



- Merge the old-age social pension, the complement (CES) and the top-up (CSI), and remove the means testing of the CSI to descendants' income
- Duly implement the link between increases in the retirement age and life expectancy gains and extend this link to the early retirement age

The pay-as-you-go defined benefit scheme and its interactions with old-age safety nets is complex. Eligibility for earnings-related pensions requires 15 years of contributions. For those eligible but with less than 20 years of contributions the accrual rates are 2% per year. For more than 20 years of contributions the annual accrual rate varies between 2% and 2.3% depending on the reference wage level. For those with short contribution periods or low pension entitlements more generally there are several first-tier pension benefits. The main ones are: the minimum pension from the earnings-related scheme, between 21% and 30% of the gross average wage depending on the length of the contribution period; the means-tested old-age social pension (including the CES complement) at 11% of the average wage; and, a supplement (Solidarity Supplement for the Elderly, CSI) up to 29% of the average wage for those with total income below a certain threshold that takes into account various resources including descendants' income.

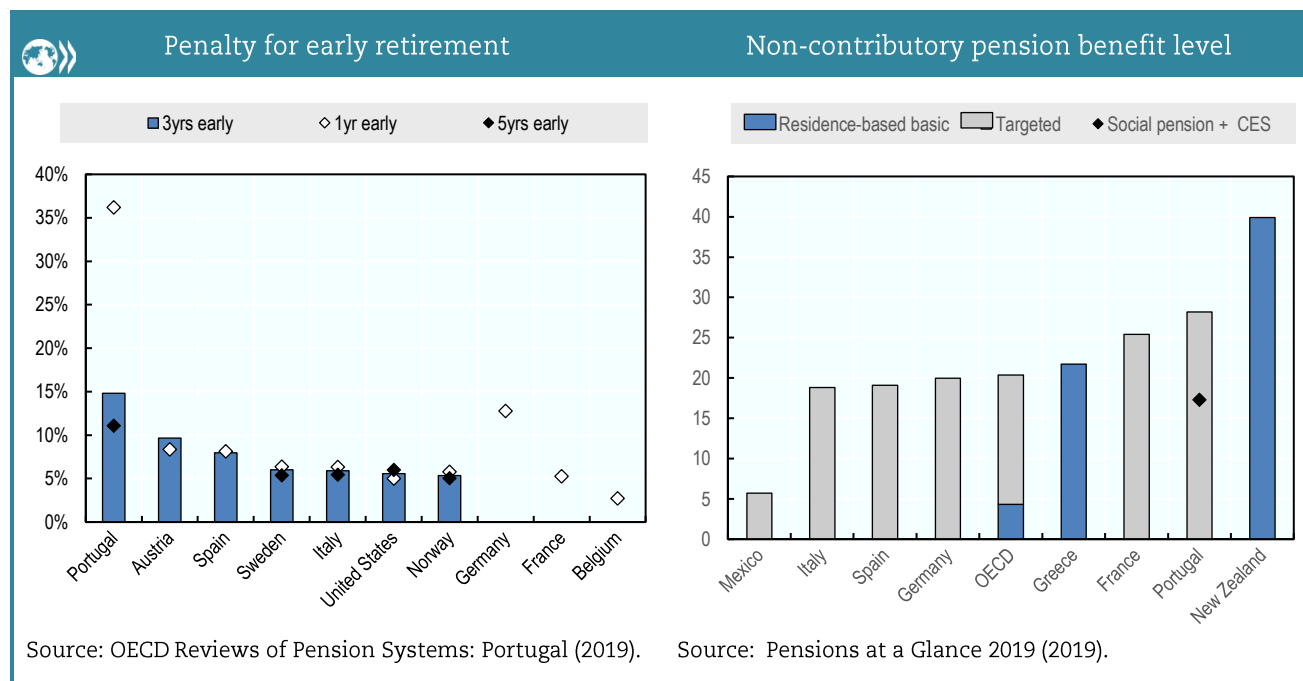
Key indicators: Portugal and OECD average

