

Assessing Current and Future Pensions Adequacy

IMSERSO - European Centre - UNECE

Workshop on

“Sustainable Ageing Societies: Indicators for Effective Policy Making

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The Open Method of Coordination and Indicators

- Member States are responsible for their social protection systems
- Social cohesion and a high level of social protection are fundamental goals of the EU and are part of the 'Lisbon Strategy'
- A new policy coordination tool has been created: the Open Method of Coordination
 - Common objectives
 - Common indicators to measure progress towards these objectives and to make mutual learning possible
 - Common assessment of national policies

Indicators are Important:

- because they clarify the common objectives
- because they tell us how successful the policies of a Member State really
- and thereby help policy makers in other countries decide whether it is worth pursuing similar policies
- because they allow target setting and monitoring

Common objectives on pensions

Adequacy (=meeting the social objectives)

which requires:

Financial Sustainability (being able to finance pensions without adverse economic impacts or reducing other essential spending)

and:

Modernisation (adapting to changes in society so that pension systems cater for different working and living arrangements)

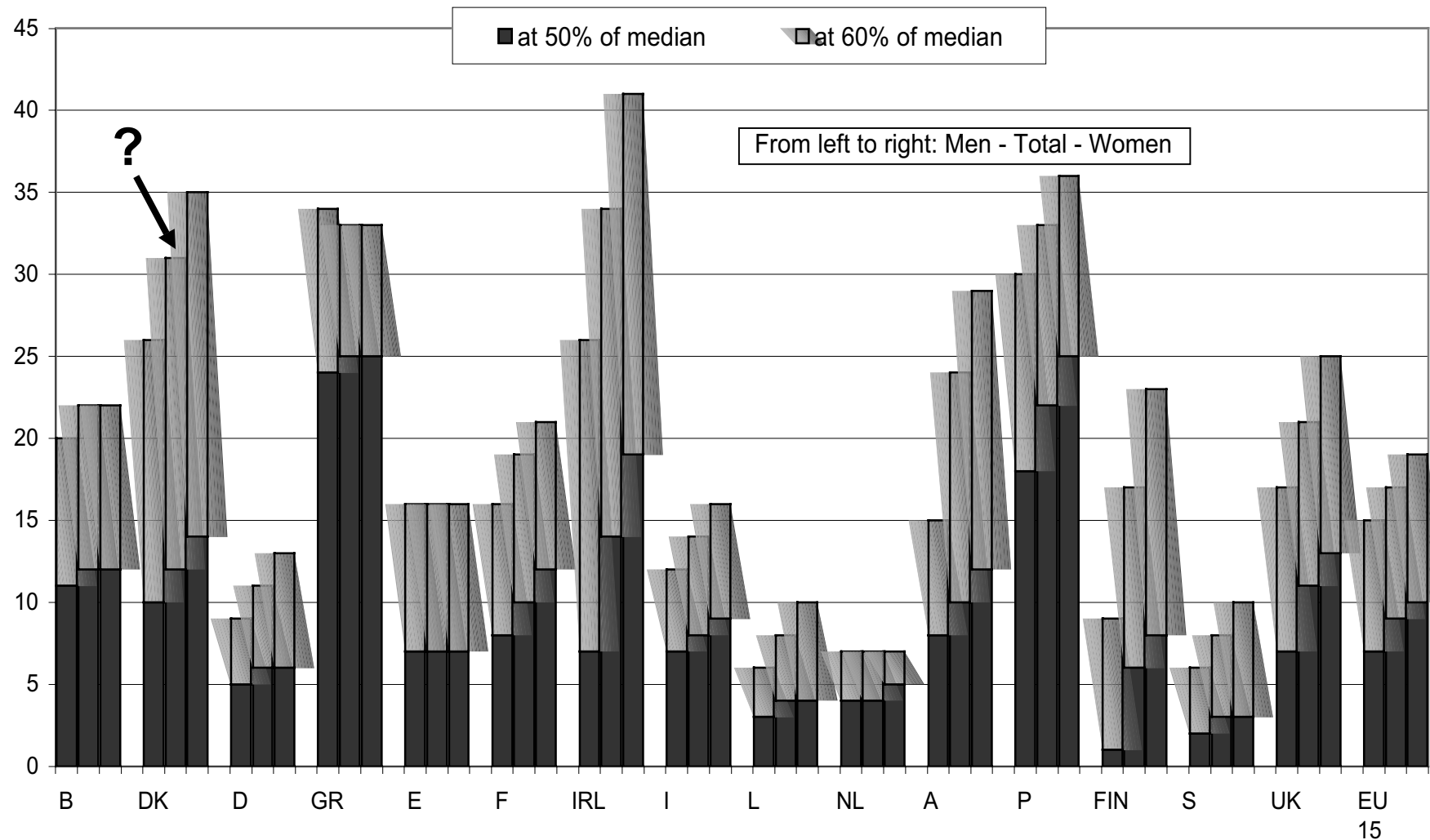
Common objectives (I)

