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**Theme 1: Efficient collection of social  
security contributions**

***Collection of social contributions: Current  
practice and critical issues***

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# Collection of social contributions: Current practice and critical issues

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## Introduction

This paper provides a brief description of the administrative arrangements for the collection of social contributions currently used internationally. It places this description within the context of the overall administrative structures of pension institutions and of revenue collection agencies. Its goal is to identify critical issues and to establish why a government-wide approach to addressing these issues is necessary to successful reforms.<sup>1</sup>

## Basic administrative aspects of pension systems

There are five core requirements for a viable pension system: (1) reliable collection of revenues; (2) payment of benefits in a correct way; (3) secure financial management and productive investment of assets; (4) maintaining an effective communications network, including development of accurate data and record-keeping mechanisms to support collection, payment and financial management activities; and (5) production of financial statements and reports that are tied to providing effective governance, transparency, and accountability.

There are two basic administrative models for public pension institutions: one is a full service social insurance institution; the other is a benefit payment institution.

A full service social insurance institution handles all the major functions, including collection of revenues and payment of benefits. These institutions can be found in countries such as France, Germany, Brazil, Mexico, Japan and Thailand.

In contrast, the benefit payment model relies on a tax administration for collection and focuses its attention primarily on the payment of benefits. Examples of this model can be found in the United States, Canada, Australia, New Zealand, the United Kingdom and Sweden.

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<sup>1</sup> This paper draws on material in Stanford G. Ross "Building Pension Institutions: Administrative Issues", *The Third APEC Regional Forum on Pension Fund Reform* (Asian Development Bank, 2000) and "Common issues of social security and taxation systems", in *Interactions of Social Security and Tax Systems, Social Security Documentation, European Series*, No. 25, International Social Security Association, Geneva, 1997.

There are, however, many variations on these basic models. For example, in the United States, while the Social Security Administration is a benefit payment agency, cash management and the investment of its assets are handled by the Treasury Department. In other countries, such as Sweden, the benefit payment agency handles cash management and investment of pension assets.

Increasingly, countries are adopting funded, individual account approaches for pensions, which utilize fund managers to collect contributions. These fund managers can be organized as private sector organizations regulated by the government or public sector organizations. There are many variations in practice based on historical and cultural factors, as well as legal and political constraints particular to a country.

Appendix 1 sets out a selected list of countries by the predominant type of administrative collection arrangements they utilize for public pension schemes.<sup>2</sup>

In fact, no two countries have identical pension institutions. Pension institutions are characterized by a great deal of diversity that reflects different economic and social conditions, as well as political and legal traditions. However, whatever institutional model is used, it is important that the core functions be carried out effectively. Moreover, there are objective criteria for measuring performance. Thus, Appendix 2 sets forth the core functions of a public pension system, the administrative structures that are needed to carry out those functions, and the criteria that can be used to evaluate the efficiency of those structures.

In mature, well-run social security systems, administrative costs of old age and survivor pension programs are often less than 1 percent of contribution collections (or benefits payments, depending upon which ratio is most appropriate). Even with more difficult to administer programs like disability pensions, administrative costs are often less than five percent.

A relatively high level of costs may be justifiable in the early phases of introducing a new system or adapting an old system to new circumstances. However, many systems, especially in developing and transition countries, unfortunately display very high administrative costs with low levels of efficiency, a situation that should be remedied. Also, the administrative costs of funded, individual account schemes are often relatively high in relation to the contributions collected or assets managed, again a situation that should be remedied.

## **Collection issues are critical everywhere**

In many respects, the critical issue for a pension system is to have reliable revenue collection that establishes a strong financial base for the system. Reliable revenue flows are the key to a viable system, whether collected by the social insurance institution or the tax collection agency. Contributory pension systems cannot pay benefits unless the required contributions are made. Further, there are no assets to manage to produce investment returns if collections are not made. While all of this may seem elemental, it is indeed the fact that in many places in the world weak collection mechanisms are conspicuous.<sup>3</sup>

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<sup>2</sup> This Appendix is adapted from a "Note on social security pension scheme systems of contributions collection" by W.R. McGillivray and D. Karasyov, International Social Security Association (Geneva, October 2001).

<sup>3</sup> Warren McGillivray, "Contribution Evasion: Implications for Social Security Pension Schemes", *International Social Security Review*, Vol. 54, 4/2001.

