



# Adequate and sustainable pensions

Synthesis report 2006



European Commission



# **ADEQUATE AND SUSTAINABLE PENSIONS**

## **SYNTHESIS REPORT 2006**

European Commission  
Directorate-General for Employment, Social Affairs and Equal Opportunities  
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## Foreword

This second Report on Adequate and Sustainable Pensions provides a synthesis of recent developments in the area of pension reform in the EU. It was prepared jointly by the European Commission's Directorate-General for Employment, Social Affairs and Equal Opportunities and the Directorate-General for Economic and Financial Affairs and analyses the second round of Member States' 2005 National Strategy Reports on pensions. The report's conclusions have also been taken on by the 2006 Joint Social Protection and Social Inclusion Report.

The fall in the EU's effective retirement age in the 1970s and 1980s goes against the significant rise in life expectancy for the same period. In short, the number of contribution years has decreased, while the number of years in receipt of pension benefits has grown, putting pressure on the sustainability of adequate pension systems. In response to this, Member States are pursuing policies to boost employment and many have already carried out reforms that have helped to push up the employment rates of older workers from 36% in 2000 to 43% in 2005. The main pension challenge for Europe's ageing society is to ensure that this rise in the effective retirement age continues.

This report shows that, since 2003, there has been substantial progress in reforming pension systems. Some Member States are still in the early stages of the reform process, but others have strengthened their reform efforts and several have made comprehensive reforms.

Recent reforms include automatic or semi-automatic review mechanisms which ensure the periodic monitoring of sources of pressure on pensions and, together with efforts to inform citizens about their pension rights, build public confidence. Other positive developments are the reduction of disincentives to work longer coupled with the strengthening of incentives to remain active. Links between contributions and benefits have been tightened and life expectancy is now more commonly taken into account when calculating pension formulae. Some Member States are increasing the level of guaranteed minimum pensions and many recognise care work when calculating pension entitlements. In addition, the provision of supplementary pensions has been further developed and the relevant legislative framework strengthened. In many Member States, the contribution of privately-managed pensions to pensioners' living standards in retirement is expected to grow over the coming decades, even though public pay-as-you-go schemes will remain the main pension source.

At the same time, concerns over unequal access to private pensions have been raised and some Member States are working on policy responses. Reforms have led to a decrease in pensions generally, but this can be compensated for by longer working lives as well as by higher personal savings. All of this requires careful monitoring. Inadequate pensions are a serious threat to social cohesion and unless Europe develops an integrated approach which links adequacy and sustainability, the risk of poverty and social exclusion will grow. Unsustainable pension systems jeopardise the security of adequate incomes in retirement. An insufficient accrual of pensions increases pressure on public finances and a rise in the demand for ad-hoc re-evaluations of pensions, as well as additional pressures from other social benefits, means more public spending. So for reform strategies to succeed, adequacy, sustainability and modernisation must be considered as one.

This second Report on Adequate and Sustainable Pensions is a solid basis for deepening the review and policy exchange on pensions within the Open Method of Coordination on Social Protection and Inclusion. It also highlights policy issues which are vital to growth and employment, as well as to the sustainability of public finances.

I invite you to read about the recent developments in pension systems in the EU. I am confident that this analysis will serve as an inspiration to us all in tackling pension reform.

Vladimír Špidla  
European Commissioner for  
Employment, Social Affairs  
and Equal Opportunities



## Table of contents

### Part I – General synthesis

English .....	9
1. The pension challenge .....	9
2. The open method of coordination in the field of pensions in the context of the Lisbon strategy .....	10
3. Main lessons from the second round of open method of coordination in the field of pensions .....	11
4. Conclusion .....	18
 Français .....	 21
1. Le défi des retraites .....	21
2. La méthode ouverte de coordination pour le domaine des retraites, dans le cadre de la stratégie de Lisbonne .....	22
3. Principaux enseignements à tirer du deuxième cycle d'application de la méthode ouverte de coordination dans le domaine des retraites .....	23
4. Conclusion .....	31
 Deutsch .....	 34
1. Die Rentenherausforderung .....	34
2. Die Offene Methode der Koordinierung im Bereich Renten im Kontext der Lissabon-Strategie .....	35
3. Wichtigste Lehren aus der zweiten Phase der Anwendung der offenen Methode der Koordinierung im Bereich Renten .....	36
4. Schlussfolgerung .....	44

Part II – Horizontal analysis .....	47
Methodological note – Background statistics for the Synthesis report on pensions .....	47
<b>Adequacy</b> .....	53
Objective 1 – Preventing social exclusion .....	53
Objective 2 – Enabling people to maintain living standards .....	66
Objective 3 – Promoting solidarity .....	77
<b>Sustainability</b> .....	80
Objective 4 – Raise employment levels .....	80
Objective 5 – Extend working lives .....	84
Objective 6 – Making pension systems sustainable in a context of sound public finances .....	90
Objective 7 – Adjust benefits and contributions in a balanced way .....	122
Objective 8 – Ensure adequate and financially sound private pensions .....	126
<b>Modernisation</b> .....	136
Objective 9 – Adapt to more flexible employment and career patterns .....	136
Objective 10 – Meet the aspirations for greater equality between women and men .....	140
Objective 11 – Demonstrate the ability of pension systems to meet the challenges .....	145
Index of boxes and tables .....	149



Part III – Country summaries .....	151
Belgium .....	151
Czech Republic .....	156
Denmark .....	161
Germany .....	167
Estonia .....	171
Greece .....	175
Spain .....	179
France .....	184
Ireland .....	188
Italy .....	192
Cyprus .....	197
Latvia .....	201
Lithuania .....	205
Luxembourg .....	209
Hungary .....	212
Malta .....	217
The Netherlands .....	221
Austria .....	226
Poland .....	230
Portugal .....	235
Slovenia .....	240
Slovak Republic .....	244
Finland .....	248
Sweden .....	253
United Kingdom .....	257



## 1 | The pension challenge

One of the main achievements of social policies in the second half of the last century is that being old is no longer synonymous with being poor or being dependent on the support of one's children. This success has mainly been achieved through the provision of public pensions.

While recognising the achievements of pension systems, the challenges of the ageing populations, in particular the financial strains on pension systems, have already long been high on the agenda of European policy-makers. Most recently, the informal European Council in Hampton Court asked Europe to reflect in more depth on the consequences of demographic trends on economic and social policies and the Commission's first annual progress report 'Time to move up a gear' of 25 January 2006 identifies responding to globalisation and ageing, and in particular reforming of public pension systems, as one of the main actions to be undertaken in Europe. As highlighted in the joint report by the Commission and the Council on adequate and sustainable pensions of 2003, the pension challenge in an ageing society is to continue the increase of effective retirement ages. While in the 1960s it was normal to retire well after 60, employment of older workers declined in the 1970s and 1980s in many countries and has only recently started to increase: average ages of leaving the labour market are still below the levels of the late 1960s.

This decline in average effective retirement age (accompanied by an increase in the age of entering the labour market) runs contrary to the substantial increase in life expectancy in the same period. Life expectancy at 60 for EU-25 increased by 4 years from 1960 to 2000 (from 15.8 years to 19.3 years for men and from 19 years to 23.6 years for women). The most recent Eurostat projections see life expectancy in the EU-25 at 65 to increase by another four years from 2004 to 2050 (4.4 years for men and 3.9 years for women). Even in the context of a favourable demographic situation where the active population was increasing, the increase of life expectancy over the second half of the 20th century would still need to be partly accommodated through increases in contribution rates.

To sum up, contribution years have decreased while years in receipt of benefits have increased, putting pressure on the financing of pension systems. Reforms are now needed to ameliorate past reductions in the effective retirement age and increases in the dependency ratio and to cope with the retiring of the baby-boom generation and future increases in life expectancy.

Pension reforms require long-term strategies. The process of reform itself is lengthy as pensions reforms are usually built on broad consensus as they are a fundamental part of our social protection systems and of social cohesion. Furthermore, States dedicate significant amounts of public expenditure to old age provision, which in light of demographic trends is set to grow significantly. Therefore reforms of pensions systems should be seen both in the context of ensuring adequate and sustainable retirement provision, and in the context of sustainable public finances as a whole and sustainable growth across the EU.

The Stockholm European Council outlined a three-pronged strategy to tackle the budgetary implications of ageing populations:

- Member States should reduce public debt levels at a faster pace;
- Member States should undertake comprehensive labour market reforms, including tax and benefit systems, in order to achieve higher employment rates, in particular among older workers and women;
- Member States should undertake appropriate reforms of pension systems in order to contain pressures on public finances, to place pension systems on a sound financial footing and ensure a fair inter-generational balance.

A dominant proportion of total pension provision in almost all Member States is organised within the general government sector and, thus, affects the public finances to a great extent. It is necessary to ensure that rising public spending on pensions due to the ageing of the population does not jeopardise sustainable pub-

lic finances and that appropriate strategies are in place for ensuring that the long-term commitments of pension systems can be met. At the same time, sound management of public finances can provide room for manoeuvre as regards the budgetary pressures of ageing populations.

There are strong grounds based on equity and efficiency for government involvement in pensions, be it provision, financing or regulation. This is in particular linked to basic social objectives, such as securing adequate income in old-age. This requires making choices today for the long term, despite uncertainties resulting from the unpredictability of economic and social trends. At the individual level, such choices would be extremely difficult and are likely to lead to under-provision for most people, in particular for people with low

incomes or with difficulties engaging in long-term financial planning. Private insurance also has great difficulties dealing with uncertainties involved in long-term commitments. Pension systems based on universal coverage have the largest ability to cover uncertainties related to long-term commitments to provide adequate old-age income.

Public provision plays a central role in national pension systems, which are very diverse among EU-25, highlighting that there is no one-size-fits-all solution. While the basic goals of access, adequacy and financial viability are universal to all systems, there is considerable degree of variation in design at national level, as a result of historical differences and reflecting differing preferences for redistribution or for leaving choices to individuals.

## 2 The open method of coordination in the field of pensions in the context of the Lisbon strategy

The Laeken European Council of December 2001 recognised that there could be significant benefits by enhancing dialogue and cooperation on issues related to the reform of pension systems. It endorsed common objectives of adequacy, financial sustainability, adaptability, and a working method based on the open method of coordination (hereafter OMC).

Subsequently, a first wave of National Strategy Reports (NSRs) described in 2002 how the 15 Member States intended to meet these objectives. On the basis of these NSRs the Commission and the Council adopted a Joint Report on adequate and sustainable pensions in March 2003.

The 2003 Joint Report concluded that “Most Member States see pension reform as a continuous process rather than a one-off, discreet event [...] The momentum behind reform process to secure the sustainability of adequate pensions must be maintained.”

Responding to the Joint Report on Pensions, the European Council of March 2003 called on Member States to ensure the implementation of further reforms and for continued application of the OMC in the field of pensions. The Council asked for progress to be presented in 2006, and for the new Member States to be included. This is presented in the Commission's proposal for the Joint Social Protection and Social Inclusion Report of 2006.

In 2005, the Commission proposed and the Council endorsed the revision of the Lisbon strategy for growth and jobs and revised Integrated Guidelines<sup>(1)</sup>. It is recognised that the OMCs on social protection and social inclusion feed into the Lisbon strategy. The Commission also intends to make the EU level coordination in the area of social protection more effective by streamlining the OMCs on pensions, social inclusion and healthcare and long-term care starting in 2006. This aims to create a stronger, more visible OMC with a heightened focus on the modernisation of policies and

(1) See in particular Guideline 2: “Member States should [...] reform pension and healthcare systems to ensure that they are financially viable while being socially adequate and accessible, and take measures to raise employment rates and labour supply”. And Integrated Guideline 18: “Promote a lifecycle approach to work through [...] modern pension and healthcare systems, ensuring their adequacy, financial sustainability and responsiveness to changing needs, so as to support participation in employment and longer working lives, including appropriate incentives to work and discourage early retirement.”

policy implementation and which will interact positively with the revised Lisbon strategy, while simplifying reporting and expanding opportunities for policy exchange.

Separate reporting as part of the OMC will continue along Member States' national reform programmes that present an overall review of reforms contributing to the objectives of growth and employment. Similarly, reporting at EU level via the Joint Report on Social Protection and Social Inclusion will feed into the EU annual progress report.

Within this framework, this document provides the necessary analysis as an input for the pension aspects of the Social Inclusion and Social Protection Report of 2006. To this end, Member States presented their second NSRs in the summer of 2005. The NSRs were discussed in a peer review in mid-September 2005, involving the Social Protection Committee (hereafter SPC) and the Economic Policy Committee (hereafter EPC). This report presents a synthesis of this new wave of reports.