Adequate Pensions

- Ensure a decent living standard, a share in the economic well-being of one's country and the ability to participate in public, social and cultural life
- Provide access to appropriate pension arrangements necessary to maintain one's living standard
- Promote solidarity between and within generations

Recent Pensions Adequacy (1)

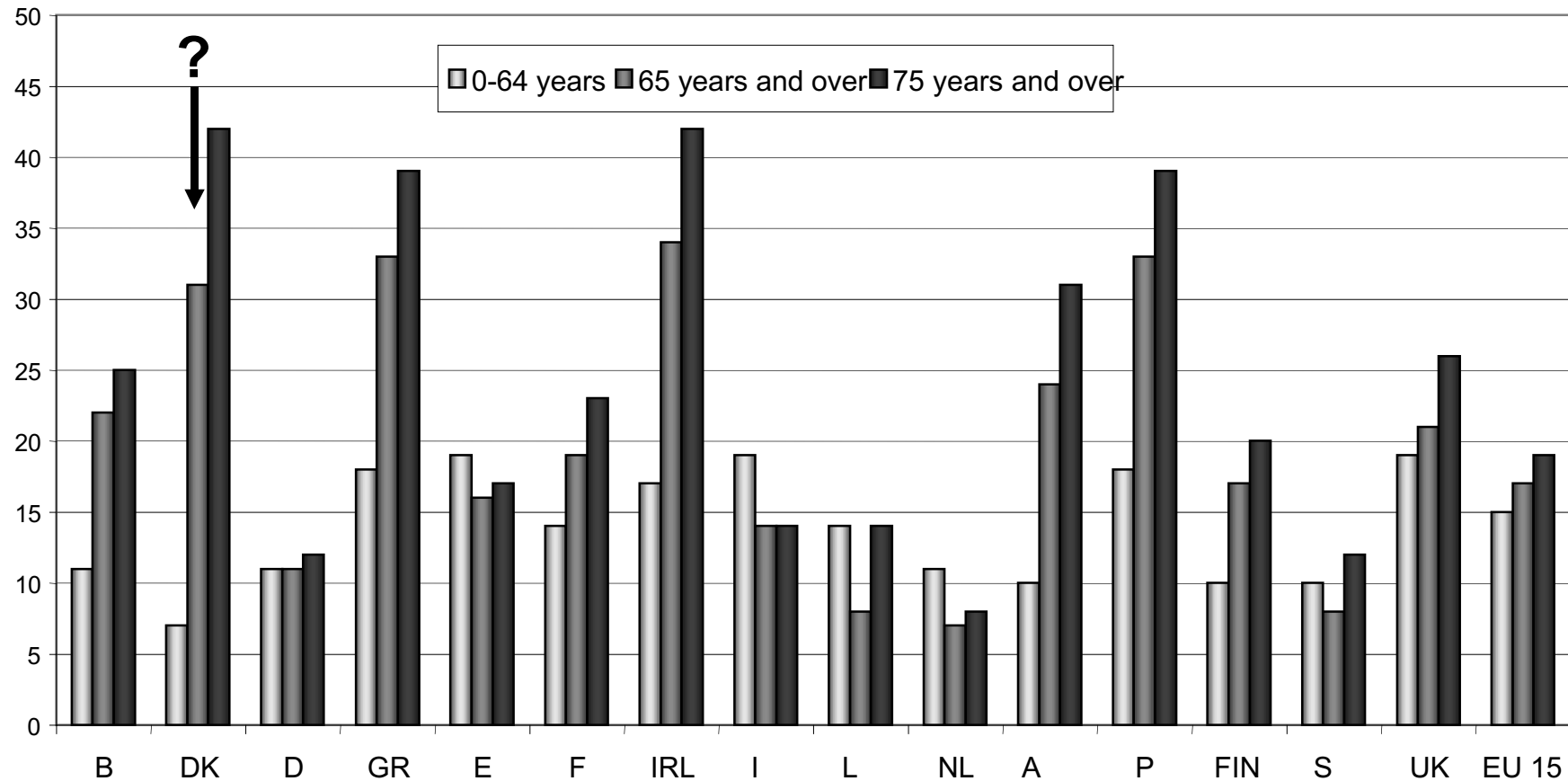
At-risk-of-poverty rate ^{a)}, people aged 65 years and over