One of the key aspects of any pension system is its effective coverage, that is, the number of people who actually are brought into the system as contributors and who will ultimately receive a pension as a beneficiary. Where collection systems are weak, effective coverage is weak. Indeed, if systems are not carefully managed, people can come in without having made the required contributions and that makes a system even weaker. If effective coverage is inadequate, government subsidization generally becomes important and, while subsidies for some social pensions may be in order, major government subsidization of a contributory scheme often undermines its basic rationale.

Another issue that is tied to collection is the adequacy of benefits. Unless contributions are reliably collected at a sufficient level, benefits cannot be adequate. Moreover, benefits need to be calibrated to collections in a contributory system. If the level of collections is low, benefits need to be kept low. In this regard, it is important for policymakers to avoid over-promising about the benefits that will be forthcoming based on dubious assumptions about revenues. Prescribed benefits may not be attained or may become impossible to pay when actual collections lag those erroneously assumed.

Fundamentally, revenues are essential to achieving financial solvency and fiscal sustainability. Program reforms and institutional modernization are inherently dependent on collection performance at projected levels. Given the importance of the collection function, this aspect of pension institutions deserves far more attention than it is frequently given.

Some believe that labelling a mandatory payment to a pension institution as a “contribution” makes it easier to collect than if it is labelled a “tax” and collected by a tax administration. This may well be true in some places, but in most countries, any mandatory payment, whether labelled a contribution or a tax, is subject to resistance by the persons upon whom it is levied. Whether viewed as a contributor or a taxpayer, the individuals involved are being deprived of currently disposable income for a longer-term promise of questionable credibility. This aspect of collection issues is an especially critical reform issue in developing and transition countries where revenue collection infrastructure is generally in need of modernization.<sup>4</sup>

Collection is also an issue in some advanced economies of the Organisation for Economic Co-operation and Development (OECD). For example, in Italy collection has long been a major issue only recently addressed. Even where the issue is not as apparent, as in France, it is a critical factor in shaping the design of the system. Thus, there are separate systems for various categories of workers on the premise that solidarity and compliance will be enhanced by this approach. In sum, collection issues are critical everywhere, even though the most dramatic problems are manifested in developing and transition countries.

## Collection models vary

There are two fundamental ways in which the collection function can be organized.<sup>5</sup> One is to run parallel collection systems, as in the case of Germany and France. The other is to run integrated collection systems, as is the case in the United States and Sweden. Historically, in Western Europe, parallel systems developed, but in other places, integrated collection systems have always prevailed, as in the United States and Australia. In these countries,

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<sup>4</sup> David Williams, “Chapter 11, Social Security Taxation”, *Tax Law Design and Drafting*, Vol. 1, Victor Thuronyi (ed.) (IMF, 1996).

<sup>5</sup> Stanford G. Ross, “Common issues of social security and taxation systems”, in *Interactions of Social Security and Tax Systems*, op. cit.

social insurance institutions developed later and could effectively use established tax collection systems, again a reflection of historical circumstance. In some places, dual systems have converted to a single integrated collection system, such as in Sweden, the United Kingdom, Ireland and Italy to achieve greater efficiency. Recently, some transition countries, such as Estonia, Latvia, Hungary, and Slovenia, have taken steps to move from dual systems to integrated systems. In contrast, there appear to be no cases of a well-run integrated collection system converting to a dual collection system.

An alternative model is manifested in countries that rely on funded, individual account approaches as their predominant system for pension provision. In these countries, the fund manager collects the contributions directly or through an agent. In Asia, for example, Hong Kong, Malaysia and Singapore have provident funds that collect funds, manage investments and pay benefits.

Because these are essentially public sector institutions, provident funds may be viewed as a type of social insurance institution operating a parallel collection system. However, because of the funded, individual account nature of the scheme, they differ from a traditional Western Europe type of social insurance institution and have much in common with private sector systems based on fund management.

In Latin America, there is a new generation of defined contribution plans that have developed out of failed defined benefit schemes that dated back to the 1920s. Commencing with Chile in the 1980s, such models, in which private sector fund managers collect contributions, have been adopted in other Latin American countries including Peru and El Salvador. Argentina, which initially adopted such a plan, subsequently integrated its collection operations in the tax collection agency.

Australia adopted a mandatory occupational scheme to supplement its basic means-tested pension scheme funded by general revenue collections. Managers directly collect the contributions to these new defined contribution schemes, which over time are expected to become the primary pension institutions for the country.

