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# Effects of the Classification of Benefits from Pension Schemes on OECD Poverty Indicators for Switzerland

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# The Swiss old-age security system

The three pillars of the Swiss old-age security system:

- 1st pillar: Old-age and survivors' insurance
  (public, compulsory, transfer, maximal annual benefit of 28'000.- CHF, complementary benefits)
- 2nd pillar: Pension schemes
  (private, compulsory, collective capital accumulation)
- 3rd pillar: Private schemes
  (private, voluntary, individual capital accumulation)





# The Swiss old-age security system

The classification problem of old-age benefits in Switzerland:

| | 1st pillar | 2nd pillar | 3rd pillar |
|---|---|---|---|
| Institution | Public | Private | Private |
| Status | Compulsory | Compulsory | Voluntary |
| Classification of benefits | Social security transfer | Capital income or social security transfer | Capital income |
| Types of benefits | Periodic | Periodic and lump-sum | Lump-sum and periodic |

# The Swiss old-age security system

Reasons for considering benefits from pension plans as a social security transfer:

- Compulsory by law for every employee earning more than 24 000.- CHF per year
- Defined benefits (minimal interest rate and conversion rate)
- Contributions at source from employee and employer
- No free choice of pension institution (for employee)
- No free choice on how to invest the accumulated capital (for employee)
- Solidarity among members of a pension institution (ruled by law)





# Classification of contributions and benefits of pension schemes

| | **OECD** | **Switzerland** | **Alternative** |
|---|---|---|---|
| Contributions to $2^{nd}$ pillar | Taxes and social security contributions (TA) | Taxes and social security contributions (TA) | Not accounted |
| Benefits from $2^{nd}$ pillar | Capital and property income (K) | Social security transfers (TR) | Capital and property income (K) |

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## Classification of contributions and benefits of pension schemes

| | OECD | Switzerland | Alternative |
|---|---|---|---|
| Contributions to 2nd pillar | Taxes and social security contributions (TA) | Taxes and social security contributions (TA) | Not accounted |
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## Effects of classification on disposable and market income

Equivalised disposable income
(after taxes and transfers):

OECD definition: *2nd pillar benefits*

$$W = EH + ES + EO + K + SE + TR - TA$$

Swiss definition: *2nd pillar benefits*

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# Effects of classification on disposable and market income

Equivalised market income
(before taxes and transfers):

OECD definition: *$2^{nd}$ pillar benefits*

$$M = EH + ES + EO + K + SE$$

Swiss definition: not accounted



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# Effects on OECD poverty indicators for Switzerland

| **Entire population** | | **OECD** | **Switzerland** |
|---|---|---|---|
| Threshold = 50% of the current median income (relative poverty) | | | |
| Before taxes and transfers | **Headcount ratio** | **14.4%** | **20.7%** |
| | Mean pov gap | 56.2% | 75.0% |
| | Median pov gap | 56.1% | 89.4% |
| After taxes and transfers | **Headcount ratio** | **9.5%** | **9.5%** |
| | Mean pov gap | 26.3% | 26.3% |
| | Median pov gap | 19.8% | 19.8% |

- 4.9

- 11.8

Source: FSO, Statistics on income and living conditions, SILC-2010 version 26.06.2012

# Effects on OECD poverty indicators for Switzerland

| Retirement age population | | OECD | | Switzerland | |
|---|---|---|---|---|---|
| Threshold = 50% of the current median income (relative poverty) | | | | | |
| Before taxes and transfers | **Headcount ratio** | **53.4%** | | **83.5%** | |
| | Mean pov gap | 62.4% | - 31.6 | 86.9% | - 61.7 |
| | Median pov gap | 66.2% | | 97.3% | |
| After taxes and transfers | **Headcount ratio** | **21.8%** | | **21.8%** | |
| | Mean pov gap | 21.6% | | 21.6% | |
| | Median pov gap | 18.9% | | 18.9% | |

Source: FSO, Statistics on income and living conditions, SILC-2010 version 26.06.2012



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# Conclusions

The classification of benefits from mandatory private schemes into capital income (K) has large effects on poverty indicators before taxes and transfers, especially for the retirement age population in Switzerland.

The effectiveness of the Swiss old-age security system is not properly represented in the OECD statistics.

## Suggestions

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In coordination with the Federal Social Insurance Office we suggest :

- To allow the classification of benefits from **compulsory** private pension schemes into social security transfers (TR) (lump-sum payments not accounted)