



**Technical Seminar of the ISSA Technical Commission of  
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***Optimal financing of social security pension schemes***

**Views on financing Social Security  
programs**

Alice Wade, U.S.A

# **Optimal Financing of Social Security Schemes?**

## **by Ole Settergren**

- Thought provoking paper.
- Discussion of the difference between the philosophy of funding social security pension schemes and philosophy of funding other government expenditures.

# Goal of “optimal funding”

- Dedicated revenue sufficient to pay benefits.
- Dedicated revenue and benefits, relative to wages, should be similar over time.
- Individuals are able to know their benefit levels and contribution rates.

# Accomplishing optimal funding

- Minimize options to avoid anti-selection.
- Indexing is important.
  - Indexing of initial benefit levels and contributions to growth in wages.
  - Indexing of retirement age to life expectancy gains.
- Include automatic triggers to address remaining uncertainty; thereby eliminating the need for large changes in plan design.
  - Applied to both contribution levels and benefits.
  - If revenue source is tied to employee contributions, more difficult to change benefit levels.

# Provide financial information

- Provide reports to law makers on the financial condition of the program.
  - Identify and quantify changes since the last report.
- Provide information to participants.
  - Mail benefit estimates.
  - Make other information available on the internet.

# **Competing Views of Social Security Design and its Impact on Financing**

by Robert Brown

Discuss the paper's decision points in design and funding using the defined benefit plan of the United States as a case study.

# 1. Funded versus PAYGO

## 2. Voluntary versus Mandatory

### 3. Individual Accounts verse Commingling of Risk

- ***Funded versus PAYGO:*** U.S. system is basically a PAYGO with a buffer fund invested in special issue government bonds.
- ***Voluntary versus Mandatory:*** U.S. system is generally mandatory with little non-compliance issues.
- ***Individual Accounts verse Commingling of Risk:*** U.S. system is a defined benefit program – benefit levels are specified in law.

## 4) Public versus Private

# 5) Automatic Balancing Mechanism

- ***Public versus Private:*** The U.S. Social Security System provides initial benefit levels that replace, on average, 40 percent of average *career* earnings. Replacement rates for higher career earners are lower and for lower career earners, they are higher.
- ***Public versus Private:*** Private pension coverage varies (currently about 50% of workers have private pension coverage).
- ***Public versus Private:*** Private pensions are mainly defined contribution plans.
- ***Automatic Balancing Mechanism:*** Scheduled benefits are payable in full and on time as long as money is in the trust funds. When the trust funds exhaust, only scheduled revenue coming in can be used to pay benefits.