In Western Europe, many countries have added in recent years complementary plans based on funded, defined benefit approaches to their traditional schemes. These steps have often been part of a reform agenda to compensate for retrenchments in public defined benefit schemes that manifested financial shortfalls because of changing demographics. In the United States, there are large voluntary, funded defined contribution plans and individual account systems, in which funds are contributed directly to private fund managers by employers, employees and the self-employed.

In Central and Eastern Europe and the former Soviet Union, there has been an extraordinary amount of change in the past decade. There has been an integration of collection activities in Estonia, Latvia, Croatia, Hungary, Russia and Slovenia. There are reforms in process for integration in Albania, Bulgaria, Romania, Montenegro and the Slovak Republic. In addition, there have been adoptions of funded defined contribution schemes in a number of countries, including Poland, Hungary and Bulgaria, in which funds are collected in a variety of arrangements.

Appendix 3 provides a regional classification of selected countries by the predominant type of collection agency for social contributions. It should be recognized, however, that most countries manifest a combination of collection mechanisms and in a sense are mixed systems. For example, while the United States has the largest integrated collection system

in the world, it also has the largest private pension and individual account systems, with contributions being paid directly to fund managers in the latter systems. Also, the states and local governments are collectors for social schemes such as unemployment insurance and workers compensation. Issues of fiscal federalism often influence collection systems to produce complex arrangements.

## **Commonalties and differences in collection models**

Collection models obviously have developed for a variety of historical, cultural, and other factors particular to a country. Many consequences flow from the way that the collection function is organized. As Appendix 4 sets forth, some operations of social security and tax administrations differ, and some are common. In principle, common operations do not have to be duplicated. Thus, if a full service social insurance institution model is followed, then arguably all of the duplicative costs of running parallel collection systems should be justified. In many countries with long-established systems, such as Germany, these greater costs are unquestioned and raise no major concerns. Although in others, such as Japan, concerns are leading to consideration of integration with the tax administration.

In some environments, building one modern, state-of-the-art collection system is a challenge and the possibility of building two or more is not within reach. If an integrated collection system is used, then mechanisms must be in place to assure a steady flow of pension contribution revenues and data to the pension system so that it can pay benefits on time and properly manage the investment of its assets.

Similarly, when a funded defined benefit scheme is added to an existing pension system, the issue arises as to whether the contributions should be collected separately by a fund manager, or by an existing social insurance institution or tax collection agency. Creating parallel collection systems is inevitably costly and time consuming and utilizing existing collection systems is inherently more cost effective.

Whatever collection system is followed, there must be cooperation between various government agencies. Ministries of Finance and ministries of Social Affairs, as well as social security organizations and tax administrations, need to cross-match data and exchange information with one another. They need to be highly supportive of each other in many ways if they are to succeed in their respective missions.

It is frequently not well understood that tax collection or contribution collection in modern societies requires a government-wide approach. It is necessary to have the cooperation of a number of government agencies to be effective. Parochial bureaucratic interests in agencies are often self-defeating. Thus, an isolated full service social insurance institution cannot be effective at collection in most places, and an integrated collection system cannot be effective without the cooperation of the social security organization and other governmental agencies. Mutual trust and strong mechanisms for effective coordination are essential ingredients for success whatever model is used. The highest levels of government must assure that all involved agencies are cooperative and follow the government's overall strategy.

## **Core elements of collection systems**

There are some basic core elements that are present in any effective system for collection of social contributions.

First, there must be a registry of employers and insured persons. To do this most cost-effectively, there should be a single, unique identifying number used on a government-wide basis. Moreover, this number must be protected against official or other misuse to ensure privacy concerns.

Second, there must be straightforward reporting of insured earnings and withholding of contributions at the source. Development of a single reporting form is highly useful. It is in the interests of the government and contributors to avoid complexity and duplicative activities by multiple governmental collection agencies.

Third, there must be data taken from the reports and turned into lifetime records that can be used to pay pensions. This function is solely that of the pension institution. While tax collection agencies record some of the same information, tax collection records generally are maintained for only limited periods of time.

Fourth, there needs to be information technology systems, including computerization and telecommunication networks, that handle the assignment of identifying numbers, collection of data, record keeping, and payment of benefits. Systems development is essential and ongoing.

Fifth, there must be functional collection organizations in place that send notices quickly in the case of non-payment or underpayment. There must be audits and enforced collection mechanisms to follow up promptly if notices are ignored. Enforcement must be balanced with incentives for compliance. In this regard, a functional organization is standard for tax administrations since it is essential to address all aspects of the collection process in an orderly process.

