A complement to Swiss pension plans : Providing a dedicated Credit Card ?

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SUMMARY

At the end of the XIXth century, life expectancy at birth was approximately only 40 years. Between1876 and 2006, i.e. 130 years, life expectancy doubled. This increase in longevity is gratifying *per se,* but the consequence has been that Swiss pension plans now need to be funded for a longer period.

By the beginning of the XXIst century, some adjustments to the Social Security regime had already been made and others would follow within the framework of the project "*Prévoyance 2020",* at present being examined by the Federal Chambers. This consideration coincides with calls at the international level by the Organization for Economic Cooperation and Development (OECD) and the United Nations (UN) to reduce poverty and for a fairer redistribution of the wealth among national populations.

Within this context, except for the recurrent discussions about "Increase of contributions, or reduction of grants", few alternatives to pension plans have ever been proposed. This document is a tentative proposal to remedy this lack of new ideas: more precisely, we think that it is worth examining other efficient forms of improving social security benefits through strictly monetary measures. Being purely technical, the proposed new provisions should also be effective from the point of view of social policy and relations. The subject is particularly relevant since Switzerland participated actively in the United Nations Summit in September 2015 for the adoption of the Post-2015 Development Agenda. This is aimed at adopting a Global Action Plan to ensure better prosperity for present and future generations.

1. Context

In recent years, the media and political and professional circles have repeatedly focused our attention on the uncertain future of financing retirement pensions. Among many examples, the headline on the cover page of the French language weekly magazine "*L'Hebdo"* of 5 November 2015; read "Pensions - Storm Warning in Force !". Without wishing to fully endorse the various motivations behind such a headline, we must admit that, in Switzerland and abroad, pension conditions have been gradually deteriorating for a number of years under the influence of several factors. The three most important are: the continuing increase in human longevity, lower financial returns from investments and societies becoming more and more individualistic in nature.

At the end of the XIX^th^ century, life expectancy at birth was approximately only 40 years.

Between 1876 and 2006, i.e. 130 years, life expectancy doubled[1]. The increase in longevity is good news; however, this situation has resulted in the need to increase the financing of pensions since they must now be paid for a longer period.
Considering the
relative level of paid benefits, expressed with regard to final salary, the decreasing trend in investment profitability is not necessarily a bad thing, since the level of such benefits depends on the difference between profitability and inflation. The greater the difference, the more the relative benefit level increases. At the present time, the economic context is characterized by very low profitability of investments and a historically very low level of inflation. This situation still provides some margin to support pension benefits. On the other hand, the decline in profitability poses serious funding problems for those involved in pension planning; they have to revise downwards the level of the technical interest rate applying to pension plans, which therefore generates an increase due to the revised actuarial commitments.

During the last thirty years, the social environment and attitudes have changed considerably. The increased emphasis given to individuals rather than "the collective" in society and the short-term approach to solving problems have also reached the retirement pension domain. This change of paradigm naturally has led to a questioning of the principle of solidarity between individuals and insured generations. But this principle is the foundation of insurance and welfare sector operations. Without solidarity, the process underlying these operations becomes strictly financial, which causes a transfer of all the risks onto the insured person and leads to greater precarity in pension conditions. Furthermore, in economic terms, social security remains a fundamental instrument of income redistribution to the population of a country.

The general deterioration of retirement pension conditions has resulted in policy makers challenging this very important social achievement. In this regard, it is

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[1] In the following text we shall often refer to the work of Meinrad Pittet & Claude Chuard Pittet, "*La prévoyance professionnelle suisse*" (Editor Slatkine, Geneva 2013), without quoting it systematically.

interesting to point out that “Switzerland is criticized by the OECD as one of the countries where the proportion of poor among the elderly is highest: worse than the United States, barely better than Mexico”[2], despite the existence of complementary benefits (CB) financed by the state. In this context, except for the recurrent and perpetual discussions about "Increase of contributions, or reduction of grants", few alternatives to pension plans have ever been proposed.

Our document is a tentative proposal to remedy this lack of new ideas. The subject is particularly relevant since Switzerland participated actively in the United Nations Summit in September 2015 for the adoption of the Post-2015 Development Agenda[3]. This is aimed at adopting a Global Action Plan to ensure better prosperity for present and future generations. The solution we propose in the final part of our presentation is innovative. It is therefore expected that it will generate many comments. While presented in the Swiss context, it could be applied in any country, particularly in developing countries. Our hope is that it will lead to new initiatives to alleviate the poverty of an important part of the population, when its members reach retirement age.

