

Pension Policy in EU25 and its Possible Impact on Elderly Poverty

Meeting of National Focal Points on Ageing
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EUROPEAN CENTRE · EUROPÄISCHES ZENTRUM · CENTRE EUROPÉEN
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Overview of our research

(project undertaken for the European Commission during early 2006)



Part I: An account of income-based poverty amongst the *current* population of older people....

Part II: A review of recent reforms in pension policy in EU25, and an outlook on expected evolution of poverty among *future* population of older people

Work we did in Part I.....



- I. Review of **Concepts** and **Measurement Methods** used in accounting poverty risk amongst older people;
- II. **Results:** A statistical profile of risk of poverty amongst older people in EU25;
- III. **Impact:** how poverty amongst the current pensioners is linked to the pension policy.

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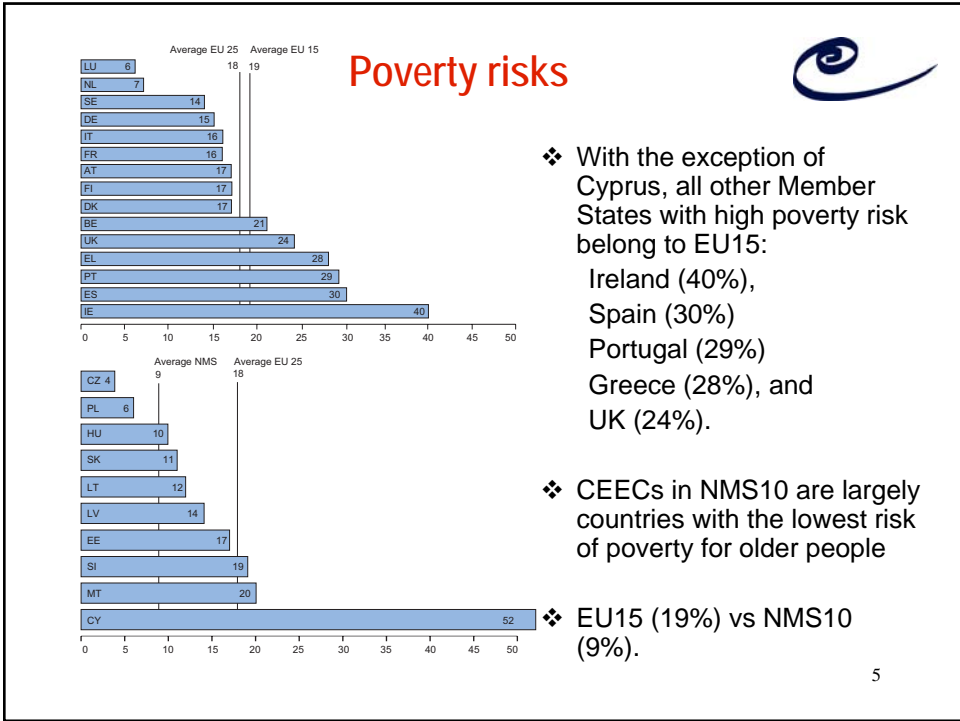
Methods used in measuring elderly poverty risk



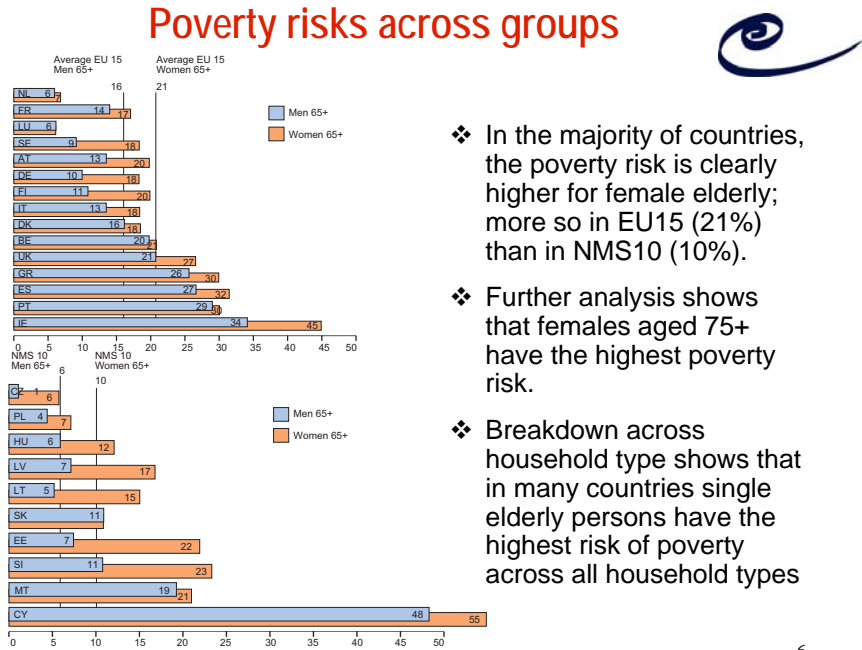
- Limited to '**monetary**' aspects of personal well-being
- Choice of poverty line as 60% of national median income (.. certain degree of arbitrariness!)
- Critically, no account of housing resources and financial wealth (.. relative economic status of older people underestimated)

Our paradigm has been that policy purposes are best served if a harmonised method is adopted in such EU-wide studies; methods which have attained some degree of consensus....! Thus, the Laeken Indicators methods had been adopted, as per ISG recommendation

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What link with pension policy?



