Pensions at a Glance

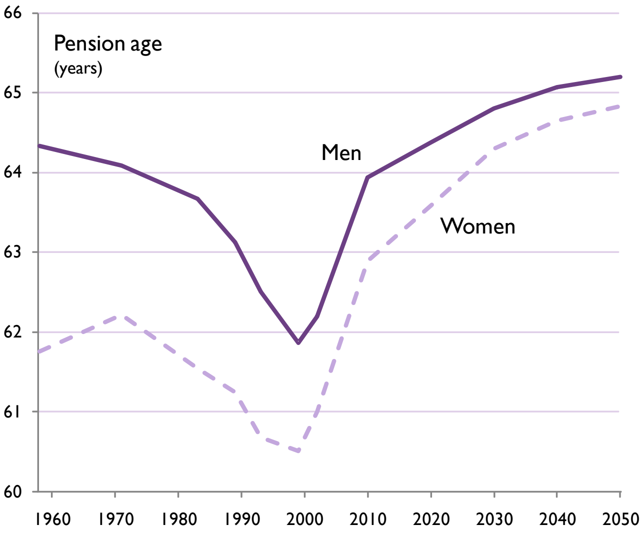
Current trends and policy topics in retirement-income provision in OECD countries

Pension reform remains high on the agenda; the financial and economic crisis has accelerated the pace of change. Encouraging people to work longer – through increases in pension age and reduced pension incentives to retire early – is a key objective. Other recent measures aim to improve financial sustainability while ensuring adequate old-age incomes.

The pension eligibility age is the most visible and easily understood number in pension systems. As such, proposals to increase it have frequently met with strong resistance, while more technical, 'stealthy' reform measures have often proved rather easier to implement.

Nevertheless, the Czech Republic, Greece, Hungary and Turkey have all recently announced increases in the normal pension age to 65. And some countries have set out plans in the past five years for phased increases in pension age *beyond* age 65: Australia and Germany to 67, and the United Kingdom to 68. Denmark will increase pension age to 67 and then link it to life expectancy. Along with Iceland, Norway and the United States, this brings to seven the number of OECD countries that already have, or plan to have, normal pension ages above 65.

1 Pension ages in the OECD 1960-2050



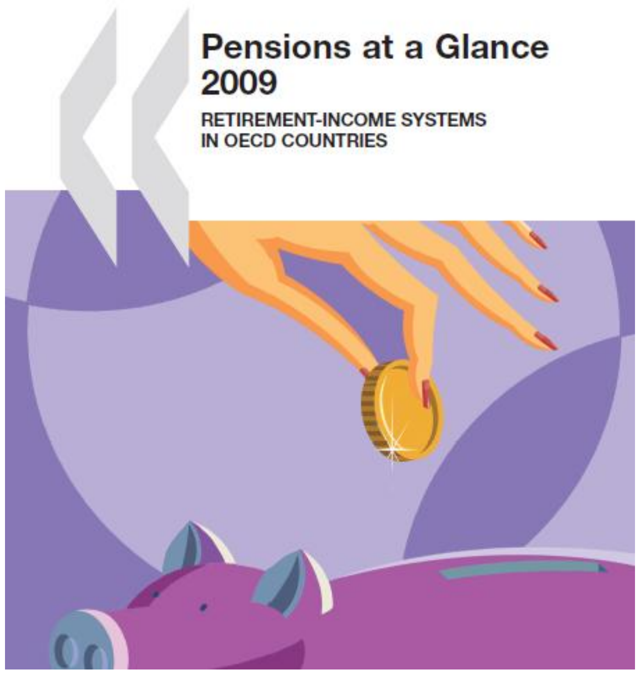
Source: OECD analysis

Pension ages had been falling for decades, until relatively recently (Figure 1). For men, they declined by 2.5 years between 1958 and 1999, to just under 62 on average in OECD countries. For women, the decline was smaller, but women's pension age averaged 60.5 years in 1999, some 1.5 years lower than that for men.

