Kazakhstan under a similar system would contribute to ensure a decent retirement.

Conclusion

In this work was studied in detail by the U.S. pension experience. The study can be a brief overview of the system.

In the United States, equal pay pension contributions by employers provides a strong incentive for the expansion of voluntary employee participation in company-sponsored 401 (k) plans. State employees' contribution to the so-called universal savings accounts can also be seen as a system of credit transfers. The pension plan is a discount plan established by employers, where employees can send part of their salaries to their retirement plan, and the payment of income tax on that part of the salary will be delayed. Employers offering a 401 (k) retirement plan can contribute to the plan to carry out on behalf of their employees. Employers also provide the ability to make deductions from wages not only for employees, but also in the transfer of part of a company's profits. Income on such pension plans is based on accumulated deferred tax.

Based on learned experience, we draw three main conclusions: First, in all developed countries, the pension mechanism functions best with equal participation by employees, employers and the state, and secondly, through tax incentives the state encourages employers who, in turn, increase the pension payments to the limit, and third, equal participation in employee pensions not only leads to an increase in the replacement rate, but also to some extent reduces the burden on the budget.

Thus, Kazakhstan requires the creation of a pension system that contributes to the creation

of a socially-oriented model of development of human capital, improving the social protection in accordance with international standards.

SOURCE

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Дата поступления статьи в редакцию журнала 12 января 2013 года