| | Mid-1980s | Mid-1990s | Mid-2000s | latest available | latest OECD | long-term | long-term OECD |
|---|-------------|-------------|-------------|------------------|-------------|-------------|----------------|
| Normal retirement age for a full-time career starting at age 22 | 65.0 | 65 (62) | 65.0 | 65.2 | 64.2 (63.5) | 67.8 | 66.1 (65.7) |
| Statutory retirement age | 65.0 | 65 (62) | 65.0 | 65.2 | 64.5 (63.8) | 67.8 | 66.5 (66) |
| Net replacement rate, average earner | | | | | | 89.6 | 58.6 (57.6) |
| Effective contribution rate (average earner) | | | | 22.7 | 18.4 | | |
| Total pension spending, % of GDP | 4.3 | 7.3 | 10.3 | 14.1 | 10.0 | | |
| Public pension spending, % of GDP | 4.0 | 7.2 | 10.1 | 13.4 | 8.5 | | |
| Public debt, % of GDP | .. | 67 | 80 | 139 | 80 | | |
| Employment rate 55-64, % | 64.5 (30.5) | 58.2 (33.6) | 58.1 (43.6) | 64.5 (54.6) | 68.5 (54.8) | | |
| Labour-market exit age | 66.4 (66.7) | 63.6 (63.0) | 66.3 (66.2) | 68.5 (65.4) | 65.4 (63.7) | | |
| Old-age poverty rate, % | | | 17.8 | 9.5 | 13.5 | | |
| Life expectancy at 65, years | 14.2 (17.5) | 15.0 (18.6) | 16.8 (20.5) | 18.4 (22.0) | 18.1 (21.3) | 22.6 (26.1) | 22.5 (25.2) |
| Old-age to working-age ratio | 0.22 | 0.25 | 0.28 | 0.39 | 0.31 | 0.71 | 0.58 |
| Fertility rate | 1.6 | 1.5 | 1.4 | 1.3 | 1.7 | 1.6 | 1.7 |

Note. The figures for women appear in parenthesis where they differ from those for men.
 Long term: Around 2065 based on all legislated reforms up to mid-2019.

Portugal has been particularly active in reforming its pension system over past decades, mainly focusing on improving financial sustainability. A combination of low fertility and rising life expectancy has resulted in fast ageing. As a consequence, the financial pressure on Portugal's pension system has grown. In 2007, a sustainability factor was introduced which adjusted the initial benefit level for all new retirees to changes in life expectancy. In 2014, the retirement age was raised from 65 to 66 years and linked to life expectancy from 2016 onwards. This reform was implemented while abolishing the sustainability factor for those retiring at or after the official retirement age. Therefore, the sustainability factor remains in place for early retirement only, and Portugal stands out among other OECD countries in terms of penalties for early retirement. The largest part of the penalty in Portugal comes from the sustainability factor, which was equal to 14.5% in 2018 and, if consistently applied, is expected to rise to

31.0% in 2065. The sustainability factor is applied regardless of the number of months of early retirement, while on top of it a penalty of 0.5% per month of early retirement is applied. In 2018, eligibility to penalty-free early retirement was expanded from age 60 – the standard early retirement age - to individuals who began contributory employment at age 16 or younger and have at least 46 years of contributions. In addition, from 2019, the sustainability factor will not be applied for workers aged 60 or more and having a contribution record of at least 40 years at age 60.



Numerous non-contributory schemes pursue similar objectives. The social pension and the CSI have different eligibility criteria, but both schemes aim to avoid poverty in old age. This gives the impression that with the introduction of CSI in 2006, rather than adjusting existing eligibility criteria or benefit levels to changes in social and economic conditions, additional schemes have been piled up. In addition, the CSI means-testing takes into account not only all income sources of the household but also the income of descendants with whom the applicant is in contact (regardless of whether they live in the same household). Such a broad means-testing might contribute to perpetuating low disposable income from one generation to the next within the same family. It might cut cost by restricting the number of beneficiaries, but makes the pension system complicated. The administrative complexity generates costs and long waiting times, and some people may be discouraged or uncomfortable to have their children’s income means-tested. Given longer life expectancy, the standard early retirement age of 60 is too low. This age reference helps shape social norms and influence behaviours by both employees and employers about working at older ages; it is not consistent with other efforts to enhance the labour supply of older workers. Moreover, as it is associated with very detrimental penalties, maintaining such a low age threshold could induce people to make bad choices. This is difficult to justify by the implied saving of public money.

Efforts should focus on simplifying non-contributory benefits to avoid the multiplication of instruments with similar objectives. In particular, the old-age social pension (including the CES complement) and the top-up (CSI), should be merged and the means testing of the CSI to descendants’ income removed. The link between the retirement age and life expectancy plays a key role in dealing with challenges raised by population ageing. It should be extended to the minimum age of early retirement, which at 60 years is currently too low. The sustainability factor should be used to adjust pension benefits across the board as an ultimate instrument to ensure financial sustainability. Once the sustainability factor has been reshaped, early retirement could rather be discouraged by raising the current 0.5% penalty per month of early retirement.

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