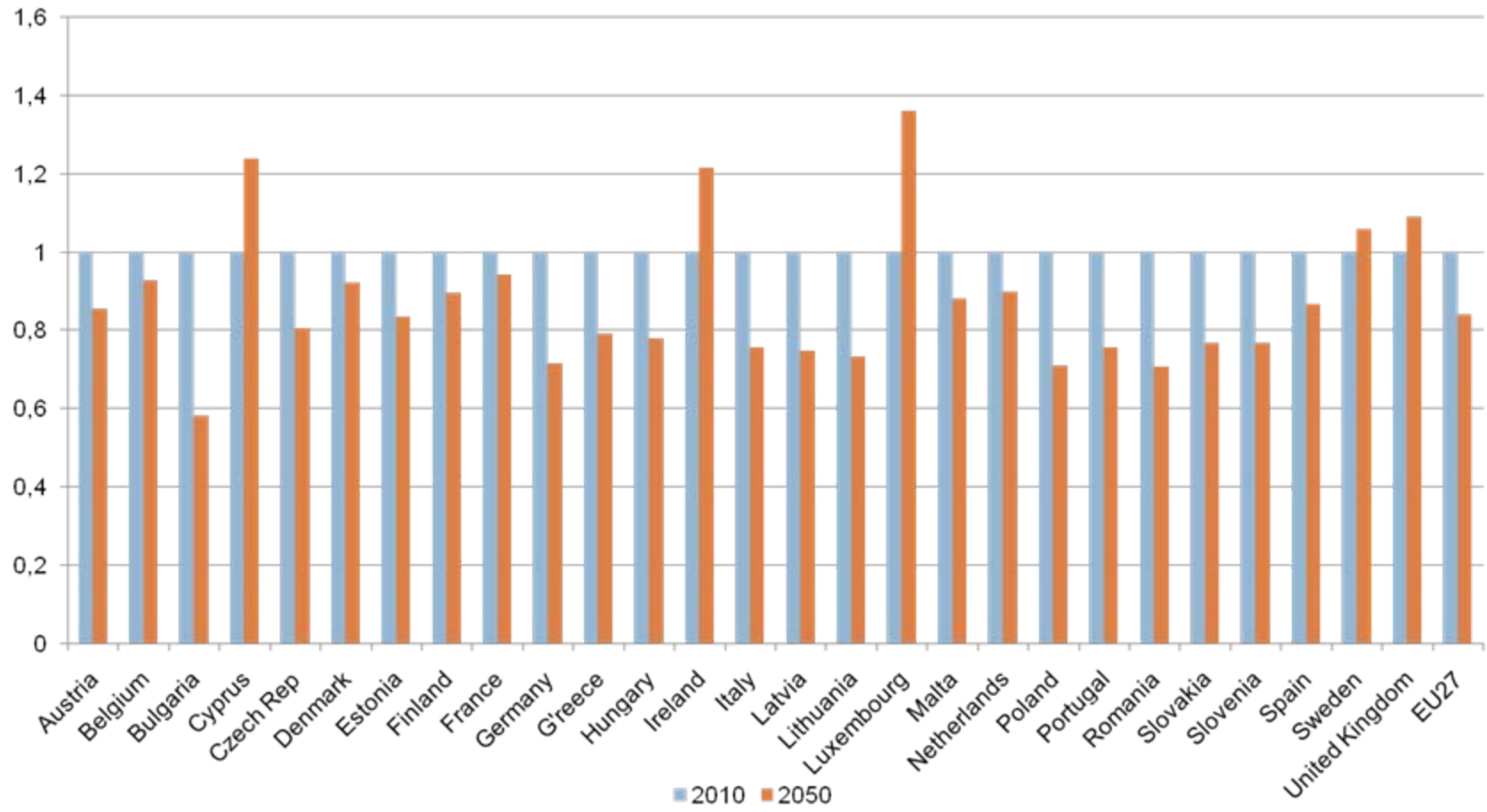


ADEQUACY AND SUSTAINABILITY OF PENSION SYSTEMS IN EUROPE

