Pension Challenges and Pension Reforms in OECD Countries

Peter Whiteford
Social Policy Division, OECD
http://www.oecd.org/els/social
Email: Peter.Whiteford@oecd.org

Issues and Outline

- The challenges of population ageing
- The demographic and labour market context
- Pension systems in OECD counties
- Pension reforms
- Is there an optimum system?
Korea currently spends relatively little on retirement pensions

Populations are ageing

Figure 1: Share of the population aged 65 and over, 2000 and 2050
Cash benefits are strongly age-related

… and, pension spending will increase in most countries

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Many countries will see shrinking labour forces

The potentially mobilisable labour force varies in size

Excess inactivity and unemployment as % of population 15 to 64, except students
Older people are a large share of the mobilisable labour force
Persons 50-64 as % of mobilisable labour resources

Real dependency depends on employment

Standard dependency ratio  Employment-adjusted
A very wide range of employment levels across OECD countries

% of men aged 50 to 64 years in employment, 2004

Men retire before pension age in many countries

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As do women, but not in Korea

Illness or disability is a major cause of inactivity at older ages
Disability and disability pensions

- The prevalence of disability for people aged 50 to 64 years is nearly twice as high as for the working-age population generally
- Employment rates for people with disabilities are only around 40%—45%
- Older disabled people have lower employment rates than younger people with disabilities
- Across OECD countries benefit recipiency rates average 5.5%, but are close to 8-9% in Denmark, Norway, Sweden and the Netherlands
- Roughly one in four persons who are not employed receive disability benefits
- People over 45 are 70-90% of the stock of disability beneficiaries, and similar proportions of inflow to benefits

Social protection and retirement disincentives

- Low official pension eligibility ages or implicit penalties for working longer in public pension schemes (sometimes in defined benefit occupational pensions)
- Early retirement schemes introduced to deal with unemployment
- *De facto* early exit schemes through sickness, disability or more generous unemployment benefit schemes
- Interactions between tax and benefit systems
Retirement incentives – how to measure them

- Replacement rates
- Change in pension wealth from working an extra year
Pension systems and retirement incentives – important parameters

- Normal and early retirement ages
- Qualifying conditions – periods of residence or contributions
- Measures of earnings – final, lifetime average or other
- Adjustments for early or late retirement
- Penalties for earning or combining pensions and work

Pension reforms – some examples

- **Changes in the number of years used in benefit calculation.** Individual earnings are measured in different ways: measures include earnings in the last (few) year(s) of employment, earnings over a number of best years, or lifetime earnings. In the past, the last few years of earnings were commonly used to calculate public pension benefits. Today, many countries have moved towards the use of lifetime earnings.

- **Changing the valorisation of past earnings.** Pension benefits have also been made less generous through changes in ways in which past wages enter into the benefit calculation. In many public pension systems, past earnings are re-valued to take account of changes in living standards between the time pension rights accrued and the time they are claimed. Some countries have recently moved from earnings to price-valorisation or to a mix of wages and prices. Changes in valorisation can strongly influence benefit levels, since prices tend to rise more slowly than wages.
Pension reforms – some examples

- **Changing indexation of pensions in payment.** Some countries have moved from indexation to earnings towards full or partial indexation to prices. This means the purchasing power of pensions is preserved, but pensioners are not participating in increasing living standards enjoyed by workers. When poverty thresholds are set in relation to household income, price indexation leads to higher relative poverty rates among pensioners as the economy grows.

- **Linking pensions to higher life expectancy.** Several countries have changed benefit formulae to include a factor reflecting increases in life expectancy at retirement. Incorporating such a factor is particularly simple in the notional account systems that have been introduced in recent years in some countries. Explicit links between life expectancy and pension benefits have also been introduced in defined benefit systems. The impact of these measures has varied depending on the parameter chosen, but have generally lowered the amount of public pension benefits paid to current and future generations of retirees.

Pension reforms – changing retirement incentives

- Increasing pension age for women – Australia, Austria, Belgium (private sector), Hungary, Portugal, Switzerland, United Kingdom

- General increases in retirement ages - Czech Republic, Greece, Japan, Korea, New Zealand, Sweden, USA

- Adjusted retirement incentives – Australia, Austria, Belgium, Denmark, Finland, France, Germany, Italy, Portugal, Spain, Sweden, United Kingdom
Conclusions

- Multiple policy responses required to meet the challenges of population ageing
- Increase employment among older workers, mothers, people with disabilities and unemployed and welfare recipients
- Address employer practices, discrimination; strengthen skills; immigration
- Pension and benefit reform only one part of the response.

Conclusions

- Recent increases in employment of older men, except in Germany, Greece, Italy, Poland and Turkey (also Iceland, Japan, Korea and Switzerland, but employment levels very high)
- Older women have seen increases in employment more generally, except Greece, Korea, Poland and Turkey
Conclusions

- For older men, no OECD country has employment levels back at 1980 levels (except perhaps Denmark and New Zealand)
- New Zealand reforms from 1991 apparently very successful:
  - Employment of males aged 60-64 years rose from 36% to 65% between 1991 and 2001
  - Employment of women aged 60-64 rose from 17% to 41% over same period
  - But question of what made this feasible and successful.

Conclusions

- Reform proposals need to build on existing systems and be sensitive to specific country context
- NDC systems tend to have good incentives to continue employment
- So do systems with basic pension, and mandatory or quasi-mandatory pillars
- Careful design of first pillar or of means of guaranteeing minimum incomes is important, and complexity should be avoided
Final conclusions

- Ending early retirement schemes is of central importance, as many people choose to retire at earliest age available.
- Flexibility in choice of retirement age desirable, but decrements for early retirement and increments for later retirement should be actuarially neutral, a condition not necessarily always met.
- Need to monitor and control disability benefits, and separate support from assumption that people with disabilities are incapable of work.