## 3 | Main lessons from the second round of open method of coordination in the field of pensions

### 3.1. Main developments in pension reforms in the Member States

The 2003 Joint Report on Pensions underlined the interdependency between the financial sustainability and adequacy of pensions in the context of ageing societies and the need for comprehensive reforms with the aim of securing adequate, accessible and financially sustainable pension systems. In particular, the Joint Report called on Member States to improve incentives for older workers to remain longer in the labour market, to strengthen the link between contributions and benefits and to increase public and private funding, especially in light of the long-term implications for pension expenditures of increased life expectancy.

Europe's population will be slightly smaller, but significantly older in 2050. There will be two workers per elderly citizen as opposed to the current ratio of four to one. Recent long-term projections show that pension costs will lead to significant increases in public spending in most Member States by 2050. On the basis of current policies, public expenditure on pensions is projected to increase on average by 2.2 percentage points for the EU-25, with a large dispersion among Member States.

There has been substantial progress in reforming pension systems since the 2003 Joint Report. Member States have also reported on reforms to their pension systems in the context of the national reform programmes, assessed in the Commission's annual progress report. Disincentives to work longer have

been reduced and incentives strengthened, links between contributions and benefits have been tightened and life expectancy has been further taken into account in pension systems. Moreover, the provision of supplementary pensions has been promoted and legislative frameworks improved. Furthermore, some Member States have also tackled old age poverty by increasing the levels of guaranteed minimum pensions. Reforms have made steps regarding all three key objectives: providing adequate retirement income, ensuring financial sustainability and adapting systems to changing labour market and societal conditions.

Some Member States have introduced major reform packages. **Germany**, in addition to 2001 reforms (which led to a lower increase of first-pillar pension levels and the creation of State supported, funded, voluntary, second- and third-pillar pensions), undertook measures through the Sustainability Act of 2004, which are aimed at aligning the importance of the levels of contribution rates and the levels of benefits paid out. It also introduced a sustainability factor to the pension indexation formula, requiring additional adjustments if the ratio between contributors and beneficiaries worsens. In **France**, the 2003 reform improved long-term sustainability via an increase in the number of contribution years required for a full pension (this will be further increased in line with future increases in life expectancy), as well as via strengthened incentives to work longer. Members of the public and private schemes are now also treated more equitably. In **Austria**, the 2004 and 2005 reforms make a major step towards a more sustainable pension scheme through

a stronger link between contributions and benefits as well as an increase of the contribution years needed for a full pension. Incentives to work longer were also increased and incentives to take up early pensions decreased through a so-called bonus/malus system. It also introduces a much more uniform pension system across the public and the private sector and introduces the indexation of pensions to prices as of 2006. The **Finnish** pension reform, implemented mainly in 2003–05, increased incentives to work by providing a higher accrual of pension rights for older workers and overhauling early retirement arrangements. It will also introduce a 'life-time coefficient' with the affect of adjusting future pensions to increases in life expectancy. **Lithuania** (in 2004) and **Slovakia** (in 2005) introduced a funded tier to their social security pension system, which will strengthen the sustainability of the statutory pay-as-you-go old-age pension scheme in the long run while allowing individuals to accrue additional pension rights through privately-managed funds.

Concerning occupational and private pension schemes, the legislative framework was improved notably by the Netherlands and the United Kingdom. In **the Netherlands**, the principles for a new Financial Assessment Framework for supplementary pensions were established in 2004. It sets tighter requirements, in particular for the size of reserves for collective private pension arrangements. It also sets requirements for the break-even contribution rate and consistency between commitments regarding indexation, financing and related communications. In **the United Kingdom**, the provision of private pensions has been promoted by a streamlined and simplified regulatory regime (overseen by the new Pensions Regulator), a simplified tax regime for pension funds and greater protection for final salary schemes (by the establishment of the Pension Protection Fund).

Other Member States have continued adapting their existing system. For example, **Spain, Portugal, Belgium** and **Ireland** increased the levels of their guaranteed minimum pensions beyond the statutory index adjustments, while the **United Kingdom** implemented Pension Credits. **Portugal** strengthened incentives to work longer and fostered more equitable treatment of members of different schemes. Incentives to work longer were also developed in a number of Member States including **Luxembourg, the Netherlands** (favourable tax conditions for the take-up of early pensions have been reduced and an innovative life course arrangement,

replacing early retirement arrangements, will be introduced in 2006) and **Italy** (the 2004 reform plans a gradual increase of the age requirements for seniority pensions). In **Denmark** collective agreements will see increases in contribution rates. **Sweden** further developed information provision through a broad pension Internet portal established in 2004.

The new Member States were not covered in the 2003 Joint Report on Pensions. In most central and eastern European Member States pension systems were transformed substantially in the 1990s establishing a new architecture combining a public pay-as-you-go scheme and a mandatory private funded scheme for people below a certain age and voluntarily available to older persons while maintaining the old system for those who did not want or were not obliged to join the new system. Private schemes are mandatory for new entrants to the labour markets in **Estonia, Latvia, Poland, Hungary** and **Slovakia** and voluntary in **Lithuania**. Furthermore, in **Latvia** and **Poland**, the public pay-as-you-go scheme has been reformed into a notional defined-contribution (NDC) scheme. In a number of Member States a serious examination of the pension system has been commissioned by groups of experts or organised through social dialogue. Some pension laws provide for periodic reviews as a basis for next steps in the reform process. For example, **Spain** renewed the Toledo Pact underlining the importance of dialogue with the social and economic players involved, when it comes to monitoring present and future reform measures. The Parliament is reviewing progress and future reform measures every five years. Spain will create a Permanent Observatory to monitor the evolution of the social protection systems and is designed to carry out analysis and make proposals for necessary changes. The Pensions Commission (Chaired by Lord Turner) in the **United Kingdom** delivered recommendations for reform in its second report at the end of November 2005. The government has committed to consider these and other recommendations before bringing forward proposals in spring 2006. The **Czech Republic** reformed its existing system adapting some of the parameters such as retirement age and years of service but left several other elements untouched (retirement age in relation to number of children non-contributory periods). These features have been examined by a multi-party expert group that advocates further reforms. All major parties have committed themselves to translate these recommendations into legislation before the next election campaign

starts in 2006. **Malta** adopted a 'White Paper' on a pension reform strategy, which is currently under discussion. In **Denmark**, the government has set up a Welfare Commission charged with submitting specific proposals before the end of 2005 for reforming the Danish welfare model, including pensions and in particular early retirement provisions. In the light of the analysis from the Welfare Commission and with a view to maintaining the long-term economic targets, the government will (in spring 2006) present a new economic multi-year plan, covering at least the period up to 2015. In **Ireland**, the Pension Board is expected to submit its review on the pension system with proposals for measures for reform at the end of 2005. In particular, proposals concerning the promotion of occupational pensions are awaited. Regular reviews on the development of the pension system will also be carried out in **Germany**, **France** and **Austria**.

### 3.2. Key issues emerging from the National Strategy Reports

The OMC on pensions is based on 11 specific objectives grouped around the areas of adequacy, sustainability and modernisation. The detailed analysis of progress towards these objectives, as presented in the second round of NSRs, appears in the technical annex. The NSRs also report on the contribution made to pension sustainability by reducing public debt (BE, DK, NL) providing room for manoeuvre when making resources available to pension systems.

Four issues, already highlighted in the 2003 Joint Pension Report still remain a priority:

- strengthening incentives for working longer;
- developing a life-cycle approach and strengthening the link between contributions and benefits while ensuring adequate income replacement and managing increasing longevity;
- making pension systems more adaptable to structural changes;
- strengthening the role of minimum pensions and of solidarity in pension systems.

Two other issues emerge more forcefully in the light of recent reforms:

- secure private pensions complementing and partially replacing public pension provision;
- strengthening the governance of pension systems.

#### 3.2.1. Strengthening incentives to extend working lives

As already highlighted in the 2003 Joint Report, it is crucial that people work longer, but in some countries starting work earlier is also important. Working longer is an explicit European target in the Lisbon context, both through the objective of increasing the employment rate of older workers (aged 55–64) to 50% and through the objective of an increase of 5 years of the effective age of exit from the labour market. Longer working lives result in more contribution years and fewer benefit years, thus contributing directly to the adequacy and sustainability of the pension system. Pension systems are an important part of labour market institutions through the provision of benefits. Therefore, it is of utmost importance that the incentive structure embedded in the pension system is supportive to employment.

#### Box – Evolution of dependency ratios

According to the latest demographic projections, old-age dependency ratios (population aged 65 or more related to population aged 15–64) will more than double from 2005 to 2050 (from 24 to 51, an increase of around 110%).

The economic dependency ratio (population aged 65 and more related to the number of persons employed) is projected to increase by roughly 90%, (from 37 to 70) according to the Ageing Working Group 2005 projections, despite a projected increase of the general employment rate from the current 63% to 71% in 2050. This would mean that while there are currently almost 3 workers per each pensioner, in 2050 there would be only 1.4 workers per pensioner.



Employment rates of young people (15–24) in the EU are on average 37%, but with variations between Member States of 20% to 60%. Although it is an explicit EU objective to increase participation rates in education, this difference suggests that greater efforts are needed to integrate young people into the labour market and to support them as they pursue 'nonlinear' careers alternating between employment and study. Earlier working contributes to longer working lives and a higher accrual of pension rights, thereby enhancing welfare both at society's and individual level.

Employment rates of older workers have increased in recent years, reversing a long declining trend. Indeed, the employment rate of older workers has increased from 36% in 1995 to 42% in 2004 for EU-15, while the increase for EU-25 ranges from 36% in 2000 to 41% in 2004. In spite of recent improvements, in a number of Member States the employment rate of older workers lies below or around 30% (BE, IT, LU, HU, MT, AT, PL, SI, SK), or between 30% and 45% (CZ, DE, EL, ES, FR), while it lies between 45% and 55% in some others (LV, LT, NL, EE, IE, CY, PT, FI), and exceeds 55% only in a few (DK, SE and UK).

In nearly all Member States, recent reforms have strengthened incentives to extend working lives (especially for statutory schemes), and reduced access to early retirement. Working longer is generally encouraged by pension supplements and leaving earlier discouraged by actuarial reductions. Furthermore greater flexibility is provided in the timing of retirement, for example combining employment and partial retirement. In addition access to disability, sickness and incapacity schemes are being reviewed to eliminate other paths to early exit. While in defined contribution schemes, effective incentives are inherently imbedded. Some defined benefit schemes may require adaptation of eligibility rules and pension parameters (such as age limits of access to early or specific schemes, bonus/malus coefficients, etc.).

Moreover, as illustrated by the work carried out on replacement rates by the Indicator Sub-Group, reforms of statutory schemes have often led to a decrease of individual replacement rates, measured at the time of a given retirement age. However, many Member States have increased the accrual of pension rights if people work longer and these should act as incentives to work longer.

A key question for the future is whether the reforms carried out are sufficiently thorough to ensure efficient incentives to work longer so that the Lisbon targets for employment rates and the increase in effective retirement age can be achieved. Important differences can be observed among Member States according to the strength of incentives to work longer, depending on the design of the pension system. This suggests that the structure of incentives could be further revised in a number of Member States. In particular, attention still needs to be paid in a number of Member States to paths of early exit (before the standard retirement age) from the labour market.

Pension reforms give strong incentives to work longer and when well-designed they reward doing so with adequate pensions. However there is a need to ensure that people can work effectively longer as is underlined in Integrated Guideline for growth and jobs 18 (promoting a life-cycle approach to work). As analysed in the First Commission Report on the National Reform Programmes opening up employment opportunities for older workers through accelerating labour market reforms is essential (a reference to COM Annual Lisbon Progress Report). Pension systems can facilitate later retirement, but without suitable access for older workers to appropriate employment they are unlikely to be particularly effective.

### **3.2.2. Developing a life-cycle approach and strengthening the link between contributions and benefits, while ensuring adequate income replacement and managing increasing longevity**

The issue of the balance and the link between contributions and benefits as well as the transparency of this link are important, both for defined-benefit pensions systems (that are common among statutory pay-as-you-go systems), and for defined-contribution schemes, for which it is inherent in the system. Pension reforms have to deal with demographic developments and in particular increased longevity, which is a key driver for increasing pension expenditure in the future. This increase in a financially-balanced scheme would require either higher contributions by workers or lower benefits for pensioners, if the increase in life expectancy were spent in retirement. However, increases in life expectancy can be shared between the years in employment and retirement, thereby resulting in a better balance between lifetime contributions and benefits.