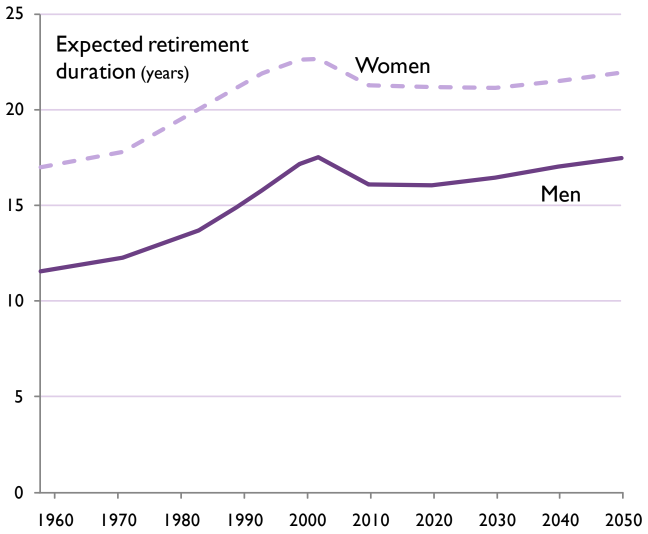
Between 1999 and the present, normal pension ages for both sexes increased by more than two years on average.

As well as past developments, Figure 1 shows the impact of future increases in pension age already announced. In the long term, the average pension age for men will be a little over 65, on current plans. The figure for women in 2050 is expected to be slightly lower than for men because a small number of OECD countries (Italy, Poland and Switzerland) currently plan to maintain differential pension ages in the future.

The decline in pension ages for a period of more than four decades came despite continuous growth in life expectancy. The combination of earlier retirement ages and longer lives meant that the average amount of time spent in retirement in OECD countries (from normal pension age) increased by 5.6 years between 1958 and 1999 for both men and women.



2 Expected time in retirement 1960-2050



Note: expected retirement duration calculated at normal pension age for each country based on national life-expectancy data and projections
Source: OECD analysis

Figure 2 also shows how the length of retirement will change in the future. The past decade has seen a decline in retirement duration due to increases in pension age already implemented. Despite pension-age increases between 2010 and 2050 already planned by OECD countries, projected life expectancy at normal retirement age is expected to increase over that period, although only slightly for women. By 2050, therefore, the average expected duration of retirement from normal pension age for men will be the same as the peak level in 1999; for women, it will be only slightly lower than the peak.

Whatever the changes in normal pension ages, it remains the case that *effective* retirement ages are lower than standard pensionable age in around two-thirds of OECD countries. Indeed, men retire before age 60 (on average) in eight OECD countries: Austria, Belgium, Finland, France, Hungary, Italy, Luxembourg and the Slovak Republic.

A number of countries have pursued policies – other than increases in normal pension age – to encourage people to work longer (shown under 'retirement incentives' in the summary of pension reforms in Figure 3). In Belgium, Denmark, Greece and the Netherlands, the option of retiring early has been restricted. Finland, France and the United Kingdom have improved the returns to working *after* normal pension age.

Financial sustainability

If people were to work longer as they live longer, that change alone would go a long way in ensuring that public pensions are affordable, and that their costs are sustainable in the long term. OECD countries currently spend an average of 7.2% of national income on public pensions (Figure 4).

The public-pension budget has been increasing rapidly, growing at a rate 17% faster than national income between 1990 and 2005. Pensions account for 17% of total public spending, on average, in OECD countries. Typically, only health and education are more expensive items in the government's budget.

Many OECD countries have already gone through an often painful process to put their pension systems on a sounder financial footing in the long term. In the past five years, a few have taken further action.

