

LUXEMBOURG

Luxembourg: pension system in 2006

The public pension scheme has two components: a flat-rate part depending on years of coverage and an earnings-related part. There is also a minimum pension.

		Key indicators	
		Luxembourg	OECD
Average earnings	EUR	43 600	28 600
	USD	54 800	35 800
Public pension spending	% of GDP	7.2	7.2
Life expectancy	at birth	79.4	78.9
	at age 65	83.7	83.4
Population over age 65	% of working-age population	22.8	23.8

Qualifying conditions

An early pension is payable from age 57 with 40 years' (compulsory or voluntary) contributions. With 40 years' coverage of compulsory, voluntary or credited contributions, the pension can be paid from age 60. Since the modelling assumes a full career from age 20, it is assumed in the base case that workers retire at age 60. Otherwise, the normal pension age is 65 (subject to at least ten years' contributions).

Benefit calculation

Basic

This was worth EUR 362 per month in 2006, subject to 40 years' coverage. This is equivalent to around 10% of average earnings. For incomplete insurance, the benefit is reduced proportionally. (Formally, the basic pension is 23.5% of a reference amount, which was EUR 1 541 in 2006.)

There is also an "end-of-year allowance", which adds EUR 49 per month to the pension for 40 years' contributions. This is proportionally reduced for insurance periods under 40 years, implying around EUR 1.23 per month for each year covered. The end-of-year allowance is indexed to nominal earnings (see below).

Earnings-related

The accrual rate for the earnings-related pension is 1.85%. The earnings measure used in the formula is lifetime average pay revalued in line with nominal earnings.

The accrual rate is higher for older workers and those with longer contribution periods. For each year of work after age 55, the accrual rate is increased by 0.01 percentage points. Furthermore, each year of contributions beyond 38 also attracts an additional accrual of 0.01 percentage points. The maximum accrual rate is 2.05% per year. Under the standard assumption of a full career starting at age 20, the accrual rate is 2.01%.

The maximum pension in 2006 was EUR 6 422 per month (formally specified as $\frac{25}{6}$ of the reference amount). This is just under 177% of average earnings.

Benefits are automatically indexed to changes in the cost of living (if cumulative inflation is at least 2.5%). In addition, adjustments to increases in real wages must be considered every two years. Recent practice has seen increases close to earnings and the modelling assumes that this practice continues.

Minimum

The minimum is EUR 1 387 per month (defined as 90% of the reference amount), conditional on 40 years' coverage, equivalent to about 38% of average earnings. This is proportionally reduced for shorter periods subject to a minimum of 20 years of service periods (compulsory, voluntary or credited contributions).

Social assistance

The social-assistance safety-net level is EUR 1 098 per month for a single person.

Variant careers

Early retirement

It is possible to retire at 57 with 40 years' paid contributions and at 60 with 40 years' paid or credited contributions. Early retirees may work periodically provided earnings do not exceed one third of the minimum social income. There is no actuarial adjustment to benefits for early retirement.

In addition, there are a number of pre-retirement programmes. Relevant here are the pre-retirement solidarity and pre-retirement adaptation schemes. The first allows early retirement on the condition that the employer hires a job seeker assigned by the employment administration. The second allows early retirement for older workers losing their jobs due to restructuring or bankruptcy. Both schemes apply from age 57 up to age 60. The pre-retirement benefit is 85% of prior earnings in the first year, 80% in the second year, and 75% in the third. The earnings measure is pay in the final three months.

Late retirement

The pension has to be claimed at the retirement age of 65. After this age, it is possible to combine work and pension benefits without reductions in the pension benefit.

Childcare

“Baby years” (two years for one and four years for two children) are credited as insured time. Pensionable earnings are based on pay immediately before the baby years are claimed. The period counts as qualifying conditions and enters in the flat rate component of the pension formula.

Employees who could not claim baby-years due to insufficient contribution period have the right to a special monthly allowance in retirement of EUR 89 per child.

Non-contributory periods bringing up children under 6 count towards the qualifying conditions.

Unemployment

Periods of receiving unemployment benefits are credited: pension contributions from the benefits are paid by state ($\frac{2}{3}$) and beneficiary ($\frac{1}{3}$). The period unemployed counts towards the qualifying conditions and enters in the earnings-related component of the pension formula. For this period, unemployment benefit is used as a base for pension calculation.

Personal income tax and social security contributions

Taxation of pensioners

Pensioners receive a deduction for professional expenses of a minimum of EUR 300 (compared with EUR 540 for people of working age). Pensioners do not receive the travel expenses deduction (which has a minimum of EUR 396 for workers) or the special deduction (of EUR 600 for workers).

Taxation of pension income

There is no special relief for pension income.