On the other hand, when collection is done by a full service social insurance organization, the collection function is often not as readily organized and special efforts must be taken to produce adequate collection activities. While in principle, a functional collection organization could be installed within a functional full service social insurance organization, it is seldom organized this way. Thus, collection is almost inevitably organized in a manner that is related to the payment organization regardless of its efficacy. The result usually is that collection activities are weaker in a full service social security organization than a comparable organization whose sole purpose and design is for revenue collection.

Sixth, there must be emphasis on human capital development, particularly recruiting people with proper background and experience and engaging them in specialized training. There is a need for targeted audits, which are a result of human interaction with information technology systems and, particularly in newly emerging sectors of the economy, such as the self-employed, there must be special compliance and audit techniques. All of these kinds of specialized administrative developments are generally somewhat easier to accomplish in a tax administration than in the tax collection part of a full service social security organization.

## **Record keeping and data**

Pension institutions inevitably need to keep individual account records.<sup>6</sup> Whether defined benefit or defined contribution, funded or unfunded, public or private, most pension designs require keeping track of lifetime earnings and/or contributions by individuals in order to do

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<sup>6</sup> Stanford G. Ross, "The Logic of Individual Accounts", Second APEC Regional Forum on Pension Fund Reform (Asian Development Bank, 1999).

accurate benefit calculations. Increasingly, information technology makes this a relatively straightforward challenge that can be done cost-effectively, provided the basic core elements of the system are in place.

Second, indexing of wage records and indexing once initial benefits have been set are important functions of most pension systems. This, again, can be done through information technology in a cost-effective and straightforward way.

Third, eligibility and initial benefit calculations must be done. This is based on accessing record systems and can be highly computerized.

Fourth, old age pensions must be kept up to date for address changes, status changes, and again provided the core elements of the system are in place, this also can be an efficient operation.

Disability pensions present a more challenging assignment for data collection and record keeping. Medical data very often are difficult to reduce to electronic form. Also, beneficiaries' conditions change and there is more frequent need for re-evaluation and post-entitlement actions. It is more difficult to develop electronic systems for disability determinations than old age and survivor pensions, but it can be done.

In time, moreover, new information technology should make all data collection and record keeping easier. The biggest problem is developing pension designs that do not make overly difficult the design of internal systems for data collection and record keeping. Too often, legislators, as part of a political process, produce unduly complex and convoluted systems. This, in turn, makes the systems development and computerization of the internal record keeping more difficult. Some accommodation must be reached between the resources available for data collection and record keeping and the degree of difficulty imposed by policymakers in the enabling legislation.

## **Accountability: Accounting and transparency issues**

Any pension institution needs to issue on a timely basis various kinds of reports to ensure for contributors and beneficiaries, as well as the public, that it is correctly performing its functions. Thus annual reports to contributors are produced increasingly by pension institutions. Also, annual reports on the activities of the organization as a whole are produced. All of these reports and the activities of the organization are generally subject to audit. The business processes are subject to quality control and reporting on the results. In addition, there are management reports that bring timely information together to help identify issues that need special attention. Moreover, accounting and other data are necessary for policy development. This also becomes a core function of the pension institution.

Accountability is closely related to governance systems. Governance of pension institutions should always be based on having adequate checks and balances. Thus, there should be strong oversight of an agency's collection, payment and investment functions. The governance mechanisms provide a structure for the entire system.

It is obvious in private systems where there are fiduciary duties and regulatory regimes that these functions should take place. However, it should be equally obvious that public institutions need such control mechanisms just as critically, even if they are organized somewhat differently. Particularly if a public institution is autonomous or semi-autonomous within the government, having adequate governance mechanisms is a critical issue.



Accountability is also closely related to maintaining political and public support for a pension system. The system needs to conduct its business openly and in public with full explanations for its performance. In public systems, resources are usually provided by a legislature and the legislature must have good information if it is to provide resources adequate to ensure successful performance. Similarly, the public must have confidence that the institution is functioning in accordance with the laws and their understanding of its purposes. Thus, any corruption, or creation of special privileges in the system often undermines the pension scheme and the administering pension institution. Accountability and transparency are keys to the success over the long term of pension institutions.

## **Aligning core administrative functions**

It is seldom recognized that if individual core functions are properly done they require tight linkages with other core functions and provide for seamless pension institution operations. Thus, if collection is done in an efficient way with a single reporting form that is well designed, data collection and record keeping follow from this process, and benefit payment can follow smoothly from the record keeping. Tight relationships and a seamless flow of information can take place even if more than one agency is involved. Indeed, it is frequently the case that many parties, including some outside the government, may do particular functions, provided it is pursuant to a system that is reliable and in which there is mutual trust and support between the parties.