Source: Eurostat, ECHP

Recent Pensions Adequacy (2)

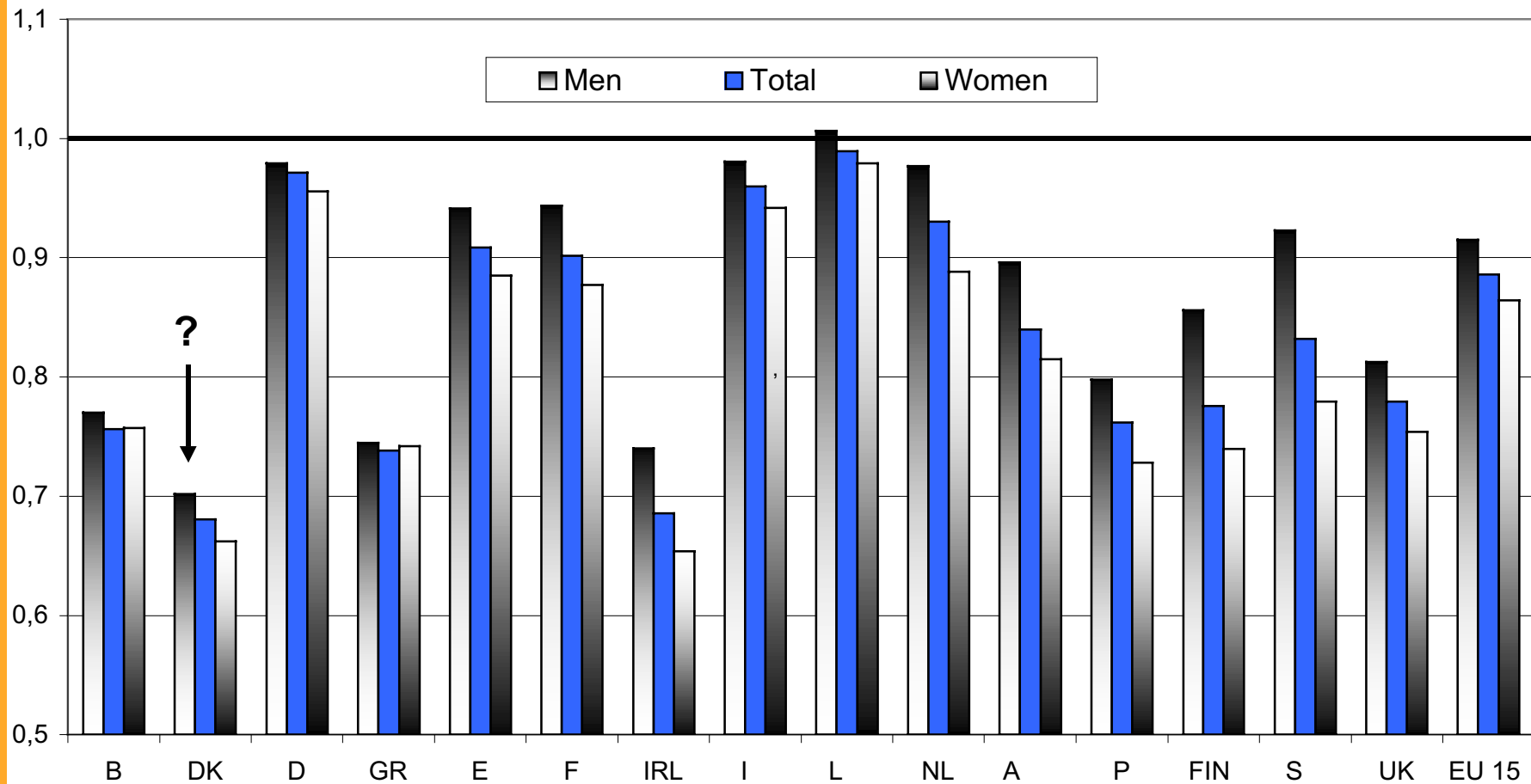
At-risk-of-poverty rate at 60% of median income :
People aged 0-64, 65 years and over and 75 years and over