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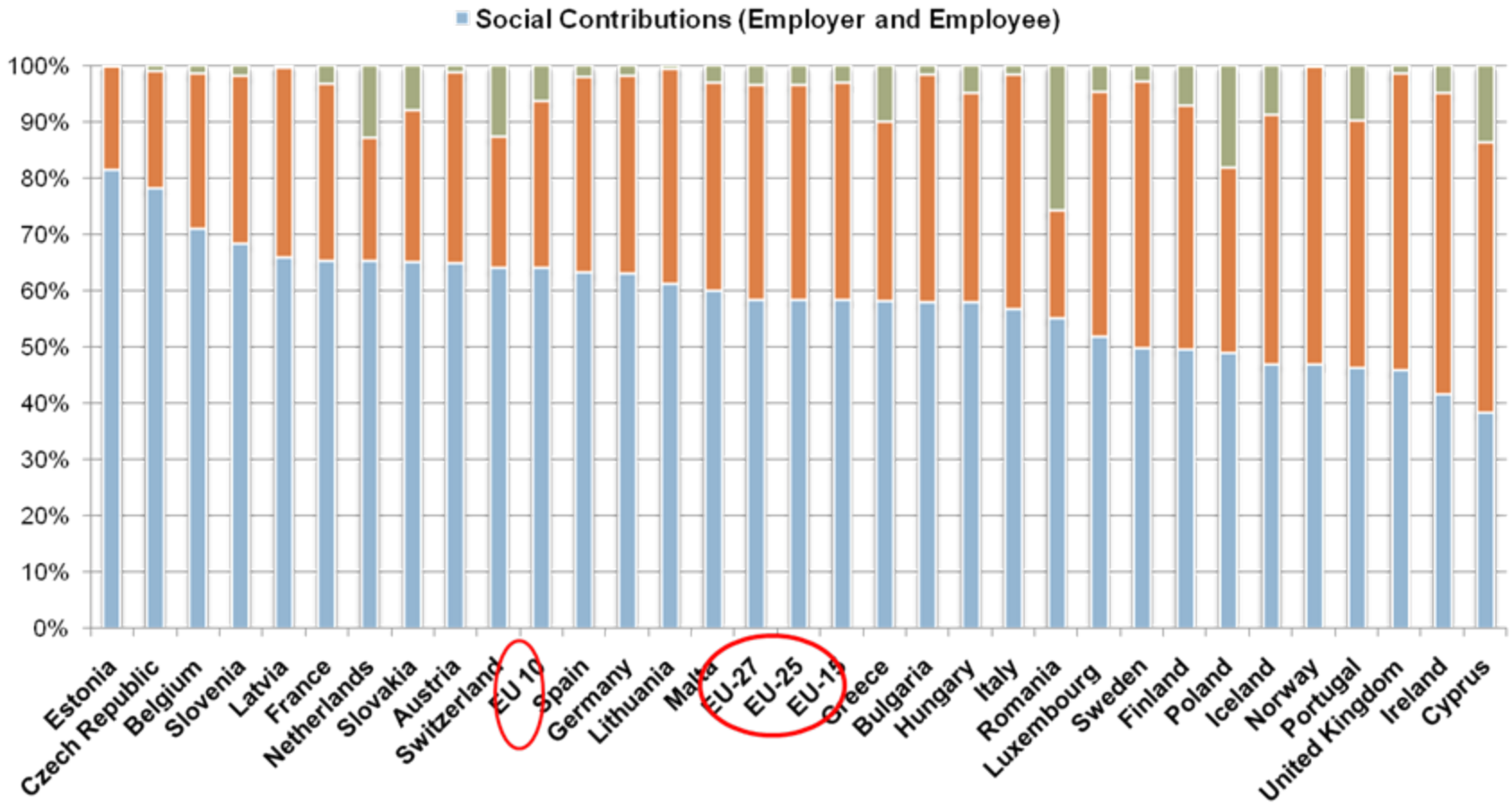
Shrinking of the Working Age Population