As a response to future increases in life expectancy, a number of reforms are designed to stabilise pension systems through automatic adjustment mechanisms (as in SE, FI, PL, LV or DE) or periodically required reviews and adjustments (like in AT, IT or FR). These adjustments will also promote a life-cycle approach.

Weak links between contributions made to pension schemes and benefits received may lead to inequitable and inefficient outcomes both within and between generations. In particular, people may see contributions more as general taxation, rather than as a build-up of their own pension rights. Reforming such pension provision together with other benefit systems may encourage them to work longer or to move out of the black economy.

A number of recent reforms have strengthened the benefit/contribution link of pension systems. Funded and notional defined contribution schemes establish a strong link. Also in many defined-benefit schemes, links have been strengthened. This has occurred firstly, through the introduction of longer contribution periods required for a full pension. Secondly, by calculating full pensions on the basis of life-time earnings instead of final salary, thus reflecting more accurately contributions over an entire career, rather than just wage progression in later years. Thirdly, applying actuarial reductions/increases for early/deferred retirement also contributes to a culture in which early retirement is less prevalent (this has occurred in a number of Member States, like AT, FR, FI, ES, PT, NL or IT), while the link was strengthened by previous reforms in many Member States, such as DE, BE, or LU, HU, EE, LV, LT, PL, SK, SI or SE).

However, reinforcing the link between contributions and benefits has to be combined with a careful monitoring of the accrual of pension rights during breaks in careers such as childcare, other caring responsibilities, unemployment, sickness or education leaves to ensure both adequacy and equity in retirement.

### **3.2.3. Modernising pension systems by making them more adaptable to structural change**

New labour supply structures require adaptable pension systems. Due to increases in participation rates and societal changes more and more people do not follow the standard career of full-time, life-long employ-

ment. Career breaks and part-time work are becoming more frequent, and more and more people, at least for part of their professional career, are self-employed. These trends make adjustments of pension systems necessary in order to encourage activity and ensure adequate pension entitlements for all, even if this may make the system less transparent.

Member States have started to review pension provision for workers with atypical careers and for the self-employed, with a view to easing access to statutory and supplementary pension schemes. For example, some Member States, in particular where the link between contributions and benefits have been strengthened, allow people to acquire pension credits for periods of short-term contracts, part-time and voluntary work as well as for some breaks in the work career such as child and old-age care, education and unemployment. The purpose of such provision is to ensure that working part-time or on fixed-term contracts combined with periods of other activities or unemployment should not harm pension entitlements disproportionately. Against the overall trend to reduce future pension benefits in the pay-as-you-go schemes, several Member States are improving credits for childcare and have introduced similar provisions for old-age care. Progress in this area of modernisation seems to be difficult to achieve and this may relate to tensions between incentives to accrue original pension rights through paid employment and recognising non-paid labour.

Most of the Member States are gradually phasing out differences in legal retirement ages between men and women. Other Member States appear to be retaining different retirement ages on gender grounds, at least for the next two decades. Some Member States still provide early retirement provisions for women with children. It is notable that the design of survivors' pensions is changing as the traditional widow's pension will become less and less frequent, due to rapid increases in employment opportunities for women.

Generally, workers who change employers frequently are better served by statutory schemes, and many statutory schemes have moved towards accommodating short-term contracts, while supplementary pension schemes (notably those which are linked to an individual employer), can disadvantage mobile workers with regard to pension rights in comparison to long-term employees (notably due to waiting and vesting peri-

ods). Given the rising importance of supplementary schemes some Member States (DK, DE, NL, UK) have improved the portability of supplementary pension rights which pose obstacles to worker's mobility – a growing feature in labour markets today and in the future. In order to improve the overall conditions of portability of supplementary pension rights and accompany the initiatives already taken by some Member States, the European Commission has recently adopted proposals for a directive designed to improve portability.

### **3.2.4. Guaranteeing minimum retirement income provision and solidarity**

In some Member States, in response to the need to provide decent retirement income for older people, guaranteed minimum pensions have been recently increased by more than statutory indexation requirements (like in BE, ES, IE, IT or PT). In 2003, the UK implemented an improved income-related benefit 'pension credit', in order to increase incentives to save for one's retirement.

An issue raised by these reforms of minimum pensions and more generally minimum benefits for older people is how they affect incentives for the accrual of pension rights. In this respect, the links between minimum benefits, indexation rules and incentives should be carefully considered.

Another issue is whether minimum pensions or minimum benefits are indexed differently from earnings-related pensions and whether this can have unintended effects on the income distribution among pensioners. Recent developments show that more and more countries have switched to price, or close to price, indexation both for earnings-related schemes and for minimum pension schemes. However, indexation of guaranteed minimum pensions on prices usually means that the income of those being dependent on minimum pensions lags behind the general evolution of income and may raise the risk of increased relative poverty among older pensioners even though it preserves their purchasing power. In order to prevent poverty increasing, governments are often required to take discretionary corrective measures (which is at

odds with the provision of a long-term, secure and stable system, which individuals can have confidence in). Indeed, this issue should be considered in the broader context of promoting inclusion of older people. Some Member States address this by providing minimum income guarantees and others benefits in cash and kind, for example healthcare and care services, housing and transport.

### **3.2.5. Secure private pensions complementing or replacing partially public pension provision**

Many Member States place greater emphasis on the contribution private funded provision can make in ensuring adequate retirement incomes, emphasising the positive role of diversification of the demographic risk between public and private schemes. Ageing populations, notably the retiring of the baby-boom generation, means that the financial sustainability of pay-as-you-go systems requires close attention as the dependency ratio changes substantially. However, funded systems will also be affected by population ageing.

The NSRs have captured much better than in the last exercise the issue of supplementary pensions. Several countries see a role for the private pension provision as part of the total pension provision. This has traditionally been the case in some Member States (like DK, NL and UK). Moreover, the importance of private pension provision has essentially been increased by the introduction of a funded tier of statutory schemes in a number of Member States like in SE, PL, HU, EE, LV, LT, and SK. Furthermore, a great number of countries have increased provisions for occupational or private schemes that complement public pensions (DE, IT, AT).

However, as underlined by the special study of the SPC on privately-managed pension provision, while the expected contribution of privately-managed pension schemes is projected to increase in the coming decades, in all but a few Member States, the public pay-as-you-go pension schemes are expected to remain the principal source of income of pensioners. This will allow Member States to maintain a degree of redistribution and solidarity that is necessary to provide fair incomes to all older people and to diversify risk at the individual level in an appropriate manner. In any case, the provision of guar-

anteed minimum pensions remains not only a State responsibility but is provided everywhere through public schemes. Moreover, the trend towards a broader use of privately-managed pension provision does not allow public policy to retreat from the area. Monitoring and regulating private pension provision is becoming an important and complex task for public policy. Moreover, transparency and competitive markets for financial intermediaries should be promoted.

If private pensions are to provide retirement incomes for people with lower incomes it is therefore essential that Member States invest in good governance structures for them. Some Member States provide relatively favourable incentives for low-income people (DE, CZ) to participate in privately-managed pension provision, but this may not be sufficient. This also explains the debate in some Member States about making private savings mandatory, in particular if a major part of the pension provision should be based on private saving (as is the case in many new Member States). As far as private pensions are based on a wider use of voluntary private pensions, they are generally used more frequently by higher income groups. This could exacerbate the impact of reductions to the level of individual replacement rates in statutory pension systems especially for older pensioners.

It is important for Member States to monitor whether the actual development of private pension provision matches needs, by assessing levels of coverage and benefits and their distribution by age and socio-economic status. Moreover, privately-managed schemes, as well as reserve funds of pay-as-you-go schemes have to operate at a sufficiently high level of security and efficiency. Rules on acceptable investment risks and prudent assumptions about future returns are important safeguards if their implementation is well-enforced and monitored, while efficiency also means ensuring that administrative charges are kept low.

Finally, the translation of individual accounts into safe and secure annuities will become more and more

important, in particular for the regimes recently introduced that will begin to provide first, partial benefits in a few years and often before the end of the decade (like in PL, EE, HU, LV, LT or SK).

### **3.2.6. Strengthening the governance of pension systems**

Periodic or ad-hoc reviews of pension systems, as well as automatic or semi-automatic adjustment mechanisms already mentioned in 3.2.2 contribute to a better governance of pension systems. In many cases they deal indeed with longevity but also with other changes in pension parameters such as employment and growth. NSRs outline developments of independent institutions responsible for monitoring pension systems. Such reviews make clear the need to balance the length of active life and of retirement, the income replacement and the total contribution required in view of the fundamental objectives of maintaining pension adequacy and sustainability. This is indeed an interesting trend as it increases the general transparency of pension systems and facilitates more consensual decision-making.

The introduction of more flexibility for retirement ages in statutory pension schemes, the development of a closer link between contributions and benefits as well as the development of privately-managed provisions all imply greater and more complex choices for future beneficiaries.

As underlined in a number of Member States (like UK, IT, NL, DK, SE or IE), this trend should be accompanied by appropriate information on future pension levels and more generally by promotion of awareness of pension issues and a better understanding of financial services. It is important to recognise the limits of information when expecting populations to make complex individual decisions about retirement provision. Major efforts to provide information and to increase financial literacy are described in most reports and it is indeed important to define the rights of members and beneficiaries through high-quality information.

## 4 Conclusion

### 4.1. Adequacy, sustainability and modernisation should be considered jointly

The second round of NSR confirms that the three main objectives of pensions adequacy, sustainability and modernisation are appropriate to guide the reform strategies necessary to address the pension challenge in Europe.

The NSRs highlight the interlinkages between the three broad objectives and the synergies and trade-offs between them. For reform strategies to be successful, all three elements must be present and considered together.

If society does not develop an integrated approach linking adequacy and sustainability the risks are substantial. Unsustainable promises for future pensions jeopardise the possibility of adequate incomes in retirement. Inadequate accrual of pensions and delivery of low levels of income (or reducing pension provision previously promised) would create unforeseen pressures for the sustainability of public finances, as an increasing demand for ad hoc revaluations of pensions and possible unexpected demands for other (even means-tested) social benefits can result in higher public expenditure. These situations could lead to sharp conflicts concerning the credibility of the pension system.

Increasing transparency in pension systems is important for both individuals (who need information and clarity in order to make long-term decisions) and governments (which need to develop monitoring tools for the long-term management of pension systems). A particularly interesting new feature of recent pension reforms is the introduction of automatic or semi-automatic mechanisms that contribute to a periodic monitoring of various sources of uncertainties – in particular demographic trends – and promote the likelihood of proportionate and timely reforms.

### 4.2. Contribution of pension reforms to employment and growth

As underlined in many NSRs, pension reforms have to be considered in the broader context of society and the economy. The reform efforts outlined by Member States in their national reform programmes can be supported by pension reforms, while stronger economies can also deliver better pensions. Increasing employment opportunities for older people is vital for both achieving Lisbon employment goals and supporting sustainable growth, thereby allowing the maintenance of a high level of social protection in an ageing society. Pension reforms, employment and growth are therefore interdependent.

Firstly, pensions constitute a major part of public expenditure in almost all countries. A financially sound public pension system is essential to the sustainability of public finances as a whole, which in turn supports the overall growth and economic performance. Furthermore, a successful implementation of the Lisbon strategy leading to improved competitiveness and productivity can create room for manoeuvre for pension reform.

Secondly, pension systems and labour market performance have close ties. Pension systems embed incentives that affect the labour supply of older workers, while a high level of employment also ensures high levels of contributions into the system. Contributions required for the financing of pension systems also affect labour costs and, consequently, labour demand. Higher contribution rates can result in reduced labour demand, while overly generous benefits can reduce labour supply, thereby aggravating labour market imbalances. Both benefits and contributions need to be considered in the context of their impact on the functioning of labour markets.

### 4.3. Key issues to be monitored

Since 2003, many Member States have engaged in substantial pension reform, often against public opinion. Some Member States seem to have established comprehensive reforms, others have strengthened their efforts, while some remain at an early stage of the reform process. While in the latter countries the momentum for reform needs to be accelerated, in most Member States the momentum should be maintained.