2. Historical reminder

In his book entitled “*Sécurité Sociale*” published in 1993, Guy Perrin[4] recalled the three main stages of social consciousness, namely: (i) stemming from the French Revolution, the right of the poor to social assistance; (ii) since the industrial revolution, the right of the worker to social insurance; and, finally, (iii) going back to the Second World War, the right to Social Security. This latter stage of the evolution of social consciousness has contributed to a fairer redistribution of income among the population, in particular through the development of pension retirement schemes.

In Switzerland, measures of welfare and pension benefits within enterprises replaced the relief funds essentially created during the XIXth century. Subjected to few legal requirements, they were able to develop relatively freely in most industrial branches. If the uniformity of their coverage was not their main specificity (the priority between contributions and benefits was still not on the agenda), they gradually included an increasingly important part of the population, in particular that of the wage sector. The initial coverage of insurance schemes was, at that time, limited to death and incapacity. With the progressive increase in human longevity the need for coverage of the elderly in retirement appeared.

After the creation of the *Assurance Vieillesse et Survivants - AVS*[5] in 1948 and

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2 See article by Yves Genier, “***Retraites*** *Cotisations à la hausse - Rentes à la baisse, p. 6 etc.*” “*L’Hebdo”* (N° 45, week of 5 November 2015).

3 United Nations. Resolution adopted on 25th September 2015, “*Transforming our world: the 2030 Agenda for Sustainable Development”.*

4 Former student in France at “École Normale Supérieure” and “École Nationale d'Administration (ENA). Social Security specialist of the International Labour Office in Geneva.

5 Insurance for the elderly and survivors.

the *Assurance Invalidité - AI*[6] in 1960, it was necessary to guarantee the coordination between State (AVS and AI) and private (provident societies) welfare insurance systems. Thus gradually came into being the concept of the "*trois piliers*" (three pillars) formulated for the first time in 1964 by the Federal Council and enshrined in the Federal Constitution since 1972. The relevant article[7] of the Constitution stipulates that: "The Confederation shall take measures to ensure adequate financial provision for the elderly, surviving spouses and children, and persons with disabilities. These shall be based on three pillars, namely the Federal Old-age, Survivors' and Invalidity Insurance, the occupational pension scheme and private pension schemes".

Roughly speaking, the 1st pillar is financed by dispositions known as "*répartition des dépenses*[8]" that includes the financial contributions (one third each) of the insured person, of the employer and of the State. The insured person and the employer are responsible for financing expenditure, half each, under the 2nd pillar. Expenditure under the 3rd pillar concerns exclusively the insured person who benefits, in return, from certain tax reductions. In 2014, funding of the 1st and 2nd pillars amounted approximately to 107 billion Swiss francs, roughly divided in equal shares between the two concerned pillars (including 4.7 billion francs for additional complementary benefits). During the past 20 years, expenditure under the three pillars has almost doubled, with an average annual growth of approximately 3.2 %.

Since the 1st pillar has a specific social purpose, financial solidarity plays an important role. This is why, for this pillar, there is no wage ceiling for the calculation of contributions; such a ceiling exists, however, for the calculation of benefits. In this context, high income wages contribute much more to the financing of benefits. Since the beginning of the financing of the system, the State contribution has also been based on the solidarity principle.

It is worth noting that encouraging access to property (housing) through professional welfare schemes, such as the 2nd pillar, constitutes a first *diversification* of the range of benefits granted by social insurances. At the level of the individual, this is an original and interesting orientation. However, access to property should normally be financed by parallel bodies such as saving funds, with or without State aid.

3. Present situation

The growing complexity which characterizes the legal and economic context of Social Security, the successive financial market crises (of 2000, 2003 and 2008), the reduction in inflation and in bond interest rates, the increase in human longevity, as well as the alignment of regulations on international safety standards, has in recent years prompted a more general reflection on the structural strength of social security systems.

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6 Disability insurance.

7 https://www.admin.ch/opc/en/classified-compilation/19995395/index.html#a111.