Social security contributions paid by pensioners

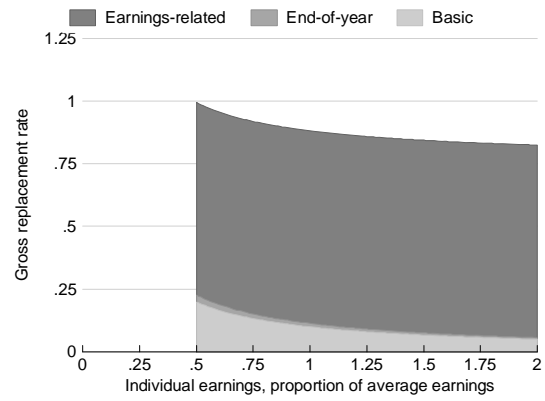
Pensioners pay 2.70% sickness contributions on their gross income plus about 1% for long-term care insurance. This compares with 5.05% sickness contributions for employees (and the same 1.0% for long-term care). Pensioners also contribute to the unemployment-insurance scheme through a 2.5% solidarity surcharge on their central-government income-tax liabilities. But they do not contribute to the pension scheme.

Pension modelling results: Luxembourg

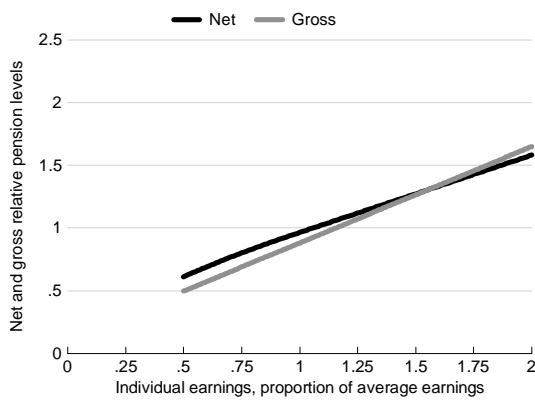
Gross relative pension level



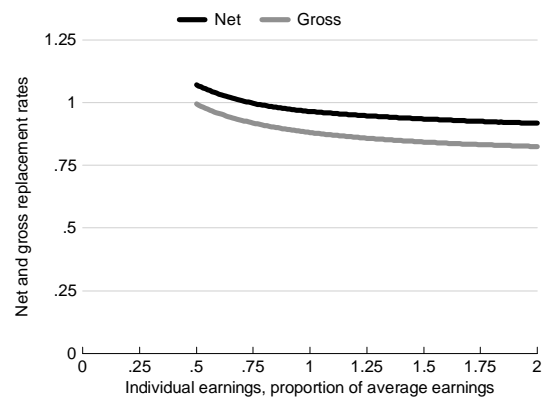
Gross replacement rate



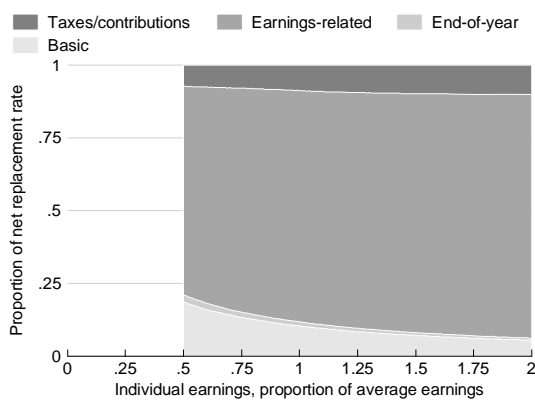
Net and gross relative pension levels



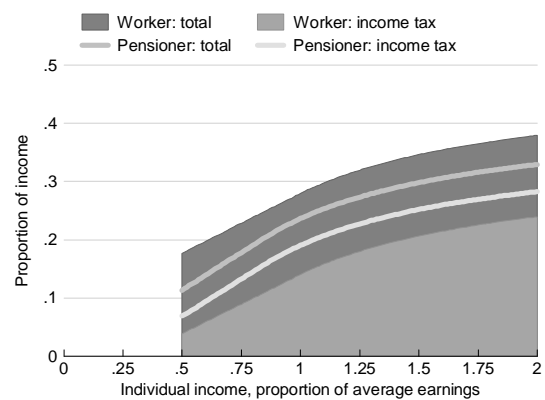
Net and gross replacement rates



Sources of net replacement rate



Taxes paid by pensioners and workers



Men Women (where different)	Median earner	Individual earnings, multiple of average				
		0.5	0.75	1	1.5	2
Gross relative pension level (% average gross earnings)	76.6	49.7	68.9	88.1	126.5	164.9
Net relative pension level (% net average earnings)	87.0	61.2	80.1	96.5	127.3	158.2
Gross replacement rate (% individual gross earnings)	90.1	99.4	91.9	88.1	84.3	82.5
Net replacement rate (% individual net earnings)	98.1	107.1	99.7	96.5	93.5	91.8
Gross pension wealth (multiple of average gross earnings)	19.7 24.0	21.7 26.5	20.0 24.5	19.2 23.5	18.4 22.5	18.0 22.0
Net pension wealth (multiple of average net earnings)	16.1 19.6	19.2 23.5	16.8 20.5	15.2 18.5	13.3 16.3	12.4 15.2