In Korea, the target replacement rate – pension

3 Pension-reform measures 2004-09

	Coverage	Adequacy	Financial sustainability	Pension age	Retirement incentives
Australia	●	●		●	
Austria					
Belgium		●			●
Canada					
Czech Republic				●	
Denmark				●	●
Finland		●	●		●
France	●	●			●
Germany	●			●	
Greece	●			●	●
Hungary	●		●	●	
Iceland					
Ireland			●		
Italy	●				
Japan					
Korea	●	●	●		
Luxembourg					
Mexico					
Netherlands					●
New Zealand	●				
Norway	●				
Poland	●				●
Portugal			●		
Slovak Republic					
Spain		●			
Sweden		●			
Switzerland	●		●		
Turkey				●	
United Kingdom	●	●		●	●
United States	●				

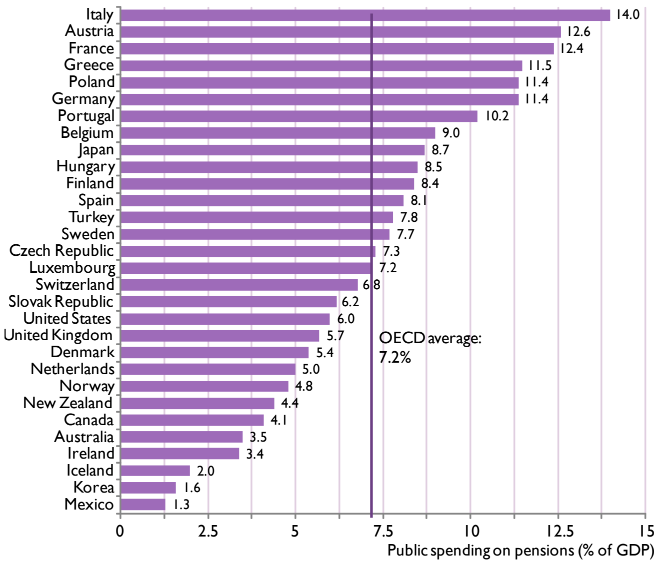
Source: OECD *Pensions at a Glance 2009* relative to earnings when working – will be cut from 60% to 40%. In Switzerland, the minimum benefit from compulsory occupational plans will be lower.

France and Mexico have tackled pensions of public-sector workers, which were left largely unchanged when benefits for workers in the private sector were cut. Ireland will make its civil servants pay a levy towards their pensions.

Adequate retirement incomes

Pension policymakers cannot focus on financial sustainability alone: the need remains of ensuring that people have adequate incomes in their old age. The balance between *financial* and *social* sustainability of pension systems is a very fine one.

4 Public pension spending 2005



Source: OECD *Pensions at a Glance 2009*

Increases in pension benefits over the past five years have, in general, been targeted on retirees with low incomes. There have been one-off, flat-rate payments in Australia, Greece, the United Kingdom and the United States. Basic (flat-rate) pensions in Korea and the United Kingdom have been increased. Australia will raise the age pension by nearly 11% and Finland will guarantee, from 2011, a minimum retirement income 23% higher than the current national pension. Belgium, France and Spain will all increase minimum pensions by more than required by the normal indexation rules.

With public pensions being scaled back, many countries are encouraging people to save voluntarily, through individual or employer-based private pensions.

France, Hungary, Poland and Portugal have introduced new private-pension plans, often with tax privileges. Germany extended the tax incentives that were due to expire in 2008. Norway mandated employers to contribute a small amount to private pensions.

Italy and Korea have continued to try to convert existing, employer-managed severance-pay schemes into occupational pension plans, but with limited success so far.

New Zealand introduced its KiwiSaver scheme, which requires individuals to opt out of rather than opt in to private pensions. The United Kingdom has legislated for a similar scheme that will begin operating in 2012. These policies of automatic enrolment as a way of increasing coverage of voluntary private pensions are examined in detail in the chapter on 'The pension gap and voluntary retirement savings' in OECD *Pensions at a Glance 2009*. This strategy has been widely discussed in other OECD countries, including the United States.

Just a few countries have introduced changes designed to expand coverage of mandatory (mainly public) pension schemes. Greece hopes to achieve broader coverage with new, simpler institutional arrangements. Switzerland has reduced the earnings floor so that more part-time, low-paid workers are covered. The United Kingdom has relaxed qualifying conditions for the basic pension and strengthened credits for carers. One expected result is that 90% of women will qualify for a full basic pension in 2050, compared with just 30% now.