8 Expenditure distribution.

Confronted by these challenges, corrective measures have been implemented in the past to re-establish the financial balance of the various pension plans. In particular, we refer to: (i) the increase in the women's retirement age (from 62 to 64 years); (ii) the reduction in the conversion rate (from 7.2 % to 6.8 %); (iii) the reduction of some pension benefit adaptations to price increases; and (iv) the consolidation of the number of welfare institutions belonging to the 2nd pillar, in order to reduce management costs.

In 2011, the Federal Council sent a report to the Parliament regarding the future of the first two pillars. This report aimed at identifying current and future stakes in the social security system, as well as finding a solution to be applied the future. It was not a question of revolutionizing the current system, which has demonstrated its adaptability over time, but rather to identify measures to strengthen the existing structures and to consolidate the system in the long term.

4. The desires of insured people

At the time of retirement, each insured person paying contributions into a social security scheme looks for the preservation of a level of income reasonably compatible with the one he/she had at the end of his/her working life. In other words, the insured person wishes to maximize what we usually call the *replacement rate*, i.e. the ratio between his/her beneficiary income at the time of retirement and his/her final work income.

Although not formulated in a clear way in the fundamental legal text, the Swiss constitutional objective for the replacement rate is to attain a rate of 60 % for single persons at retirement time, and 80 % for couples; this concerns exclusively the first two pillars. It is not clear if this average level has been attained. There is also significant doubt as to the possibility of reaching the constitutional objectives because of the demographic, financial and economic problems previously mentioned; moreover, the very existence of the 3rd pillar has been thrown into question by the current weakness of capital returns.

In 2013, according to the Federal Statistical Service, household consumer expenditure represented approximately 75 % of disposable income (gross income less compulsory transfer expenditure). The main categories of consumer expenditure comprised: food (in the broad sense of the term), approximately 14 %; transport and communications, approximately 18 %; and accommodation including energy, approximately 28 %. In this context, any reduction of expenditure, in whatever form, would have a significant impact.

5. An alternative approach

In spite of the difficulties which pension plans or, more specifically, the Swiss social security system, will have to face in the future, such plans will always remain, in terms of the economy, an essential instrument of income redistribution in the population.

This redistribution is applied in a *horizontal* way by resource transfer between insured persons. This transfer appears especially in the absence of a ceiling for the contribution calculation, and/or in some limitation on pension benefits, as is the case in the AVS regime. Income redistribution is also applied in a *vertical way* by resource transfer between the higher income categories and the least favoured categories. This represents an important objective in any country's social policy, which is concretely realised by *direct* interventions such as tax or price controls and/or *indirect* interventions through subsidies in the health and housing domains, or by the promotion of access to property [Federal law of 17th December 1993 on "*L'encouragement à la propriété du logement*" (LEPL)]). As is the case for the AVS, the income redistribution is also effective when the pension plans are partially financed by the State (currently, approximately a third).

At this stage, it is interesting and significant to note that Switzerland, by participating in the United Nations Summit in September 2015 for the adoption of the Post-2015 Development Agenda[9], subscribed to the UN Global Plan[10] to ensure better prosperity for present and future generations. The objective of this Summit was in particular to stimulate action by governments during the next fifteen years on, among others: (i) reducing disparities, including economic disparities; (ii) revitalizing social security systems by setting adequate floors and improving access to social security coverage by the most vulnerable people; (iii) granting better access to economic resources; and (iv) investing in a social policy for eradicating poverty. This orientation seems somehow a little contradictory with the social aid cuts that some would like to impose to balance the public budgets in Switzerland.

If we bring the objectives of the aforesaid Summit back to social security systems, there is an opportunity to take new measures to secure medium and long term financial equilibrium.

Indeed, we consider that, in the future and within the context of a social security system which is broader in scope, benefits could be based not only on monetary contributions, but also *on consumption incentives and/or service redistribution.* This would approach be completely compatible with a progressive social policy. It could also further facilitate the eradication of poverty, and at the same time, stimulate the country's economic development.

6. Range of social security benefits

Considering the legal issues involved, in Switzerland no one questions the fact that the right to a pension must be primarily be satisfied by a contribution that will be financed during the working life by the insured person and the employer.