Another factor is that there are always multiple systems involved. In addition to the pension institution, the banking system, the capital markets and financial community, and the tax collection operations are always implicated. The notion that any pension institution can be entirely self-sufficient is misleading.

In order to provide for these tight linkages and seamless operations, it is necessary to have a proper legal framework to ensure clear designation of responsibilities and precise accountability.

Cash flows generally differ from information flows. Thus, cash flows and information flows inevitably, while involving different actors, must be coordinated and focused on together. Senior management of pension institutions must be in a position to align all of this information to properly carry out their duties.

Perhaps most importantly, in addition to having a proper legal framework and solid and reliable administrative institutions, is the role of strong leadership and resourceful management. Inevitably institutions must adapt and change. The world changes, communities change, and the needs of the people being served by the pension institution change. Leadership is providing vision and educating people internal to the organization, as well as in the political world and the broad public, of the changing nature of the pension institution. Creative management is often called upon because administrative assets are scarce and it is necessary to employ them as effectively as possible.

## **Recent integration experience in Central and Eastern Europe**

There are many transition countries with recent experience in developing and implementing plans to integrate all or some aspects of the collection of social contributions and taxes. Many of these countries are in the early stages of their initiatives, with most of the activity

having taken place in roughly the last eight years. It is premature to fully assess the results. Nonetheless, some preliminary observations about this recent activity are possible and it is not too early to draw some lessons that may be useful to thinking about the issues often presented by plans for integration.

There are three key parameters that determine the degree of success of plans for integrated collection: (1) the status of modernization of the tax administration; (2) the status of modernization of the social security agency; and (3) the particular culture surrounding revenue collection and taxpayer/contributor compliance. In principle, integration of collection activities will work best where both the social insurance agency and the tax administration are both modernized so that the task of integration can be narrowly focused on the transfer of collection functions. Such a set of circumstances was present in the case of Sweden and the project to integrate collection worked extremely well and expeditiously.

Even in the developed country world, however, such fortuitous circumstances often are not present. Thus, integration in the United Kingdom, Ireland, and Italy took place with a variety of problems on both the social security institution and revenue agency sides. However, the integration projects in these cases were combined with a plan for attendant modernization and the integration efforts were successful.

In the circumstances of Central and Eastern Europe, it is often the case that both the social security institution and the revenue collection agency need significant modernization and integration of collection activities in such circumstances is far more challenging. Moreover, there are differences in the circumstances of each country, as exemplified in the following three cases.

In the case of Albania, modernization of the revenue agency was sufficiently advanced that the integration could go forward and indeed may help the social insurance agency to move forward with a modernization plan. An interesting feature of the Albanian experience is that while an employer-based withholding system for personal income taxes was present, the integration of collection of social contributions into this system has led to steps to improve the withholding system for income taxes.

In the case of Bulgaria, the social security institution was essentially modernized, which led to a plan to create a new revenue administration that could modernize tax collection as well as integrate the collection of social contributions. The existing tax administration agency was too weak to take responsibility for the integration. It lacked core competencies.

Romania involves a situation in which modernization of the social security institution and the revenue agency are both at very preliminary stages. Thus, the degree of integration of collection is greatly limited and only as both institutional sides of the equation modernize will integration of collection be able to be effectively implemented. Integration is essentially an aspiration at this point.

Looking more deeply at the three key parameters, it is apparent that an integration project can be implemented only if the tax administration has modernized to the point where it is effectively using modern information technology and has a reasonably reliable employer-based system for the withholding of personal income taxes. If tax modernization has proceeded to this point, accepting responsibility for the social contribution collection is reasonable since basic foundations are present.

In the case of social security administrations, modernization needs to have proceeded to the point where individuals are effectively registered with unique identifying numbers and contributions collected from employers can be recorded in personal accounts. In this regard, many Central and Eastern European countries adopted during the 1990s so-called second pillars, *i.e.*, funded defined contribution plans, which require identification of individual contributions and tracking of investment returns for each individual account. In many cases, the degree of difficulty of implementing and administering these so-called second pillar plans was greatly underestimated and there have been major problems of administration. This highly troubled experience includes some of the larger, more important European Union (EU) accession countries like Poland and Hungary. In these cases, the problems of integrating collection of the first tier social contributions are greatly complicated by the need to make provision for the second pillar contributions and to coordinate or integrate both with tax collections.