Across the NSRs the following points emerge as requiring careful monitoring:

- Pension reforms need to continue to support the good functioning of labour markets by correcting and strengthening incentives for working longer and reviewing both the levels of contribution rates and benefits. Progress in labour market reform, including a culture shift among employers concerning retaining and re-employing older workers, is necessary.
- Pension reforms need to promote adjustment of systems for the management of changes in life expectancy and the introduction of a life-cycle approach in their design.
- Modernisation needs to take better account of new forms of employment, flexible working, career breaks, care, and systems that allow women to build up their own pension rights.
- Measures to ensure future adequate minimum pension gain importance but care must be taken over indexation rules and creating disincentives to work or save.
- The financial sustainability of public pensions systems and their effect on government budgets need careful monitoring while taking into account the impact private pension systems may have on public finances. Furthermore, public debt should be reduced in order to make room for manoeuvre for expected increase in age related expenditure.
- Development of private provision can complement or partially replace public pension provision, and thus diversify risk at the individual level, but security and equity need to be ensured.
- Transparency and the promotion of better education and understanding of pension issues among the public needs to be enhanced.
- Regular review and adjustment mechanisms are important innovations not only to adapt systems over time but also to promote a better understanding of the need for reform in the face of demographic challenges.

### 4.4. Further steps within the open method of coordination

The OMC on pensions has proved to be a good tool for the Union and Member States to advance their understanding of pension reform by defining common objectives, reviewing progress and promoting a learning process. The new OMC as outlined in the Commission's Communication of 22 December 2005: 'Working together, working better: A new framework for the open coordination of social protection and inclusion policies in the European Union' could, because of its integrated structure and its closer links to the Lisbon strategy for growth and jobs, enhance Member States' efforts to progress pensions reform. Future work should follow two methodologies:

- Continue the overall monitoring of progress made towards the common objectives without overburdening reporting requirements from Member States. As outlined in the Commissions' communication, there will be alignment with the Lisbon three-year cycle (2005–08). Member States will not be required to deliver national strategies in intervening ('light') years. The OMC in light years will concentrate on in-depth analyses of specific issues, on disseminating policy findings and on assessing indicators of progress towards the common objectives.
- Focus policy analysis and exchange of best practices on key issues. In addition to the ongoing work on replacement rates, in the light of the challenges identified in this document, future horizontal work could focus on the following issues:
  - the design of minimum income provisions for older people (including the link between pensions and other benefits provided to people in retirement);

- the strengthening of the link between contribution and benefits (to be conciliated with non-contributory credits and taking into account gender issues);
- the link between the flexibility in the age of retirement and longer working lives;
- key issues in the development of private pensions (efficient legal framework, inequality in coverage, security, information, transition costs, contribution private pensions can make to financial sustainability);
- developing regular review and adjustment mechanisms.

This could be achieved via special studies and workshops. The Peer Review methodology successfully used in the social inclusion strand could also be applied for some of the priority topics. The outcome of such work could be reported in an appropriate way to the SPC and EPC. The SPC may wish to consider submitting reports on some of the issues to the Commission and Council. Working methodologies, national reporting and horizontal studies provide important inputs into future joint reports on social protection and social inclusion and allow an effective contribution of the OMC to the Lisbon strategy for growth and jobs.

## Français

## 1 | Le défi des retraites

Un des grands succès des politiques sociales de la seconde moitié du XX<sup>e</sup> siècle est que la vieillesse n'est plus synonyme de pauvreté ou de dépendance de la part des personnes âgées vis-à-vis de l'aide que leur apportent leurs enfants. Cette réussite est en grande partie celle des régimes publics de retraite.

Sans renier ces résultats, les décideurs européens se soucient depuis longtemps du problème du vieillissement de la population et, notamment, des contraintes financières qui en découlent pour les régimes de retraite. Tout récemment, le Conseil européen informel de Hampton Court a demandé à l'Europe une réflexion plus poussée sur les retombées des tendances démographiques sur les politiques socio-économiques; par ailleurs, la réponse à la mondialisation et le vieillissement de la population, avec en particulier la réforme des régimes publics de retraite, sont décrits dans le premier rapport de suivi annuel de la Commission intitulé «Passons à la vitesse supérieure», en date du 25 janvier 2006, comme deux des principaux futurs champs d'action de l'Europe. Comme le soulignait le rapport conjoint du Conseil et de la Commission de 2003 sur des pensions adéquates et viables, le défi, dans une société vieillissante, consiste à repousser encore l'âge effectif de départ à la retraite. Alors qu'il était normal, dans les années 60, de partir à la retraite bien au-delà de soixante ans, l'emploi des travailleurs âgés a décliné dans de nombreux pays au cours des années 70 et 80 — tendance qui n'a commencé à s'inverser qu'il y a peu. L'âge moyen de sortie du marché du travail demeure donc inférieur à celui observé à la fin des années 60.

Ce recul de l'âge moyen réel de départ à la retraite (combiné à une entrée plus tardive sur le marché de l'emploi) s'oppose à l'allongement significatif de l'espérance de vie enregistré au cours de la même période. De 1960 à 2000, l'espérance de vie à soixante ans a augmenté de quatre ans dans les vingt-cinq États membres de l'Union européenne (UE) (passant de 15,8 à 19,3 ans pour les hommes et de 19 à 23,6 ans pour les femmes). Selon les projections les plus récentes d'Eurostat, l'espérance de vie à soixante-cinq ans dans l'Union devrait encore

augmenter de quatre ans entre 2004 et 2050 (4,4 ans pour les hommes et 3,9 ans pour les femmes). Même dans un contexte démographique favorable où la population active augmenterait, l'allongement de l'espérance de vie enregistré au cours de la seconde moitié du XX<sup>e</sup> siècle exigerait encore d'être en partie compensé par une hausse des taux de cotisation.

En résumé, la durée d'assurance diminue tandis qu'augmente le nombre d'années durant lesquelles les prestations doivent être payées, ce qui met à mal les finances des régimes de retraite. Des réformes sont désormais nécessaires pour contrer l'abaissement passé de l'âge réel de départ à la retraite, l'augmentation du rapport de dépendance, la sortie du marché du travail de la génération du «baby-boom» et les futures hausses de l'espérance de vie.

Toute réforme des retraites exige une stratégie à long terme. Le processus même de réforme est long, car il repose habituellement sur un vaste consensus, les régimes de retraite constituant l'une des composantes fondamentales de nos systèmes de protection et de cohésion sociales. En outre, les États consacrent une part substantielle de leurs dépenses publiques à l'assurance «vieillesse» — part qui, au vu des tendances démographiques, ne manquera pas d'augmenter de manière significative. Par conséquent, la réforme des régimes de retraite relève aussi bien de la nécessité de garantir des pensions adéquates et viables que de la volonté de maintenir la pérennité de l'ensemble des finances publiques et de la croissance au sein de l'UE.

Le Conseil européen de Stockholm a défini les trois axes d'une stratégie visant à atténuer les répercussions budgétaires du vieillissement de la population. Les États membres devraient:

- réduire plus rapidement leur dette publique;
- réformer en profondeur leur marché du travail, dont les régimes d'imposition et de prestations sociales, afin de relever les taux d'emploi, notamment des travailleurs âgés et des femmes;



- réformer leurs régimes de retraite pour asseoir leur financement sur une base saine, atténuer la pression sur les finances publiques et préserver un juste équilibre entre les générations.

Dans la quasi-totalité des États membres, l'organisation des régimes de retraite relève en majeure partie de l'action générale de l'État et influe donc largement sur les finances publiques. Il faut veiller à ce que les dépenses de l'État consacrées aux retraites — en hausse sous l'effet du vieillissement de la population — ne menacent pas la viabilité des finances publiques et mettre en place des stratégies appropriées permettant de satisfaire aux engagements à long terme des régimes de retraite. Parallèlement, une gestion saine des finances publiques peut contribuer à atténuer les contraintes budgétaires engendrées par le vieillissement de la population.

Il existe de solides arguments, fondés sur les principes de l'équité et de l'efficacité, justifiant l'action de l'État dans le domaine des retraites, que ce soit pour l'organisation, le financement ou la réglementation des régimes. Ces arguments sont notamment liés à des objectifs sociaux fondamentaux, comme la nécessité de garantir un revenu adéquat aux personnes âgées.

Cette action nécessite de faire aujourd'hui des choix pour l'avenir, malgré les incertitudes résultant de l'imprévisibilité des tendances socio-économiques. À l'échelon des individus, de tels choix seraient extrêmement difficiles et conduiraient probablement à une couverture insuffisante de la plupart des citoyens, notamment ceux disposant de faibles revenus ou pouvant difficilement planifier à long terme leurs finances. De même, les assurances privées ont beaucoup de mal à gérer les incertitudes liées aux engagements à long terme. Ce sont donc les régimes de retraite reposant sur une couverture universelle qui sont les plus aptes à faire face à de tels engagements et à garantir un revenu adéquat aux personnes âgées.

La contribution de l'État joue un rôle crucial dans les régimes nationaux de retraite, très disparates au sein de l'Union des Vingt-cinq, ce qui montre bien qu'il n'existe pas de solution unique. Bien que les objectifs essentiels d'accès, de garantie de prestations adéquates et de viabilité financière soient communs à tous les régimes des États membres, la conception de ces derniers varie considérablement, reflétant leur histoire respective et les préférences données à une redistribution des revenus ou encore à la libre décision des individus.

## 2 La méthode ouverte de coordination pour le domaine des retraites, dans le cadre de la stratégie de Lisbonne

Lors du Conseil européen de Laeken, qui s'est tenu en décembre 2001, il a été reconnu qu'un dialogue et une coopération renforcés sur certaines questions liées à la réforme des régimes de retraite pourraient se révéler fort bénéfiques. Le Conseil européen a approuvé des objectifs communs — prestations adéquates, viabilité financière, capacité d'adaptation — et une méthode de travail connue sous le nom de méthode ouverte de coordination (ci-après dénommée «MOC»).

En 2002, les États membres ont décrit, dans une première série de rapports stratégiques nationaux (RSN), comment ils comptaient atteindre ces objectifs. À partir de ces documents, le Conseil et la Commission ont adopté en mars 2003 un rapport conjoint sur des pensions adéquates et viables.

En conclusion, ce rapport précisait : «La plupart des États membres considèrent [...] la réforme des retraites comme un processus continu plutôt qu'un événement isolé [...]. Il faut maintenir l'élan de ce processus de réforme qui vise à assurer la viabilité de pensions adéquates.»

En réponse au rapport conjoint sur les pensions, le Conseil européen de mars 2003 a appelé les États membres à garantir la poursuite des réformes et l'application constante de la MOC dans le domaine des retraites. Il a demandé à être informé en 2006 des progrès réalisés et souhaitait que les nouveaux États membres soient intégrés dans ce processus. Ces progrès sont présentés dans la proposition de rapport conjoint de 2006 de la Commission sur la protection et l'inclusion sociales.



En 2005, la Commission a proposé — et le Conseil approuvé — une révision de la stratégie de Lisbonne pour la croissance et l'emploi et un remaniement des lignes directrices intégrées<sup>(2)</sup>. Il est admis que les MOC sur la protection et l'inclusion sociales alimentent le processus de Lisbonne. La Commission entend aussi rendre plus efficace la coordination communautaire de la protection sociale en harmonisant les MOC qui débiteront en 2006 dans le domaine des retraites, de l'inclusion sociale et des soins de santé et de longue durée. Créer une méthode ouverte de coordination plus percutante, plus visible et davantage axée sur la modernisation et l'application des politiques, générant des effets positifs sur la stratégie remaniée de Lisbonne, tout en simplifiant le dispositif de présentation des rapports et en élargissant les possibilités d'échanges sur les mesures introduites, tel est le but recherché.

Dans le cadre de la MOC, des rapports séparés rendant compte des programmes nationaux de réforme

des États membres et brossant le tableau des réformes qui contribuent aux objectifs de croissance et d'emploi seront préparés. De même, les informations réunies à l'échelon de l'Union dans le rapport conjoint sur la protection et l'inclusion sociales alimenteront le rapport de suivi annuel de l'UE.

Dans ce contexte, le présent document analyse la problématique des retraites, préalable nécessaire au traitement de cette question dans le rapport de 2006 sur la protection et l'inclusion sociales. Les États membres ont à cette fin présenté leur deuxième rapport stratégique national (RSN) durant l'été 2005. Ces rapports ont fait l'objet, à la mi-septembre de la même année, d'un examen par des pairs associant le comité de protection sociale (CPS) et le comité de politique économique (CPE). Le présent document fournit une synthèse de cette nouvelle série de rapports.

## 3 Principaux enseignements à tirer du deuxième cycle d'application de la méthode ouverte de coordination dans le domaine des retraites

### 3.1. Les grandes lignes de la réforme des retraites dans les États membres

Le rapport conjoint de 2003 sur les pensions soulignait l'étroite corrélation entre, d'une part, des régimes financièrement viables et des niveaux de pension suffisants au vu du vieillissement de nos sociétés et, d'autre part, la nécessité d'introduire des réformes de fond garantissant des régimes adéquats, accessibles et financièrement pérennes. Il invitait notamment les États membres à améliorer les mesures incitant les travailleurs âgés à rester plus longtemps sur le marché du travail, à renforcer le lien entre cotisations et prestations et à accroître le financement public et privé, compte tenu en particulier des répercussions à long terme de l'allongement de l'espérance de vie sur les dépenses des régimes de retraite.