- **Netherlands:** the country with the lowest poverty risk:
 - universal basic pensions; indexing in line with wages
 - mandatory occupational pensions;
 - Good survivors' benefits in occupational pensions
- **Sweden and Germany:** generous pension crediting for absences from labour market;
- **CEECs:** have had a generous defined-benefit public pension schemes; less often early retirement (and good redistribution).

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Work we did in Part II.....



- I. Detailed and systematic **review of pension reforms** implemented in EU25 over the last 10 years;
- II. Analyse possible **impacts of pension reforms** on retirement incomes and poverty risk of the elderly populations;
- III. **Quantitative Projections** of poverty risk amongst the future generations of elderly populations (*not to be discussed in the presentation!*).

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Pension reforms in EU countries



For convenience of analysis, the reforms that have taken place can be classified into two broad sets:

- **Parametric reforms** (i.e. maintaining the **PAYG** nature of the existing system, but making substantial changes in pension rules -- in retirement age, accrual rates, contributions, indexation, etc.)
- **Systematic reforms** (i.e. moving away from the **PAYG DB-type** public pension system and adopting **DC-type** personalised accounts system – thus, linking pension receipts more strictly to pension contributions and to investment performance)

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So..., what is the difference?



- Parametric reforms appear to be **less drastic**, and thus face less political opposition;
- Yet, their impact on financial sustainability and pensioner incomes could be **equally impressive, or more** (France 21%, and Sweden 20%, decline in RR);
- Main difference lies in the **sharing of longevity risks**
 - Sticking to DB system implies that the longevity risk is still borne by the pension provider;
 - shift to DC structure in systematic reforms implies greater risks borne by individuals and lesser risks for the State and employers.

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1. Parametric Reforms: what changes?



Typical contribution side changes

- The most frequent reform involved changing the state pension age (a reform that is more justifiable in view of rising longevity);
- Many countries also changed contribution rates;
- Contribution requirements were also toughened, by rolling back early retirement opportunities and increasing years of contributions required for a full pension (*Austria, Germany*).

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1. Parametric Reforms: what changes?



Typical benefit side changes

- More countries moved away from uprating of pensions in line with earnings to a less generous uprating (e.g. in line with prices)
- Changes in pension formula leading to a reduced generosity of public pensions
 - Accrual rates fallen in many instances; this tends to a lowering of the income to be replaced.
 - Pensionable salary to be less often the final salary and more often a representative salary during lifetime.

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1. Parametric Reforms: possible impact



Why such reforms in the first place?

- Reforms driven mainly by fiscal sustainability concerns.

What impact for the future elderly populations?

- Pensions set to replace less of pre-retirement annual income (unless people are able to extend their working careers);
- Pension incomes will lose their value relative to earnings during retirement;
- Automatic stabilisation will create confusion over what pension entitlements are accrued;
- Those with lower lifetime earnings will be affected most.

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2. Systematic reforms



1. World-Bank multi-pillar model

- Poland, Estonia, Latvia, the Slovak Republic, Lithuania and Hungary all implemented multi-pillar reforms before they joined the EU (and also three other applicant countries, Romania, Bulgaria and Croatia).

2. NDC schemes (as in Sweden)

- Reforms in some other European countries influenced by the NDC reforms of Sweden and Italy and in some cases, namely Poland and Latvia, the first pillar was converted from PAYG to NDC.

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2.1 Multi-pillar type reforms



Why such reforms in the first place?

- Move towards a funded system;
- Increased share of private pensions;
- Desire to join the EU/ transition towards the market economy;
- Fully funded system is more risky and such a drastic move less politically defensible.

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2.1 Multi-pillar type reforms



What impact for the future elderly populations?

They are too new to assess their long-term impacts, but

- Individuals have opted to shift to personal accounts without having recourse to enough information;
- Early problems with administration of personal accounts:
 - high administrative costs (more burdensome to lower-income persons);
 - Risks of mis-selling (as was observed in the UK)
 - Inactive accounts or contributions not enough (remember Stakeholders pensions!);
- Returns recorded so far fall short of expectations (Hungary).
- Shifting of risks to individuals (away from State or employer)
- Less redistribution possible (negative impact for women and others with low lifetime employment)

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2.2 NDC type reforms: what impact?



- NDC systems tend to be less risky:
 - *notional* accounts, so no investment risk
 - Centralised administration, so less costly
 - Securitisation of pension entitlements
- Yet, greater income risks compared to the previous public DB-type system;
- Lower pension incomes and greater poverty risk, for both men and women, as the longevity risk passed onto contributors of the same generation;
- Automatic balancing mechanism generates uncertainty about future pension income entitlements
- Pension crediting for labour market absences are very crucial (and they are different across NDC systems).

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Conclusions: Impact of pension reforms



- **Reduction in the redistributive element** that were previously present in public DB pension schemes;
- If gender differentials in employment continues, it will lead to a **greater gender inequality**;
- Pensioner positions will depend on how well they will be able to **extend the working lives** while facing a prospect of reduced benefits;
- Generosity of benefits may be on the decline, although the **pension coverage is on the rise**;
- Social sustainability risks (...although **economic sustainability of these pension systems have improved!**).

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What next?



Policymakers are to be made aware of these findings:

- debate on what lessons can be drawn from the pension experiences observed across member countries of EU:
 - Meeting of Focal Points on Ageing in the UNECE Region (today..)
 - The Finnish EU Presidency conference in Helsinki, (on 4-5 December 2006)
 - (already ticked) Presentation to Social Protection Committee / to European Parliament's Intergroup on Ageing