The third basic parameter of building a culture of revenue collection and taxpayer/contributor compliance again varies greatly among countries. In some cases, building such a culture is difficult because the tax and contribution burdens are so high that they provide huge incentives for staying in the shadow economy. Even in countries where the burden is reasonable, there are often problems with groups like the self-employed and farmers. In general, revenue authorities backed by politically astute higher levels of government can build a culture of reliable revenue collection and taxpayer compliance. But political will is very important and it is not an easy task to establish and maintain in the circumstances of most transition countries. For example, a problem that exists in many Central and Eastern European countries is that state enterprises are very often non-compliant and it becomes very difficult to develop the proper culture when the government itself is not, in effect, complying because state enterprises are allowed to have arrears and even have their fiscal obligations foregone.

Another important aspect of building the proper culture is the need to involve constructively business and labour, in many countries called the social partners. A great deal of public education and intense work with the private sector is required to produce the attitudes supporting compliance and to build in the revenue administration a culture of being friendly to taxpayers and trying to educate them at the same time as there is a clear policy of fair and honest enforcement. Revenue agencies must strike a balance between being able to make taxpayers seem like respected clients and at the same time being firm in their law enforcement responsibilities. Social insurance agencies have even more difficulty with reaching this balance since they are not equipped in many cases with the legal authority needed to be a proper law enforcement agency.

Many experiences in Central and Eastern Europe suggest a lack of continuity in high-level political support for modernization is a major problem. Securing resources and sophisticated technical assistance from donors is generally not a problem when the political and administrative environment is favourable. The failures in modernizing collection are largely attributable to internal difficulties stemming from the uneven political development of a country.

Appendix 5 sets forth selected Central and Eastern European country experience with integrated collection to date. It must be recognized that these listings are fluid since changes are taking place continuously. Categorization is inherently judgmental and perilous. Reforms in process include activities on a continuum from planning and proposals to enacted legislation to various stages of actual implementation of legislation. It seems fair to say, however, that there has been a clear trend over roughly the last eight years toward

integration. Although integration activity has had its ups and downs, and it is not clear how far and fast it will go, countries in this area appear to be increasingly taking steps to better coordinate or merge parallel collection systems in an attempt to improve their collection performance.

Even where the logic of integration of contributions and tax collection is not being fully pursued, there is increasingly coordination activities and understanding of the critical issues. The need to improve on the status quo could lead over time to integration activities in these situations since improved coordination generally can only achieve limited objectives compared to a cost-effective merger of collection activities. The real issue in most places may not be whether to move towards integration, but how to do it in a way that is well planned. Avoiding change is not a viable option in the longer run. The question is how rapidly and smoothly change can take place.

The coming period will be extremely important for the Central and Eastern European countries that will soon be achieving European Union (EU) accession. There will have to be, once entry is made into the EU, greater coordination of social benefits because of the freedom of workers to move from one country to the next. This means that there will have to be robust social contribution and tax collection systems. Thus, the revenue collection problems that have been manifested to date by countries such as Poland, Hungary and others entering the EU, will have to be overcome within the EU context. Accession itself will eventually put more impetus into the need for integration of revenue collection systems than even the aspiration to enter the EU did. The EU itself will not be able to function properly if newly entering countries do not reform their core institutions in a way in which their social obligations and revenue burdens are handled efficiently and effectively.

## Final thoughts

Making pension institutions operate effectively is an enormous challenge. Many things can and do go wrong. In some parts of the world, pension institutions work with reasonable reliability even if policy issues abound. Thus, in Western Europe, the United States and Japan, pension institutions, both public and private, work reasonably effectively even though, because of changing demographics and other factors, there are major policy issues to be resolved.

In other parts of the world, having reliable institutions is very problematic even apart from policy issues.

In Latin America, there is a new generation of defined contribution plans that have developed out of failed defined benefit schemes that dated back to the 1920s. But the same political cultures that affected the previous pension institutions are affecting the newly developing pension institutions. There are often overarching practical problems in developing pension institutions that transcend theoretical policy and design issues.

Asia presents a particularly complex variety of pension institutions. There are all manner of institutions and a great deal of experimentation. Thus, there are established provident funds in Singapore and Malaysia. Korea and the Philippines have public defined benefit plans that have operated for some time. Thailand has recently introduced a public defined benefit plan.