En 2050, la population européenne, bien qu'un peu moins nombreuse, sera nettement plus âgée. On comptera alors deux travailleurs pour une personne âgée, au lieu de quatre pour une à l'heure actuelle. Les dernières projections à long terme montrent que, en 2050, le coût des retraites entraînera une hausse significative des dépenses publiques dans la plupart des États membres. Si l'on prend comme référence les politiques actuelles, les dépenses publiques consacrées aux retraites devraient augmenter en moyenne de 2,2 points de pourcentage pour l'Union des Vingt-cinq, avec de fortes variations d'un État membre à l'autre.

Depuis le rapport conjoint de 2003, des progrès substantiels ont été enregistrés dans la réforme des régimes de retraite. Les États membres ont également rendu compte de leurs résultats sur ce front dans leur

(2) Voir en particulier la ligne directrice n° 2: «Les États membres devraient [...] réformer leurs systèmes de retraite et de soins de santé pour les rendre financièrement viables mais aussi socialement adaptés et accessibles, et [...] prendre des mesures pour relever les taux d'emploi et augmenter l'offre de main-d'œuvre» et la ligne directrice intégrée n° 18: «Favoriser une approche fondée sur le cycle de vie à l'égard du travail au moyen des actions suivantes: [...] moderniser les systèmes de retraite et de soins de santé pour assurer leur adéquation, leur viabilité financière et leur capacité d'adaptation à l'évolution des besoins, de manière à soutenir l'activité professionnelle et la prolongation de la vie professionnelle par le biais, entre autres, de mesures appropriées favorisant le travail et décourageant la retraite anticipée.»

programme national de réforme ayant fait l'objet d'une évaluation dans le rapport de suivi annuel de la Commission. Les obstacles à la prolongation de la vie active ont été réduits tandis que les incitations à rester plus longtemps sur le marché du travail ont été renforcées, le lien entre cotisations et prestations a été resserré et l'espérance de vie a été davantage prise en compte dans les régimes de retraite. En outre, les retraites complémentaires ont été mises en valeur et le cadre juridique amélioré. Certains États membres se sont aussi attaqués à combattre la pauvreté des personnes âgées, notamment en relevant le niveau des minima de pension garantis. Les réformes ont amélioré la situation par rapport aux trois grands objectifs, à savoir fournir aux retraités un revenu adéquat, garantir la viabilité financière des régimes et les adapter à l'évolution du marché de l'emploi et de la société.

Certains États membres ont introduit des réformes de grande ampleur. En 2001, l'**Allemagne** avait déjà lancé des réformes qui avaient ralenti l'augmentation des pensions de retraite relevant du premier pilier et abouti, pour les deuxième et troisième piliers, à la création de régimes (facultatifs) soutenus par l'État et reposant sur la capitalisation. Avec la loi de 2004 sur la viabilité, elle a introduit des mesures destinées à renforcer le lien entre les taux de cotisation et le niveau des prestations versées. Elle a également prévu un facteur de viabilité dans la formule d'indexation des retraites, qui requiert des ajustements complémentaires en cas de détérioration du rapport entre le nombre de cotisants et celui des bénéficiaires. En **France**, la réforme de 2003 a amélioré la viabilité à long terme des régimes en prolongeant la durée d'assurance requise pour une retraite à taux plein (le nombre d'années requises sera à nouveau relevé en fonction des futurs allongements de l'espérance de vie) et en renforçant les incitations à rester plus longtemps sur le marché du travail. De plus, les personnes affiliées aux régimes publics et privés de retraite sont désormais davantage traitées sur un pied d'égalité. Avec ses réformes de 2004 et 2005, l'**Autriche** a fait un grand pas vers un régime de retraite plus viable: la corrélation entre cotisations et prestations a été renforcée et le nombre d'années requises pour l'obtention d'une retraite à taux plein relevé. Les mesures en faveur d'un allongement de la vie active ont été multipliées et celles en faveur des préretraites ont été réduites, grâce à un système de «bonus-malus». L'Autriche a aussi uniformisé davantage les régimes publics et privés de retraite et indexera ses pensions sur les prix à compter de 2006.

En **Finlande**, la réforme des retraites, essentiellement appliquée de 2003 à 2005, a accru les incitations à prolonger la vie active en prévoyant une acquisition plus avantageuse des droits à pension pour les travailleurs âgés et un remaniement du dispositif de préretraite. Elle introduira également un «coefficient de durée de vie» adaptant le niveau des futures pensions à l'allongement de l'espérance de vie. La **Lituanie** (en 2004) et la **Slovaquie** (en 2005) ont introduit dans leur régime de retraite relevant de la sécurité sociale une dose de capitalisation qui renforcera la viabilité à long terme du régime obligatoire fondé sur la répartition, tout en permettant aux assurés d'acquérir des droits à pension supplémentaires grâce à des fonds privés.

Le cadre juridique des régimes professionnels et privés de retraite a été amélioré, notamment aux Pays-Bas et au Royaume-Uni. Aux **Pays-Bas**, les principes régissant un nouveau cadre d'évaluation financière des retraites complémentaires ont été établis en 2004. Ce cadre impose des exigences plus strictes, en particulier en ce qui concerne l'ampleur des réserves requises pour les régimes collectifs privés de retraite. Il impose aussi des contraintes pour le taux de cotisation assurant la rentabilité des régimes et établit une cohérence entre les engagements concernant l'indexation, le financement et la diffusion d'informations connexes. Le **Royaume-Uni** a favorisé les retraites privées en harmonisant et allégeant la réglementation (supervisée par un nouvel organe appelé «Pensions Regulator»), en simplifiant le régime fiscal des fonds de pension et en garantissant aux régimes à prestations définies une plus grande protection (grâce à la création du «Pension Protection Fund» ou fonds de protection des retraites).

D'autres États membres ont continué à adapter leurs régimes de retraites. À titre d'exemple, l'**Espagne**, le **Portugal**, la **Belgique** et l'**Irlande** ont majoré leur retraite minimale garantie au-delà des ajustements imposés par l'indexation obligatoire, tandis que le **Royaume-Uni** a introduit une prestation liée au revenu («Pension Credit»). Le **Portugal** a renforcé ses mesures en faveur d'une prolongation de la vie active et encouragé un traitement plus équitable entre les affiliés aux différents régimes. Des mesures incitant à rester sur le marché du travail ont aussi été élaborées par plusieurs États membres, dont le **Luxembourg**, les **Pays-Bas** (les dispositions fiscales avantageant les départs anticipés à la retraite ont été réduites et des modalités innovantes couvrant le cycle de vie seront introduites en 2006 pour remplacer les

dispositifs de préretraite) et l'**Italie** (la réforme de 2004 prévoit un relèvement progressif de l'âge requis pour la liquidation de la pension de vieillesse). Au **Danemark**, des accords collectifs prévoient une augmentation des taux de cotisation. La **Suède** a quant à elle étendu son offre d'informations en créant en 2004 sur internet un portail sur les retraites.

Les nouveaux États membres n'étaient pas couverts par le rapport conjoint de 2003. La plupart des États membres de l'Europe centrale et orientale ont considérablement transformé leurs régimes de retraite au cours des années 90: ils ont mis en place une nouvelle architecture qui combine un régime légal par répartition à un régime privé obligatoire par capitalisation s'adressant aux personnes en dessous d'un certain âge et accessible, sur une base volontaire, aux plus âgés, tout en maintenant l'ancien régime pour ceux qui ne voulaient pas ou ne devaient pas s'affilier au nouveau régime. Les personnes entrant pour la première fois sur le marché du travail en **Estonie**, en **Lettonie**, en **Pologne**, en **Hongrie** et en **Slovaquie** doivent obligatoirement s'affilier à un régime privé; en **Lituanie**, l'affiliation est facultative.

En outre, en **Lettonie** et en **Pologne**, le régime légal par répartition a été transformé en un régime à comptes individuels notionnels. Dans plusieurs États membres, un examen approfondi du régime de retraite a été demandé à des commissions d'experts ou organisé par la voie du dialogue social. Parfois, la loi prévoit une analyse périodique des régimes de retraite avant le passage à une étape ultérieure du processus de réforme. À titre d'exemple, l'**Espagne** a renouvelé le pacte de Tolède, qui souligne l'importance du dialogue avec les acteurs socio-économiques dans le suivi des réformes actuelles et futures. Le Parlement espagnol examine les avancées accomplies et les futures mesures de réforme tous les cinq ans. L'Espagne créera un Observatoire permanent chargé de suivre l'évolution des systèmes de protection sociale; cet observatoire proposera les évolutions nécessaires, sur la base des analyses qu'il aura réalisées. Au **Royaume-Uni**, la Commission des retraites («Pensions Commission»), présidée par Lord Turner, a émis des recommandations de réforme dans son deuxième rapport, présenté à la fin du mois de novembre 2005. Le gouvernement s'est engagé à examiner ces recommandations, ainsi que d'autres, avant de soumettre ses propositions au printemps 2006. La **République**

**tchèque** a réformé son régime en modifiant certains paramètres, tels que l'âge de la retraite et la durée de la carrière, mais sans toucher à de nombreux autres éléments (relation entre l'âge de la retraite et le nombre d'enfants, périodes non contributives). Ces caractéristiques ont été examinées par un groupe d'experts pluri-partite, qui plaide en faveur d'une poursuite des réformes. Les intervenants se sont engagés à traduire ces recommandations dans la législation avant le début de la prochaine campagne électorale en 2006. **Malte** a adopté un livre blanc sur une stratégie de réforme des retraites qui est actuellement examiné. Au **Danemark**, le gouvernement a créé une commission chargée de soumettre, avant la fin de l'année 2005, des propositions précises sur la réforme du modèle danois de protection sociale, y compris sur les retraites et plus particulièrement les préretraites. Au vu de l'analyse de cette commission et dans le but de préserver les objectifs économiques à long terme, le gouvernement présentera un nouveau plan économique pluriannuel (au printemps 2006), qui s'étalera au moins jusqu'en 2015. En **Irlande**, la commission des retraites («Pension Board») devrait remettre ses conclusions sur son examen du régime national et ses propositions de réformes à la fin de l'année 2005. Ses propositions visant à promouvoir les retraites d'entreprise sont particulièrement attendues. L'**Allemagne**, la **France** et l'**Autriche** examineront aussi régulièrement leurs régimes de retraite.

### 3.2. Les enjeux révélés par les rapports stratégiques nationaux

La MOC dans le domaine des retraites repose sur onze objectifs précis, regroupés selon les trois thèmes suivants: adéquation, viabilité et modernisation. L'annexe technique fournit l'analyse détaillée des progrès accomplis par rapport à ces objectifs, tels que présentés dans la deuxième série de RSN (rapports de stratégie nationale). En ce qui concerne la viabilité des régimes de retraite, les RSN évoquent aussi les réductions de la dette publique qui, dans certains pays (Belgique, Danemark, Pays-Bas), permettent de dégager des ressources pouvant être affectées à ces régimes.

Quatre priorités demeurent, qui avaient déjà été soulignées dans le rapport conjoint de 2003:

- renforcer les mesures incitant à prolonger la vie active;

- concevoir une démarche pour la totalité du cycle de vie et établir une relation plus étroite entre cotisations et prestations, tout en garantissant un revenu de remplacement adéquat et en gérant la progression de la longévité;
- accroître la capacité d'adaptation des régimes de retraite aux changements structurels;
- renforcer le rôle des minima de pension et de la solidarité dans les régimes de retraite.

En outre, les réformes récentes font apparaître plus clairement les deux autres enjeux suivants:

- garantir des retraites privées complétant et remplaçant partiellement l'offre du régime public;
- consolider la gouvernance des régimes de retraite.

### 3.2.1. Renforcer les mesures incitant à prolonger la vie active

Comme l'avait déjà mis en lumière le rapport conjoint de 2003, il est capital que les carrières professionnelles soient plus longues; dans certains pays, cependant, il est aussi important que l'entrée sur le marché du travail intervienne plus tôt. La prolongation de la vie active a été explicitement définie dans le contexte de Lisbonne comme un objectif européen, qui se reflète dans la volonté tant de porter à 50% le taux d'emploi des travailleurs âgés (55-64 ans) que d'augmenter de cinq ans l'âge effectif de sortie du marché du travail. Un allongement des carrières professionnelles se traduit par une durée d'assurance plus longue et une période de perception des prestations plus courte, ce qui facilite directement l'obtention de pensions adéquates et viables. De par les cotisations versées, les régimes de retraite constituent une composante importante des institutions régissant le marché du travail. Il est par conséquent crucial que les incitations qu'ils prévoient aient un effet positif sur l'emploi.