Source: Eurostat, ECHP

Recent Pensions Adequacy (3)

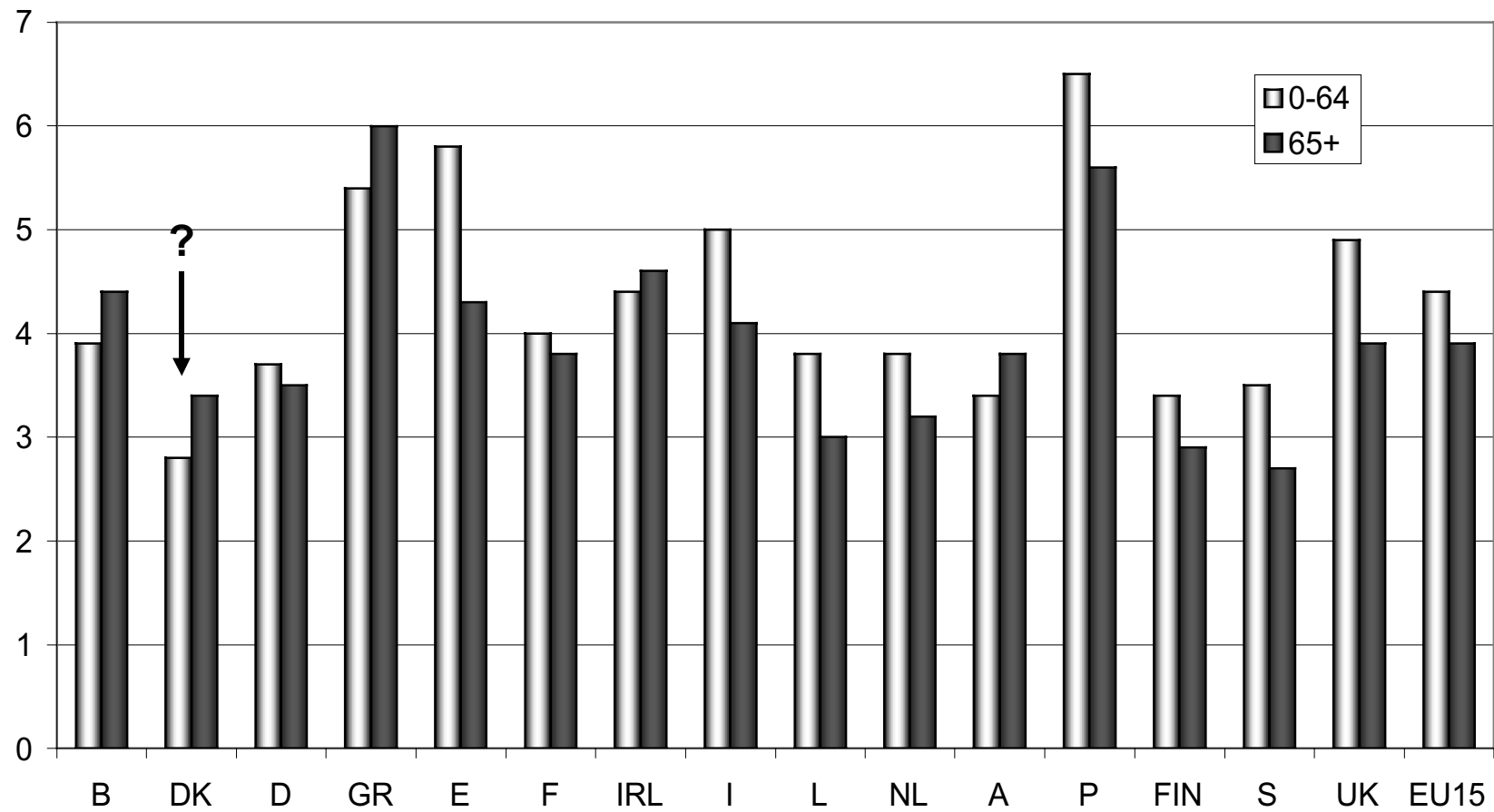
Income of people aged 65 years and over as a percentage of income of people aged 0-64 ^{a)}