Potential Mitigating Factors

- Immigration
- Increase in labor force participation of women
- Increase in retirement ages
 - ▣ Requires job opportunities for older workers
 - ▣ Requires some commitment to lifelong learning and training
 - ▣ Requires greater human capital per worker
- But these are not expected to be enough to compensate for the shrinking working age population

Heavy Reliance on Labor Taxes to Fund Social Protection Benefits



Social Contributions Today Fund a Wide Range of Benefits

- Old age and survivors' pensions
- Sickness and health care
- Disability pensions and services
- Family and children benefits
- Unemployment
- Housing and other benefits
- Work-injury compensation

What Happens When the Tax Base Shrinks?

- Can reduce the types of benefits financed by labor taxes and shift them to other financing
 - ▣ Constraints on what can be financed from general revenues as well
- Can reduce benefit expenditures
 - ▣ Benefit levels
 - Reduced across the board
 - Provide only basic benefits to all
 - ▣ Change eligibility conditions
 - Or provide benefits to more limited group of beneficiaries (age or capacity related)
 - Or provide benefits only to low and middle income
- In globally competitive world, option of raising contribution rates not really feasible

How Do We Define Adequate Pensions?

- Are pensions adequate if they prevent poverty in old age?
- Are pensions adequate if they provide a basic living standard (above poverty level)?
 - ▣ How do we define what is included in this basic living standard?
- Are pensions adequate if they replace $x\%$ of a person's lifetime average wage?
 - ▣ How is the lifetime average wage calculated?
 - ▣ What is the appropriate $x\%$?
- Are pensions adequate if they are $y\%$ of the current average economy-wide wage?
 - ▣ What is the appropriate $y\%$?
 - ▣ What would be an appropriate minimum?

Adequacy and Sustainability are Related

- Different solutions for different countries
 - ▣ Needs of the elderly in each country depend on what other benefits are already being provided
 - ▣ Different preferences for poverty alleviation vs. income smoothing vs. redistribution
- Need to arrive at a common understanding at the individual national level of what is adequate, given the constraints of affordability and sustainability, and the needs of the elderly
- Reforms which are fiscally sustainable may not be socially sustainable if they do not provide what are generally accepted as adequate pensions
- But what society considers adequate based on historical benefit levels may not be fiscally sustainable

Impact of Sustainability-Enhancing Reforms on Adequacy

- Raising of retirement age
 - ▣ Clear win-win – improves sustainability and provides better pensions to smaller number of people who are older and more likely unable to work
 - ▣ Reforms linking retirement age changes to life expectancy increases even better
- Penalizing and reducing early retirement
 - ▣ Increases adequacy by inducing longer working periods
 - ▣ Also limits pensions to those who are unable to work
- Changing indexation of pensions to inflation
 - ▣ Might reduce benefits relative to average wage, but maintains the purchasing power of the pension after retirement
 - ▣ Particularly necessary given the need for productivity increases with the shrinking labor force

More Sustainability Enhancing Reforms

- Lowering accrual rate – benefit per year of contribution
 - ▣ Lowers adequacy for those with short careers, but if coupled with retirement age increases, will maintain adequacy for most
- Linking benefits to life expectancy increases
 - ▣ Enhances sustainability, but leaves long-run adequacy questions
- Introducing funded pillars
 - ▣ Trading short run fiscal costs for long run sustainability, while maintaining adequacy
- Encouraging voluntary savings
 - ▣ Given the affordability constraints on the public pillars, people who want to live more comfortably in old age will have to work longer and save more

Public Dialogue on What is Adequate and Affordable is Crucially Important

- Given the shrinking labor force, there needs to be a national and/or EU level dialogue on what society should expect going forward
 - ▣ Longer working careers
 - ▣ Shorter retirement periods
 - ▣ More basic level of benefits