Le taux d'emploi des jeunes (15-24 ans) dans l'UE se situe en moyenne à 37%, mais les taux nationaux oscillent entre 20 et 60%. Bien que l'un des objectifs de l'UE soit expressément d'augmenter la présence des jeunes au sein des systèmes éducatifs, ces différences montrent que des efforts accrus en faveur de l'insertion professionnelle des jeunes sont nécessaires et qu'il faut soutenir les carrières «non linéaires» alternant périodes d'emploi et d'études. Une entrée plus

#### Encadré — Évolution des rapports de dépendance

Selon les dernières projections démographiques, les rapports de dépendance des personnes âgées (population d'au moins 65 ans par rapport aux personnes ayant de 15 à 64 ans) vont plus que doubler entre 2005 et 2050 (passant de 24 à 51, soit une hausse de quelque 110%).

Selon les projections de 2005 du groupe de travail sur le vieillissement, le rapport de dépendance économique (population d'au moins 65 ans par rapport au nombre de personnes ayant un emploi) devrait augmenter d'environ 90% (et passer de 37 à 70), et cela malgré la hausse escomptée du taux global d'emploi, qui devrait atteindre 71% en 2050 — contre 63% actuellement. En d'autres termes, alors qu'on compte aujourd'hui quasiment trois travailleurs pour un retraité, en 2050, ce rapport ne serait que de 1,4 pour 1.

précoce dans la vie active permet une carrière professionnelle plus longue et l'acquisition de plus de droits à pension, ce qui profite au système de protection sociale, tant à l'échelon de la société qu'à celui de l'individu.

Ces dernières années, les taux d'emploi des travailleurs âgés ont augmenté, inversant ainsi une longue tendance à la baisse. De fait, ces taux sont passés de 36% en 1995 à 42% en 2004 pour l'Union des Quinze, et de 36% en 2000 à 41% en 2004 pour les vingt-cinq États membres de l'Union. Néanmoins, malgré ces récentes améliorations, ils se situent toujours aux alentours de 30%, voire en dessous, dans de nombreux États membres (Belgique, Italie, Luxembourg, Hongrie, Malte, Autriche, Pologne, Slovaquie), ou entre 30 et 45% (République tchèque, Allemagne, Grèce, Espagne, France); ils varient entre 45 et 55% dans certains d'entre eux (Estonie, Lettonie, Lituanie, Irlande, Chypre, Pays-Bas, Portugal, Finlande) et ne dépassent les 55% que dans de rares cas (Danemark, Suède, Royaume-Uni).

Quasiment tous les États membres ont introduit dans leurs réformes récentes des mesures incitant à prolonger la vie active (notamment au sein des régimes obligatoires) et réduit les possibilités de départ anticipé à la retraite. L'allongement de la carrière professionnelle est généralement favorisé par des compléments de pension et les départs en préretraite découragés par des réductions

actuarielles. En outre, une plus grande souplesse est prévue dans la planification du départ à la retraite, par exemple grâce à la combinaison de l'activité professionnelle et d'une retraite progressive. Par ailleurs, les régimes d'invalidité, de maladie et d'incapacité sont également réexaminés, le but étant d'exclure d'autres possibilités de sortie du marché du travail. Alors que les régimes à cotisations définies comportent par essence de puissantes incitations, il est parfois nécessaire d'adapter les règles d'ouverture des droits et certains paramètres des régimes à prestations définies (âge limite d'accès aux régimes de préretraite ou à d'autres régimes spécifiques, coefficients de bonus/malus, etc.).

De plus, comme l'ont montré les travaux du groupe «Indicateurs» sur les taux de remplacement, les réformes des régimes obligatoires mènent souvent à une baisse des taux personnels de remplacement mesurés à un âge donné, lors de la retraite. Cependant, de nombreux États membres ont prévu une acquisition plus favorable des droits à pension pour les personnes repoussant leur départ à la retraite, ce qui devrait avoir un effet incitatif.

Il reste à déterminer, et la question est cruciale pour l'avenir, si les réformes vont assez loin et encouragent suffisamment une prolongation de la vie active pour que les objectifs de Lisbonne concernant les taux d'emploi et le relèvement de l'âge réel de départ à la retraite soient atteints. Des différences importantes peuvent être observées d'un État membre à l'autre, selon la force des incitations prévues et la conception du régime de retraite concerné. Il semblerait donc que la structure de ces mesures d'incitation puisse être réexaminée dans plusieurs États membres. Certains devraient notamment se pencher encore sur la question des sorties précoces du marché du travail (soit avant l'âge normal de la retraite).

Les réformes prévoient pour les travailleurs de fortes incitations à retarder leur départ en retraite et, quand elles sont bien conçues, les récompensent par des niveaux adéquats de pension. Néanmoins, il faut veiller à ce qu'il soit effectivement possible de travailler plus longtemps, comme le souligne la ligne directrice intégrée n° 18 pour la croissance et l'emploi (favoriser une approche du travail fondée sur le cycle de vie). Conformément à l'analyse effectuée dans le premier rapport de la Commission sur les programmes nationaux de réforme, il est essentiel d'accélérer les réformes du marché du travail pour élargir les possibilités

d'emploi des travailleurs âgés (référence au rapport annuel de la Commission sur les progrès enregistrés dans la stratégie de Lisbonne). Les régimes de retraite peuvent faciliter un départ en retraite plus tardif, mais si les travailleurs âgés ne bénéficient pas d'un accès adéquat à des emplois appropriés, leurs réformes risquent fort de ne pas être particulièrement efficaces.

### **3.2.2. Concevoir une démarche pour la totalité du cycle de vie et établir une relation plus étroite entre cotisations et prestations, tout en garantissant un revenu de remplacement adéquat et en gérant la progression de la longévité**

L'équilibre et le lien entre cotisations et prestations, ainsi que la transparence de cette relation, sont importants, tant pour les régimes à prestations définies (courants parmi les régimes obligatoires par répartition) que pour ceux à cotisations définies, dont ils constituent l'un des éléments intrinsèques. Les réformes des régimes de retraite doivent apporter une réponse aux évolutions démographiques et, notamment, à l'accroissement de la longévité, facteur déterminant des futures augmentations des dépenses de retraites. Si cet accroissement de l'espérance de vie portait sur les années de la retraite, elle aboutirait, dans un régime financièrement équilibré, soit à une hausse des cotisations pour les salariés, soit à une baisse des pensions versées aux retraités. Néanmoins, ces années supplémentaires d'espérance de vie peuvent être partagées entre la période d'activité professionnelle et la retraite, ce qui induirait un meilleur équilibre entre les cotisations et les prestations. En réponse aux futurs allongements de l'espérance de vie, plusieurs réformes sont conçues pour stabiliser les régimes de retraite grâce à des mécanismes automatiques d'ajustement (Allemagne, Lettonie, Pologne, Finlande et Suède) ou à des révisions et adaptations requises périodiquement (France, Italie et Autriche). Ces ajustements favoriseront également une démarche fondée sur le cycle de vie.

Une relation trop lâche entre les cotisations versées et les prestations perçues peut aboutir à un manque d'équité et d'efficacité, tant au sein d'une même génération que d'une génération à l'autre. Les cotisations peuvent notamment être ressenties comme une mesure fiscale générale plutôt que comme un moyen d'acquérir des droits à pension. Réformer cet aspect des régimes de retraite parallèlement à d'autres systèmes de presta-



tions sociales pourrait favoriser la prolongation de la carrière professionnelle tout en portant un coup à l'économie souterraine.

Plusieurs réformes ont ainsi consolidé le lien prestations/cotisations des régimes de retraite. Les régimes par capitalisation et les régimes incluant des comptes notionnels établissent une corrélation étroite entre ces deux composantes. De même, cette relation a été renforcée dans de nombreux régimes à prestations définies. Premièrement, la durée d'assurance ouvrant droit à une retraite à taux plein a été allongée. Deuxièmement, le calcul de la pension à taux plein repose maintenant sur les rémunérations perçues pendant toute la vie active et non plus sur le salaire final, ce qui reflète plus exactement les cotisations versées sur l'ensemble de la carrière et non uniquement la progression salariale des dernières années. Troisièmement, l'application de réductions/majorations actuarielles pour les départs anticipés/différés à la retraite contribue aussi à forger une culture où la pré-retraite perd de son importance. Tel a notamment été le cas dans plusieurs États membres: Espagne, France, Italie, Autriche, Portugal, Pays-Bas et Finlande. Dans de nombreux autres États membres (Belgique, Allemagne, Estonie, Lettonie, Lituanie, Luxembourg, Hongrie, Pologne, Slovénie, Slovaquie et Suède), le lien prestations/cotisations avait été consolidé dans des réformes antérieures.

Néanmoins, cette corrélation plus étroite entre prestations et cotisations doit aller de pair avec un suivi attentif de l'acquisition des droits à pension lors des interruptions de carrière — périodes consacrées à l'éducation des enfants ou à la garde d'autres proches, périodes de chômage, congés de maladie ou d'éducation —, dans le but de garantir aussi bien un niveau adéquat de pension que l'équité du régime de retraite.

### **3.2.3. Moderniser les régimes de retraite en augmentant leur capacité d'adaptation aux changements structurels**

Les nouvelles structures du marché du travail requièrent des régimes de retraite adaptables. L'accroissement des taux d'activité et les mutations de la société font que de plus en plus de travailleurs n'ont pas la carrière type correspondant à un emploi à temps plein exercé pendant toute la vie active. Les interruptions de car-

rière et le travail à temps partiel deviennent plus fréquents, et il est également de plus en plus courant d'exercer une activité indépendante, au moins pendant une partie de sa carrière. Ces tendances exigent une adaptation des régimes de retraite encourageant l'activité et garantissant des droits à pension adéquats pour tous, même si la transparence de ces régimes doit en pâtir.

Les États membres ont commencé à réexaminer les modalités prévues pour les travailleurs aux parcours atypiques et les travailleurs indépendants afin de leur faciliter l'accès aux régimes obligatoires et complémentaires de retraite. À titre d'exemple, dans certains d'entre eux, notamment ceux ayant consolidé le lien entre cotisations et prestations, les contrats de travail de courte durée, le travail à temps partiel et les activités bénévoles permettent d'acquérir des droits à pension, de même que certaines interruptions de carrière ayant pour objet d'élever un enfant, de s'occuper d'une personne âgée ou de se former, et les périodes de chômage. La finalité de ces dispositions est qu'une activité à temps partiel ou des contrats à durée déterminée combinés à des périodes d'autres activités ou de chômage ne nuisent pas de manière disproportionnée à l'acquisition des droits à pension. Face à une tendance générale à la baisse des futures retraites dans les régimes par répartition, de nombreux États membres améliorent l'acquisition des droits à pension lors des périodes consacrées à l'éducation des enfants et introduisent des dispositions similaires pour la garde des personnes âgées. Les efforts de modernisation dans ce domaine semblent laborieux, l'explication étant peut-être qu'il est difficile de concilier des droits à pension acquis à l'origine grâce à un emploi salarié et le désir de reconnaître un travail non rémunéré.

La plupart des États membres éliminent progressivement la différence entre l'âge légal de départ à la retraite des hommes et des femmes. D'autres paraissent maintenir cet écart, au moins pour les deux prochaines décennies. Certains prévoient des départs anticipés à la retraite pour les femmes ayant des enfants. Il est à noter que la conception des pensions de réversion évolue puisque la pension traditionnelle de veuve devient de moins en moins fréquente, du fait de l'augmentation rapide de l'emploi des femmes.

De manière générale, les travailleurs changeant fréquemment d'employeurs sont mieux traités par les régimes

obligatoires, qui, pour beaucoup d'entre eux, tiennent désormais compte des contrats à durée déterminée; les régimes complémentaires (notamment ceux liés à une entreprise) peuvent en revanche désavantager les travailleurs plus mobiles par rapport aux salariés en contrat à durée indéterminée (l'acquisition des droits à pension étant notamment entravée par les périodes d'attente et de stage). Au vu de l'importance croissante des régimes complémentaires, certains États membres (Danemark, Allemagne, Pays-Bas et Royaume-Uni) ont amélioré les dispositions sur la portabilité des droits à pension complémentaire, qui peuvent poser un problème en cas de mobilité des travailleurs. De fait, celle-ci constitue et constituera à l'avenir une composante de plus en plus importante des marchés du travail. Afin d'établir un cadre général plus favorable à la portabilité des droits à pension complémentaire et d'accompagner les initiatives déjà entreprises par certains États membres dans ce sens, la Commission européenne a récemment adopté une proposition de directive sur la portabilité des droits.