Other than this traditional approach and taking into account the objectives arising from the Post-2015 Development Agenda, we believe that it would be sensible in the future, in addition to contributory pensions, for the insured person to receive some non-monetary benefits in the form of access to goods and services. This will lead to a better satisfaction of individual needs, while ensuring

[9] Transforming our world: The 2030 Agenda for Global Action.

[10] https://sustainabledevelopment.un.org/post2015/transformingourworld.

a better redistribution of resources and goods in society. In other words, what we would like to see achieved, would be a better integration between social security benefits and those arising from an open social policy, applying the spirit of the Action Plan of the United Nations Summit. These non-monetary benefits could be incorporated into the regime of complementary benefits (CB).

A pensioner's income would therefore be constituted by :
1. Contributory benefit(s) [AVS / HAVE, 2nd pillar, CB].
2. A “bonus” at the time of retirement, periodically renewable, would be assigned under specified income conditions, to a retired person living in Switzerland. This bonus would be granted through a ***specific***, individual or family ***credit card*** that would be set-up in such a way as to promote the consumption of goods and services in the country. The operating modalities of this card should not raise any problem in practice, but would obviously require some political decisions on the approach to be followed.

There are diverse reasons for supporting this form of bonus. A first reason is of a rather moral nature. A worker, having had a working life of about 40 years, has contributed to his/her pension(s) and regularly and actively participated in the growth of his/her country's GNP. Arguably, therefore, the society should support him/her in a significant way, as his/her income rate of replacement following retirement degrades in a not insignificant manner. A second reason implicitly results from the commitments made by various governments, including Switzerland, to give effect to the Post-2015 Development Agenda recommendations, including in relation to achieving better income distribution. By adding the proposed bonus to CB, better well-balanced rates of replacement between insured persons would be secured. A third reason which justifies our approach results from the fact that the monetary equivalent of the proposed bonus would be fully re-injected in the consumption and economy of the country; by doing so, it will encourage production, employment and, to a certain extent, economic and fiscal returns. It is also the reason why it would be better to rely on a credit card rather than a check or cash amount where their use may not necessarily be connected to the commercial channels of the country.

7. Bonus level and costs

As regards the level of the proposed bonus, the choice is broad and variable. On the other hand, it is advisable to be reasonable in setting the level(s) considering the uncertainty of the present international and domestic economic, financial and monetary environment.

On the basis of Swiss statistical household consumption surveys, household current expenditures (food + clothing) represent approximately 20 % of disposable income. Currently, the simple monthly AVS allowance is between CHF 1'175 and CHF 2'350. According to OFAS statistics, in 2014 the average AVS monthly allowance for all categories amounted to CHF 1'832. This average has remained relatively in recent years. In addition, this level is relatively comparable between cantons. If the level of the bonus was based on 10 % of the average AVS pension, this would result in a bonus of about 180 CHF per month. We consider that a bonus of this amount would initially form a significant and acceptable approach.

The question is to determine which AVS beneficiaries should be given such a bonus. We consider that this measure should only apply to Swiss or foreign AVS beneficiaries residing in Switzerland. Those AVS beneficiaries who reside abroad already benefit from other advantages due to the difference in inflation which impacts the cost of living.

According to the OFAS[11] statistics, in 2014 the number of AVS pension beneficiaries was distributed as follows:

- AVS pensions (*) 1'492'700
- Complementary benefits (*) 17'800
- Survivors pensions (*) 74'800

(*) paid to Swiss residents

If a bonus of CHF 180 was paid to AVS beneficiaries residing in Switzerland, the total expenditure would be about 3.4 billion francs; if the bonus payment was limited to beneficiaries of complementary pensions, the total expenditure would reach 38.5 million francs. It should be remembered that approximately 80% of AVS beneficiaries currently receive at a pension higher than the average Swiss pension. Therefore, by granting a bonus only to the 20% of AVS beneficiaries receiving a lower pension, the annual expenditure would be reduced to approximately 700 million francs.

However, the previous figures considered as they stand do not produce a reasonable level of coverage for a bonus system It would be advisable therefore to correlate these figures to the budgets of the least favoured families. (*In medio stat virtus*[12]*,* said the Romans). It is therefore clear that the adoption of a bonus in the form of a credit card requires thorough political and financial consideration. However, as argued above, we consider that such a measure could be introduced in an effective way by setting up a ceiling above the income of pension beneficiaries; for example, considering the sum of the AVS and the 2nd pillar pensions. A better balance between financing and assistance to the most vulnerable persons could thereby be attained. In 2014, the total annual average pension (AVS + LPP) amounted to about CHF 52'000. This amount could be considered as the ceiling for determining eligibility for the proposed bonus scheme.