Source: Eurostat, ECHP

Recent Pensions Adequacy (4)

Income inequality
Ratio of top quintile's to bottom quintile's income share



Source: Eurostat, ECHP

Future Adequacy?

- Current adequacy varies considerably among Member States
- Minimum pension guarantees to protect against poverty in old age are being strengthened...
- ...but replacement ratios from 1st pillar schemes expected to fall in many Member States
- However: incomes of older people's households also depend on
 - higher pensions for women due to higher female employment rates
 - supplementary pensions
 - career lengths (working longer leads to higher pensions)
 - wealth

Theoretical Replacement Rates: Current

- Can be calculated for a wide range of hypothetical career profiles
- Current replacement rates provide an indication on the degree to which income levels are maintained after retirement...
- ...but they can also be used for assessing poverty risks for people with interrupted careers or low life-time earnings...
- ...and for measuring incentives for longer working lives.

Theoretical Replacement Rates: Prospective

- Pension reforms tend to affect benefit levels more in the future than in the present
- Replacement rates can be used to assess the long-term impact of reforms and automatic adjustment mechanisms
- Assumptions needed depend on type of scheme:
 - life expectancy
 - employment
 - rates of return
 - Growth of productivity, earnings, GDP...

Calculations by the Indicators Sub-Group of the SPC

- Several earnings levels and profiles: 2/3, 100% of average earnings; rising earnings from 80-120% and 100-200% of average
- Retirement today, and in 2010, 2030 and 2050
- Evolution of relative pension income 10 years after retirement
- Income components taken into consideration include:
 - 1st pillar pension
 - 2nd pillar pension
 - taxation and contributions
 - means-tested benefits and free services for the elderly

Results: An Example

S (Swedish Crowns)	100% of average earnings (last column: 10 years after retirement; relative to projected average earnings)					2/3 of average earnings		Rising earnings from 100% to 200% of average		Rising earnings from 80% to 120% of average	
	2003	2010	2030	2050	In 10 years	2003	2050	2003	2050	2003	2050
Amount of gross earnings before retirement	236023	271195	387470	553597	282119	157349	369065	472046	1107194	283227	664315
Gross replacement rate 1 st pillar	57.0	49.7	42.7	40.1	48.6	67.1	40.1	39.3	25.5	52.1	33.4
Gross replacement rate 2 nd pillar	13.9	14.2	14.5	14.2	11.6	13.9	14.2	32.4	33.0	13.4	13.6
Total gross replacement rate	70.9	63.8	57.2	54.4	60.2	80.9	54.4	71.7	58.5	65.5	47.0
Total net replacement rate (in brackets: at constant life expectancy of today)	74.6	67.2 (68.9)	59.3 (64.1)	55.7 (62.8)	63.5	100.7	56.7 (63.5)	79.6	66.7 (71.8)	68.5	48.2 (54.1)
Amount of net pension income	121521	125348	157401	210550	123302	113205	143531	227718	449462	133502	218224
Of which means- tested housing benefit	0	0	0	0	0	17944	0	0	0	0	0

Limitations of Prospective Replacement Rates

- No cross-country comparability
 - some countries have already adopted reforms to safeguard financial sustainability, other have to do more
 - common assumptions not representative of all countries (e.g. career length of 40 years, retirement age 65)
 - assumptions about private pensions too optimistic in some countries?
- Therefore, results should be used country by country rather than for cross-country comparisons
- Several national calculations could be further refined and some recent reforms (e.g. D, F) need to be included.