### 3.2.4. Garantir des minima de pension et la solidarité

Certains États membres (Belgique, Espagne, Irlande, Italie et Portugal) ont répondu à la nécessité de fournir un revenu décent aux personnes âgées en prévoyant une augmentation des pensions minimales garanties supérieure à celle requise par les dispositions de l'indexation obligatoire. En 2003, le Royaume-Uni a introduit une prestation plus favorable liée au revenu (appelée «Pension Credit») afin d'encourager davantage l'épargne retraite.

L'une des questions soulevées par ces réformes des minima de pension et, plus généralement, des prestations minimales destinées aux personnes âgées a trait à leur effet sur les mesures favorisant l'acquisition des droits à pension. Il convient, à cet égard, d'étudier avec soin le lien entre prestations minimales, règles d'indexation et incitations.

Un autre enjeu consiste à déterminer si les pensions ou prestations minimales doivent être indexées différemment des pensions liées à la rémunération et, si tel est le cas, s'il peut y avoir des retombées inattendues sur la distribution des revenus parmi les retraités. L'évolution récente des régimes montre que de plus en plus de pays adoptent une indexation totale ou quasiment totale sur les prix, tant pour les pensions reposant sur le montant des rémunérations que pour les pensions

minimales. Cependant, l'indexation sur les prix des pensions minimales garanties se traduit habituellement par une revalorisation des revenus de leurs titulaires inférieure à l'évolution générale des revenus, ce qui peut induire un risque accru de pauvreté relative chez les retraités les plus âgés, et cela même si leur pouvoir d'achat est préservé. Pour éviter une accentuation de la pauvreté, les gouvernements sont souvent obligés d'adopter des mesures correctives discrétionnaires (ce qui va à l'encontre de l'établissement d'un régime pérenne, sûr et stable inspirant la confiance). En fait, cette question devrait être envisagée dans le contexte plus large de l'intégration des personnes âgées. Certains États membres abordent le problème en prévoyant un revenu minimal garanti et d'autres prestations en espèces et en nature, par exemple dans le domaine des services de soins et de garde, du logement et du transport.

### 3.2.5. Garantir des retraites privées complétant ou remplaçant partiellement l'offre du régime public

De nombreux États membres accordent une importance accrue aux régimes privés par capitalisation, qui peuvent contribuer à garantir un revenu adéquat pendant la retraite, et mettent l'accent sur le rôle positif d'un partage du risque démographique entre les régimes publics et privés. Le vieillissement de la population, notamment le départ à la retraite de la génération du baby-boom, exige d'accorder une attention minutieuse à la viabilité financière des régimes par répartition puisqu'il modifie considérablement le rapport de dépendance. Néanmoins, les régimes par capitalisation auront aussi à pâtir du vieillissement de la population.

Les RSN ont bien mieux abordé la question des pensions complémentaires que lors de l'exercice précédent. Plusieurs pays considèrent que les régimes privés ont un rôle à jouer dans l'organisation générale des retraites. Cette vision est traditionnellement celle de certains États membres comme le Danemark, les Pays-Bas et le Royaume-Uni. En outre, dans plusieurs États membres (Estonie, Lettonie, Lituanie, Hongrie, Pologne, Slovaquie et Suède), l'importance des retraites privées s'est accrue de façon décisive grâce à l'introduction, dans les régimes obligatoires, d'un volet fondé sur la capitalisation. Nombreux sont aussi les pays qui se sont dotés de dispositions supplémentaires sur des régimes professionnels ou privés complétant les retraites publiques (Allemagne, Italie et Autriche).

Cependant, comme l'a souligné l'étude du CPS sur les régimes privés de retraite, même si ces derniers devraient gagner du terrain au cours des décennies à venir, les régimes publics par répartition devraient, à de rares exceptions près, demeurer la principale source de revenu des retraités dans tous les États membres. Les États membres seront ainsi en mesure de maintenir une redistribution adéquate des revenus et le degré de solidarité requis pour que les personnes âgées disposent de ressources convenables et que le risque soit adéquatement partagé à l'échelon individuel. De toute façon, non seulement l'existence de pensions minimales garanties relève de la responsabilité de l'État, mais, partout, celles-ci sont prévues au sein des régimes publics de retraite. De plus, un recours plus large aux régimes privés n'autorise pas pour autant les pouvoirs publics à délaisser le secteur des retraites. Le contrôle et la réglementation des régimes privés de retraite constituent de plus en plus pour l'État une tâche importante et complexe. En outre, celui-ci devrait favoriser la transparence et la compétitivité des marchés pour les intermédiaires financiers.

Pour que les régimes privés de retraite assurent un revenu aux personnes âgées à faibles revenus, il est donc essentiel que les États membres investissent dans des structures garantissant la saine gestion de ces régimes. Certains États membres (République tchèque et Allemagne) prévoient des mesures relativement avantageuses pour que les personnes disposant de faibles revenus souscrivent à un régime privé de retraite; néanmoins, ces mesures pourraient être insuffisantes. C'est pourquoi, dans de nombreux États membres, un débat a été amorcé sur la nécessité de rendre l'épargne privée obligatoire, notamment quand les pensions reposent pour l'essentiel sur cette épargne privée (comme c'est le cas dans plusieurs nouveaux États membres). Dans la mesure où les retraites privées relèvent plus largement de régimes facultatifs, ce sont généralement les catégories de population aux revenus supérieurs qui y ont le plus souvent recours. Ce facteur pourrait accentuer les répercussions des réductions au niveau des taux de remplacement individuels dans les régimes obligatoires de retraite, surtout pour les retraités les plus âgés.

Il est important que les États membres surveillent l'évolution réelle des retraites privées et vérifient qu'elles répondent bien aux besoins, en évaluant les taux de couverture et de prestations ainsi que la distribution de ces dernières en fonction de l'âge et du statut

socio-économique. En outre, les régimes privés, comme les fonds de réserve des régimes par répartition, doivent garantir un niveau de sécurité et d'efficacité suffisamment élevé. Des règles définissant les risques acceptables en matière d'investissements et l'établissement d'hypothèses prudentes sur les rendements futurs constituent des garde-fous importants, pour autant que leur application soit assurée et contrôlée; par ailleurs, le souci d'efficacité impose de maintenir de faibles charges administratives.

Enfin, la transformation de comptes individuels en annuités sûres gagnera en importance, notamment dans les régimes mis en place récemment, qui fourniront leurs premières prestations d'ici à quelques années, souvent avant la fin de la décennie (Estonie, Lettonie, Lituanie, Hongrie, Pologne et Slovaquie).

### **3.2.6. Renforcer la gouvernance des régimes de retraite**

Les examens périodiques ou ad hoc, ainsi que les mécanismes automatiques ou semi-automatiques d'ajustement mentionnés au point 3.2.2, contribuent à une meilleure gouvernance des régimes de retraite. Certes, dans de nombreux cas, ils traitent des conséquences de la longévité, mais ils s'intéressent aussi à d'autres paramètres dont l'évolution influe sur les régimes de retraite, tels l'emploi et la croissance. Les RSN mettent l'accent sur l'établissement d'institutions indépendantes, chargées de contrôler les régimes de retraite. Ces examens montrent clairement qu'il faut équilibrer la durée de la vie active et de la retraite, le revenu de remplacement et le montant total des cotisations afin d'atteindre l'objectif fondamental qu'est le maintien de pensions adéquates et viables. La tendance observée est particulièrement intéressante puisqu'elle accroît la transparence générale des régimes de retraite et facilite une prise de décision plus consensuelle.

L'assouplissement des dispositions des régimes obligatoires relatives à l'âge de la retraite, l'instauration d'un lien plus étroit entre cotisations et prestations ainsi que le développement des retraites privées sont autant de mesures impliquant des décisions plus nombreuses et plus complexes de la part des futurs bénéficiaires.

Ainsi que le soulignent plusieurs États membres (Danemark, Irlande, Italie, Pays-Bas, Suède et Royaume-Uni), une telle tendance devrait s'accompagner d'une



information adéquate sur les niveaux des futures pensions et, plus généralement, d'une sensibilisation au problème des retraites et d'une meilleure compréhension des services financiers disponibles, même si une telle information a manifestement ses limites quand l'enjeu est de demander aux citoyens de prendre des

décisions personnelles complexes sur leur retraite. La plupart des rapports décrivent les efforts importants déployés pour informer l'opinion et clarifier les options financières existantes, et il est vrai qu'une information de qualité doit permettre de définir les droits des affiliés et des bénéficiaires.

## 4 Conclusion

### 4.1. Assurer en parallèle des régimes adéquats, viables et modernes

La deuxième série de RSN confirme que les trois principaux objectifs définis — adéquation des pensions, viabilité et modernisation des régimes — peuvent servir de référence aux stratégies de réforme, sans lesquelles l'Europe ne relèvera pas le défi des retraites.

Ces rapports mettent en lumière les corrélations unissant ces trois grands objectifs, leurs synergies et les arbitrages qu'ils imposent. La réussite des réformes passe par ces trois éléments, qui doivent être pris en compte en parallèle.

Il serait dangereux pour la société de ne pas concevoir une démarche intégrée associant des niveaux de pension adéquats à la viabilité des régimes. Des promesses intenables sur les futures pensions menaceraient la possibilité même de garantir des revenus adéquats lors de la retraite. Une augmentation insuffisante des pensions et l'octroi de faibles revenus (ou la réduction des prestations promises antérieurement) mettraient inopinément à rude épreuve les finances publiques, car une augmentation des demandes de réévaluation ad hoc des retraites et, éventuellement, la sollicitation non escomptée d'autres prestations sociales (même liées au revenu) peuvent se traduire par une hausse des dépenses publiques. De telles situations pourraient créer d'importants conflits liés à la crédibilité des régimes de retraite.

Il est important d'améliorer la transparence des régimes de retraite, aussi bien pour les individus (qui ont besoin d'être informés et d'y voir clair pour prendre des décisions sur le long terme) que pour les gouvernements (qui ont besoin d'outils de suivi pour la gestion dans le temps des régimes de retraite). L'introduction de mécanismes automatiques ou semi-automatiques facilitant le suivi périodique de diffé-

rentes sources d'incertitudes — notamment les tendances démographiques — est une caractéristique particulièrement intéressante des récentes réformes des régimes de retraite, car elle rend plus probable l'application de réformes mesurées au moment opportun.

### 4.2. La contribution des réformes des retraites à l'emploi et à la croissance

Comme le soulignent de nombreux RSN, toute réforme des retraites doit s'inscrire dans un projet plus large de société et de politique économique. La volonté manifestée par les États membres dans leur programme national de réforme peut être étayée par une refonte des régimes de retraite, tandis qu'une économie plus forte peut aussi se traduire par une amélioration de ces régimes. Si l'on veut atteindre les objectifs de Lisbonne en matière d'emploi tout en soutenant une croissance durable, et par là même préserver un haut niveau de protection sociale au sein de nos sociétés vieillissantes, il est vital d'encourager l'emploi des travailleurs âgés. La réforme des retraites, l'emploi et la croissance sont donc intimement liés.

Premièrement, le financement des retraites constitue un poste important des dépenses publiques dans la quasi-totalité des pays. Un régime public de retraite aux finances saines est essentiel à la viabilité des finances publiques dans leur ensemble, facteur qui, à son tour, dope la croissance et les performances économiques. Par ailleurs, le gain de compétitivité et de productivité résultant d'une mise en œuvre réussie de la stratégie de Lisbonne peut dégager la marge de manœuvre nécessaire à une réforme des régimes de retraite.

Deuxièmement, les régimes de retraite et les marchés du travail sont étroitement liés. Les premiers prévoient des incitations qui ont des effets sur l'activité des travailleurs

âgés, tandis qu'un niveau élevé d'emploi garantit à ces régimes un afflux massif de cotisations. Les cotisations nécessaires au financement des régimes de retraite influent également sur les coûts du travail et, en conséquence, sur la demande de main-d'œuvre. Un relèvement des taux de cotisation peut aboutir à une diminution de la demande de main-d'œuvre, tandis que des prestations trop généreuses sont susceptibles de réduire l'offre, autant de facteurs aggravant les déséquilibres du marché du travail. Tant les prestations que les cotisations doivent être appréciées au regard de leurs retombées sur le fonctionnement du marché du travail.