8. Financing

Financing the bonus (or dedicated) credit card scheme would essentially be borne by the State. Today, the State already finances a considerable part (roughly a third) of AVS pensions, without obtaining guarantees of economic returns for such expenses. On the other hand, through the bonus mechanism and its possible appreciation, State support would give rise to some significant changes in the economy of the country, because the credit card could only be used in Switzerland for the purchase of essential goods and services**.** A possible means of funding would involve issuing State *solidarity* bonds. Dedicating these

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[11] Social security statistics - 2014 AVS statistics, OFAS.

[12] “Virtue stands in the middle”.

credit cards only for the purposes of domestic consumption would form an additional guarantee for the bond exchange value. As long as the market has sufficient liquidity**,** there would in principle be no difficulty to issue new bonds each year having a duration of 20 to 25 years, which approximately corresponds to a retired person's average life expectancy. Moreover, a part of the VAT collected through the use of dedicated credit cards could be assigned to the redemption of the bonds previously issued. This self-financing would even be more important where the difference between the VAT and the Bond rate is larger.

The method of financing as described above aims to improve consumption and employment at a minimum cost for the country. In principle, the State should neither gain nor lose under such a system. However, by stimulating consumption, in addition to the VAT revenue, there will be an increase in revenue from other taxes. It would therefore be reasonable to assume that these additional revenues could be used for paying interest on the bonds.

9. Implementation

It should be recalled that the Swiss economy is largely composed of the activities of small and medium-sized enterprises. It would therefore be sensible to give free choice to retailers to accept or refuse payment by the dedicated credit card. What really matters is that the flow of funds created by spending using these credit cards is quickly compensated by the opening of a parallel credit.

Swiss residents are used to shopping with consumption credit cards because they are often proposed by major commercial distributors. It should therefore not be difficult to set up a bonus credit card to be used by only some consumers (resident pensioners). Pensioners are likely to support such a scheme because of the significant reduction in their income when they retire.

The proposed scheme could be set up within the framework of the Social Security system and be managed, for a fee, by the banks and *La Poste*[13], mainly because of their extensive network coverage and specific expertise in this area. We could also imagine individual shopkeepers opening a current account at a bank participating in the bonus credit card scheme; such an account would record all the commercial transactions linked to the credit card. By these means, the implementation of the scheme would be straightforward for Swiss shop keepers and controls in the system would be facilitated. Finally, by attaching to the dedicated credit card, a name, an expiry date, a specified credit limit and the amount of available funds, retirees could easily monitor their spending.

[13] The Swiss Post Office.

10. Schema

The annex to this document provides an illustration of how the proposed system could be financed and operated.

11. Conclusion

During the XXth century, the Swiss developed a realistic and effective Social Security regime. The system model, named *the three pillars*, became very well - known and was often quoted as an example abroad. Naturally, Swiss residents have become very attached to this pension plan. Its benefits have also been appreciated by the pensioners in the country. Considering the evolution in the demographic and economic circumstances of the country, some adaptations to the regime are now necessary and a high priority in order to protect the financial balance of the system in the long-term.

By the beginning of the XXIst century, some adaptations had already been made to the Social Security regime and others would follow within the frame of the project *Prévoyance 2020*. This consideration coincides with calls by the UN and OECD for further action to reduce poverty and ensure a fairer redistribution of wealth among national populations.

It is within this context that we recommend examining other ways to improving Social Security benefits that will provide alternatives to strictly monetary measures while still ensuring that the Swiss regime remains efficient and effective, having regard to social policy issues. Providing a new means to access to goods and services, together with monetary benefits, would have a real impact on the welfare of less favoured families while stimulating the commercial and economic growth of the country.

The debate is open! Why not link this proposed system to other aspects of social policy? For instance, the system could be introduced to modify the CB system currently under discussion, or to improve the fellowship arrangements for training of young people, or to develop sustainable agriculture by favouring the purchase of such products through the dedicated credit card.

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CYCLE OF THE DEDICATED CREDIT CARD