The transition countries in Central and Eastern Europe generally have problematic institutions with complex roots from the Cold War era and prior eras. The pension reforms in

the post-Cold War era have not always been successful for political and cultural reasons. But the impetus for EU-accession has given a new impetus for reform of core institutions.

Responsible policymakers in a country need to decide what they want and to determine their own destinies. Donors and experts cannot substitute for political will on the part of governments. The key consideration in developing pension institutions is to have good design and then strong project management to implement that design. Building effective pension institutions is not easy and takes a sustained effort over a long period. There are fundamentals that need to be respected and, if they are, challenges can be met. In contrast, if the fundamentals of sound administration are ignored, failure inevitably follows, sooner or later.

The most fundamental principle that needs to be grasped is that government-wide coordination is needed for collection mechanisms. Modern collection techniques rely on the sophisticated use of information technology and data that must be gathered and shared on a government-wide basis. Increasing awareness of the crucial interrelationships of tax and social security institutions is vital. Developing and implementing a comprehensive strategy for reform of both social security and tax institutions is needed for success. Far too little attention and effort have been given to this critical subject up to this point, but hopefully this will change in the coming period. High-level political awareness and support are needed if core institutions are to be successfully reformed.

## Appendix 1

### Classification of selected countries by predominant type of collection agency for pension contributions

#### Tax collection agencies

Argentina	-	Federal Public Revenue Administration
Canada	-	Canada Customs and Revenue Agency
Hungary	-	Tax agency
Russia	-	Ministry of Tax and Contributions
Sweden	-	National Tax Board
United States	-	Internal Revenue Service, Treasury Department
United Kingdom	-	Board of Inland Revenue

#### Social security organizations

Belgium	-	National Social Security Office
Brazil	-	National Social Security Institute
China	-	Provincial or city/county social insurance agencies
France	-	Basic scheme + institutions providing complementary pensions
Germany	-	Health Insurance Funds
Hong Kong (China)	-	Central Provident Fund
Indonesia	-	Employees Social Security scheme
Japan	-	Social Insurance Offices
Korea	-	Korea National Pension Corporation
Malaysia	-	Employees Provident Fund
Mexico	-	Social Insurance Institute
Philippines	-	Social Security System
Poland	-	Social Insurance Institution
Singapore	-	Central provident Fund
Switzerland	-	Administering institutions
Thailand	-	Social Security Office
Uruguay	-	Social Insurance Bank

#### Fund managers

Australia	-	Managers of mandatory occupational schemes
Chile	-	Fund managers
El Salvador	-	Fund managers
Peru	-	Fund managers

## Appendix 2

### Administrative structures: Relationship of major functions; establishing criteria for performance evaluation

Function	Structure	Criteria for evaluation
1. Revenue base	Contribution collection system	Evasion rates based on ratio of actual collections to those legally required
2. Benefit payments	Benefit payment system	Error rates based on ratio of correct payments to those legally required
3. Financial management and investments	Actuarial office for projection of revenues and expenditures and financial office to control investments	Accuracy of projections in relationship to actual results; performance of investments
4. Communications	Data and information systems; computer systems and telecommunication networks	Record accuracy; usefulness of data bases; timeliness of reports
5. Reporting and accountability	Program management office that uses data and information to analyze results and issue reports	Usefulness of reports; transparency of activities

## Appendix 3

### **Regional classification of selected countries by predominant type of collection agency for social contributions**

#### **Asia**

*Tax Collection Agencies* – Australia, New Zealand

*Social Security Institutions* – Japan, Korea (Republic of), Philippines, Thailand, China