The demographic challenge

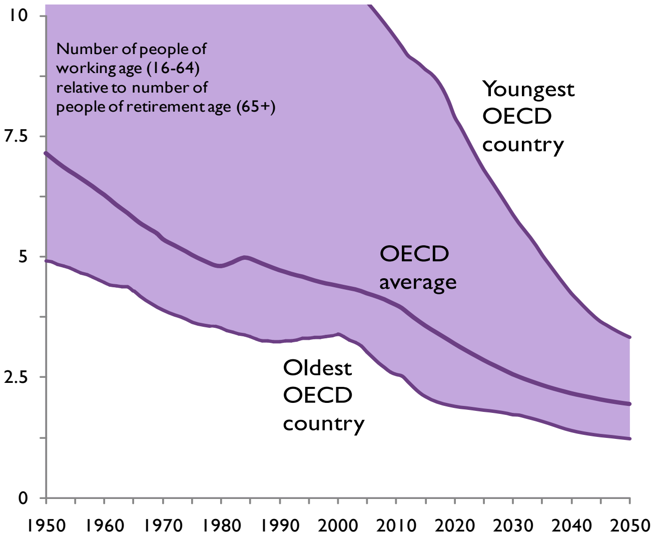
One of the principal motives for pension reform has been to improve the long-term finances of pension systems, faced with pressures of population ageing and the maturing of retirement-income provision. Both increasing life expectancy and falling birth rates have contributed to the greying of the population over the past few decades, a process that will continue.

Indeed, ageing is a long-standing phenomenon. In 1950, there were more than seven people of working age for every one of pension age (see Figure 5). This ratio fell to six by 1963, five by 1976 and is currently four. Over the next 40 years, there is expected to be three people of working age for every one of pension age from 2023 and just two from 2047.

Japan has been the OECD's demographically oldest country since 2005 and is expected to remain so in the future. In 2050, for example, there will be just 1.2

Japanese of working age for every one of pension age, compared with the OECD average of 1.9.

5 A century of population ageing



Source: OECD *Pensions at a Glance 2009*

Projected increases in the proportion of the population of pension age in some of the OECD countries that are currently old in demographic terms – Belgium, France, the Netherlands, Norway, Sweden and the United Kingdom, for example – are expected to be relatively small over the next 40 years or so. By contrast, OECD countries that are currently demographically young – Korea, Mexico and Turkey – will age more rapidly. Korea is the most dramatic example: it will move from being the third youngest OECD country currently to being the second oldest by 2050.

Pension reform: processes and politics

OECD countries have continued, in recent years, to be active in reforming their pension systems. Most have taken further steps during the past few years to make their retirement-income provision fit for the long term. These changes are outlined in the chapter on 'Recent pension reforms' in OECD *Pensions at a Glance 2009*.

The period of 2004-09, however, has been one of evolution rather than revolution in pension systems. There has been none of the wide-ranging, systemic reforms that took place in a number of OECD countries during the decade up to 2004.

The financial and economic crisis means that governments' attention is focused, more than ever, on the short term. This brings with it two dangers. The first is that long-term, strategic planning – so vital for retirement systems – is set aside. The second is that more governments may be tempted to backtrack on earlier reforms as labour-market conditions worsen. It remains necessary, in spite of these pressures, that governments take steps to ensure that public policies deliver a retirement-income system for the long term that is secure, adequate, financially sustainable and economically efficient. ■

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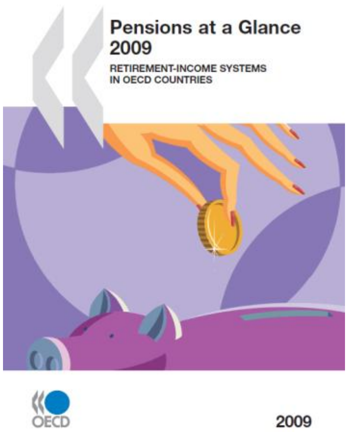

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