*Fund Managers* – Hong Kong, Malaysia, Singapore

#### **Americas**

*Tax Collection Agencies* – Canada, United States, Argentina

*Social Security Institutions* – Brazil, Mexico, Uruguay

*Fund Managers* – Chile, El Salvador, Peru

#### **Western Europe**

*Tax Collection Agencies* – United Kingdom, Norway, Sweden, Italy, Ireland

*Social Security Institutions* – Belgium, France, Germany

#### **Central and Eastern Europe and former Soviet Union**

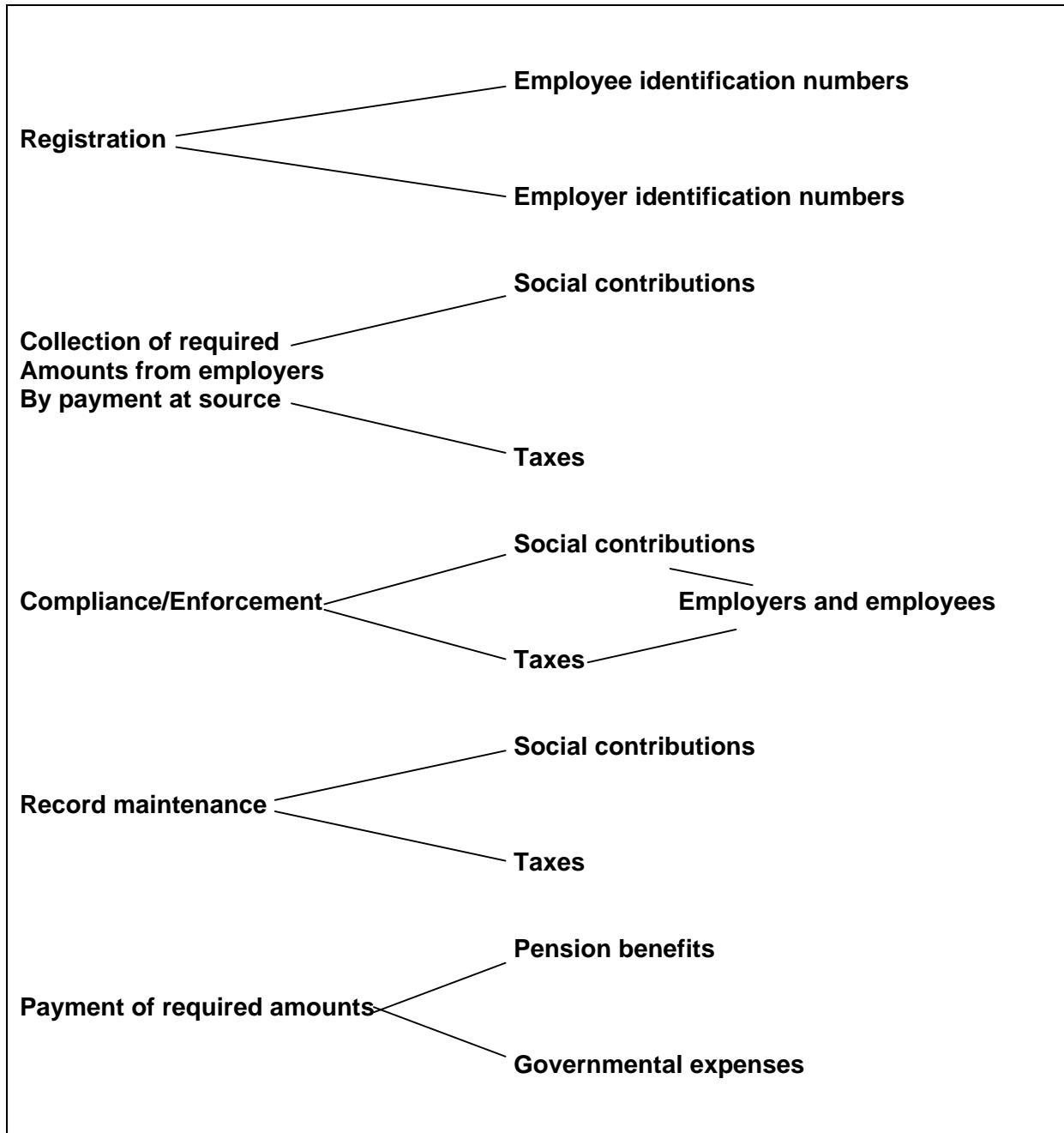
*Tax Collection Agencies* – Estonia, Latvia, Croatia, Hungary, Bulgaria, Romania, Albania, Russia, Montenegro, Slovak Republic, Slovenia

*Social Security Institutions* – Poland, Czech Republic, Georgia, Lithuania, and most former Soviet Union Republics



## Appendix 4

## Commonalties and differences in tax and social security administrations



## Appendix 5

### **Selected Central and Eastern European country experience with integrated collection**

#### *Reforms essentially implemented*

Estonia  
Latvia  
Croatia  
Hungary  
Russia  
Slovenia  
Uzbekistan

#### *Reforms in process*

Albania  
Bulgaria  
Montenegro  
Romania  
Slovak Republic

#### *Reforms stalled*

Georgia  
Lithuania  
Poland

#### *No reforms in process*

Czech Republic  
Macedonia  
Serbia  
Most former Soviet Union Republics (e.g., Armenia; Kazakhstan)