### 4.3. Les grands enjeux à suivre

Depuis 2003, de nombreux États membres se sont lancés dans des réformes importantes — souvent impopulaires — de leurs régimes de retraite. D'aucuns semblent avoir mis en place des réformes de fond, quelques uns ont redoublé d'efforts, d'autres n'ont pas encore dépassé le premier stade du processus. Ces derniers ont besoin de passer à la vitesse supérieure, tandis que la plupart des États membres devraient maintenir le rythme de leurs réformes.

Les points qui, au vu des RSN, méritent un suivi attentif sont les suivants:

- les réformes des régimes de retraite doivent continuer à favoriser un bon fonctionnement des marchés du travail; il faut pour cela corriger et renforcer les mesures incitant à prolonger la vie active et réexaminer aussi bien les taux de cotisation que les niveaux de prestation. La réforme du marché du travail doit aller de l'avant, ce qui implique un changement de culture dans les entreprises concernant le maintien en emploi et l'embauche des travailleurs âgés;
- les réformes doivent favoriser une adaptation des régimes — pour qu'ils puissent faire face à l'évolution de l'espérance de vie — et une prise en considération du cycle de vie dans leur conception;
- la modernisation doit mieux tenir compte des nouvelles formes d'emploi, des modalités flexibles de travail, des interruptions de carrière et des périodes de garde/de soins, et prévoir des systèmes permettant aux femmes d'acquérir leurs propres droits à pension;

- les mesures garantissant des minima de pension adéquats gagnent en importance, mais il faut définir avec soin les règles d'indexation et veiller à ne décourager ni l'emploi ni l'épargne;
- il convient de surveiller attentivement la viabilité financière des régimes publics de retraite et leurs retombées sur le budget de l'État, tout en prenant en considération les répercussions éventuelles des retraites privées sur les finances publiques; la dette publique devrait en outre être réduite afin que l'accroissement escompté des dépenses de l'assurance vieillesse puisse être mieux géré;
- les retraites privées peuvent compléter ou remplacer partiellement les retraites publiques et contribuer ainsi à un partage plus large du risque à l'échelon des individus, mais il faut veiller à garantir des régimes sûrs et équitables;
- il faut accroître la transparence, promouvoir une meilleure information de la population sur les retraites et mieux faire comprendre les problèmes en jeu;
- les mécanismes réguliers d'examen et d'ajustement constituent des innovations importantes, non seulement pour adapter les régimes au fil du temps, mais aussi pour favoriser une meilleure compréhension des réformes nécessaires face aux défis démographiques.

### 4.4. Les prochaines étapes dans le cadre de la méthode ouverte de coordination

La MOC sur les retraites s'est révélée être un outil efficace permettant à l'Union et aux États membres de faire progresser leur conception d'une réforme des régimes de retraite: des objectifs communs ont été définis, les progrès accomplis ont été examinés et un processus d'apprentissage a été encouragé. Telle que définie dans la communication de la Commission du 22 décembre 2005 intitulée «Travailler ensemble, travailler mieux: un nouveau cadre pour la coordination ouverte des politiques de protection sociale et d'inclusion sociale dans l'Union européenne», la nouvelle MOC, grâce à sa structure intégrée et son étroite corrélation avec la stratégie de Lisbonne pour la croissance et l'emploi, pourrait stimuler la volonté de réforme des États membres dans le domaine des retraites. Les actions à venir devraient s'orienter dans les deux directions suivantes:

- poursuivre le suivi global des progrès enregistrés dans la réalisation des objectifs communs, sans imposer aux États membres l'élaboration de rapports excessifs. Comme l'indique la communication de la Commission, les échéances seront alignées sur le cycle triennal de Lisbonne (2005-2008). Les États membres ne seront pas tenus de présenter une stratégie nationale au cours des années intermédiaires («allégées»). Durant celles-ci, la MOC se concentrera sur des analyses approfondies de certains sujets, sur la diffusion des résultats et sur l'évaluation d'indicateurs mesurant le chemin parcouru vers les objectifs communs;
- axer l'analyse stratégique et l'échange de bonnes pratiques sur des questions fondamentales. Les enjeux recensés dans le présent document montrent que, en plus des travaux actuellement menés sur les taux de remplacement, une action transversale pourrait porter à l'avenir sur les thèmes suivants:
  - la définition d'un revenu minimal pour les personnes âgées (prenant aussi en considération le lien entre les retraites et les autres prestations fournies aux retraités),
  - l'établissement d'une corrélation plus étroite entre cotisations et prestations (tenant compte des crédits non contributifs et de l'égalité des sexes),
  - la relation entre l'assouplissement des modalités de départ à la retraite et la prolongation de la vie active,
  - les principaux enjeux caractérisant le développement des retraites privées (cadre juridique performant, couverture inégale, sécurité, information, coûts de transition, contribution des régimes privés de retraite à la viabilité financière),
  - la conception de mécanismes réguliers d'examen et d'ajustement.

Ces travaux pourraient prendre la forme d'études ou de séminaires. La méthode de l'examen par les pairs, appliquée avec succès au sein du volet sur l'inclusion sociale, pourrait aussi être utilisée pour certains sujets prioritaires. Les résultats de ces actions pourraient être communiqués, selon des modalités à définir, au CPS et au CPE. Le CPS pourra envisager de présenter un rapport sur certaines de ces questions au Conseil et à la Commission. Ces deux méthodes de travail, les rapports nationaux et les études transversales servent à alimenter les futurs rapports conjoints sur la protection et l'inclusion sociales et garantissent une contribution pertinente de la MOC à la stratégie de Lisbonne pour la croissance et l'emploi.

## 1 Die Rentenherausforderung

Eine der größten Leistungen der Sozialpolitik in der zweiten Hälfte des letzten Jahrhunderts besteht darin, Altsein nicht mehr mit Armut oder wirtschaftlicher Abhängigkeit von den Kindern gleichsetzen zu müssen. Dies wurde hauptsächlich durch die staatliche Altersvorsorge erreicht.

Ohne die Errungenschaften der Rentensysteme schmälern zu wollen, ist darauf hinzuweisen, dass die Alterung der Bevölkerung und der daraus resultierende finanzielle Druck auf die Rentensysteme längst ein zentrales Thema der EU-Politik bilden. Kürzlich forderte der Europäische Rat auf seiner informellen Tagung in Hampton Court, Europa müsse sich intensiver mit den Auswirkungen der demografischen Entwicklung auf die Wirtschafts- und Sozialpolitik auseinandersetzen. In ihrem ersten Jahresfortschrittsbericht „Jetzt aufs Tempo drücken“ vom 25. Januar 2006 zeigte die Kommission zwei Bereiche auf, in denen in Europa Handlungsbedarf besteht: die Globalisierung und die Alterung der Bevölkerung, und darunter insbesondere die Reform der staatlichen Rentensysteme. Wie bereits aus dem Gemeinsamen Bericht der Kommission und des Rates über angemessene und nachhaltige Renten aus dem Jahr 2003 hervorgeht, gilt es, zur Sicherung der Renten in einer alternden Gesellschaft vor allem das effektive Renteneintrittsalter weiter anzuheben. Während es in den 60er Jahren üblich war, erst weit nach dem 60. Lebensjahr in Rente zu gehen, ging in den 70er und 80er Jahren in vielen Ländern die Beschäftigung älterer Arbeitskräfte zurück. Erst in jüngster Zeit ist erneut ein Anstieg zu verzeichnen, jedoch liegt das durchschnittliche Erwerbsaustrittsalter nach wie vor weit unter dem Niveau der späten 60er Jahre.

Der Rückgang des durchschnittlichen effektiven Renteneintrittsalters (in Verbindung mit der Erhöhung des Erwerbseintrittsalters) läuft dem beträchtlichen Anstieg der Lebenserwartung zuwider. Die Lebenserwartung ab 60 erhöhte sich in der EU-25 zwischen 1960 und 2000 um 4 Jahre (von 15,8 Jahren auf 19,3 Jahre für Männer und von 19 Jahren auf 23,6 Jahre für Frauen). Den jüngsten Eurostat-Prognosen zufolge wird in der EU-25 die Lebenserwartung der 65-Jährigen im Zeitraum 2004-2050 um weitere 4 Jahre steigen (um 4,4

Jahre bei den Männern und um 3,9 Jahre bei den Frauen). Selbst angesichts der günstigen demografischen Entwicklung in der zweiten Hälfte des 20. Jahrhunderts, d. h. einer Zunahme der Erwerbsbevölkerung, musste dennoch die Erhöhung der Lebenserwartung zum Teil durch eine Anhebung der Beitragssätze aufgefangen werden.

Es ist somit festzustellen, dass die Abnahme der Rentenbeitragsjahre in Verbindung mit der Zunahme der Rentenbezugsjahre Druck auf die Rentenfinanzierung ausübt. Reformen werden unerlässlich, um die Entwicklungen der Vergangenheit – den Rückgang des effektiven Renteneintrittsalters sowie die Erhöhung der Abhängigkeitsquote – auszugleichen und Vorkehrungen für den Übergang ins Rentenzeitalter der Baby-Boom-Generation und den künftigen weiteren Anstieg der Lebenserwartung zu treffen.

Die Rentenreformen erfordern langfristig angelegte Strategien. Der Reformprozess an sich ist langwierig und Rentenreformen beruhen gewöhnlich auf einem breiten Konsens, weil sie ein grundlegender Bestandteil unserer Sozialschutzsysteme mit erheblichen Auswirkungen auf den sozialen Zusammenhalt sind. Der Staat gibt beträchtliche Summen für die Alterssicherung aus – Ausgaben, die, bedingt durch die demografische Entwicklung, weiterhin deutlich steigen müssen. Die Modernisierung der Rentensysteme sollte somit in einem doppelten Kontext betrachtet werden: im Kontext der Sicherung angemessener und nachhaltiger Renten sowie in dem der Tragfähigkeit der öffentlichen Finanzen insgesamt und des nachhaltigen Wachstums in der gesamten EU.

Auf seiner Tagung in Stockholm legte der Europäische Rat eine dreigleisige Strategie vor, um die haushaltspolitischen Auswirkungen der Alterung der Bevölkerung in den Griff zu bekommen:

- Die Mitgliedstaaten sollten den Abbau der öffentlichen Schulden beschleunigen.
- Die Mitgliedstaaten sollten umfangreiche Arbeitsmarktreformen, darunter im Bereich der Steuer- und

Sozialleistungssysteme, durchführen, um die Beschäftigungsquoten, vor allem bei älteren Arbeitskräften und bei Frauen, anzuheben.

- Die Mitgliedstaaten sollten angemessene Rentensystemreformen umsetzen, um den Druck von den öffentlichen Haushalten zu nehmen, den Rentensystemen eine solide finanzielle Grundlage zu sichern und für Generationengerechtigkeit zu sorgen.

Die Altersvorsorge ist in nahezu allen Mitgliedstaaten größtenteils Aufgabe des Staates und belastet somit in erheblichem Maße die öffentlichen Haushalte. Es muss sichergestellt werden, dass die durch die Alterung der Bevölkerung bedingte Zunahme der staatlichen Rentenausgaben die Tragfähigkeit der öffentlichen Finanzen nicht untergräbt. Ferner müssen angemessene Strategien entwickelt werden, damit die langfristigen Rentenverpflichtungen eingelöst werden können. Ein solides Management der öffentlichen Finanzen könnte für das Abfedern des aufgrund der Alterung der Bevölkerung entstehenden Drucks auf die Haushalte Handlungsspielraum schaffen.

Es gibt gute Gründe, wie vor allem Gleichbehandlung und Effizienz, staatliche Interventionen im Bereich der Renten vorzusehen, sei es in Bezug auf die Versorgungsleistungen, die Finanzierung oder auch die Regulierung. Diese gehen insbesondere mit grundle-

genden sozialpolitischen Zielen, wie z. B. dem Ziel der Sicherung eines angemessenen Alterseinkommens, einher. Die Weichen für die künftige langfristige Entwicklung müssen ungeachtet der Unvorhersehbarkeit der wirtschaftlichen und sozialen Trends heute gestellt werden. Auf individueller Ebene die richtigen Entscheidungen zu treffen, wäre äußerst schwierig. Die voraussichtliche Folge wäre eine Unterversorgung der meisten Menschen, insbesondere der geringer Verdienenden oder derjenigen, die nicht langfristig finanziell planen können. Selbst private Versicherungen tun sich schwer, die Unwägbarkeiten langfristiger Verpflichtungen zu beherrschen. Die Rentensysteme, die alle Beschäftigten erfassen, sind am ehesten geeignet, Unwägbarkeiten in Bezug auf die langfristige Verpflichtung, ein angemessenes Alterseinkommen zu garantieren, aufzufangen.

Staatliche Leistungen sind eine zentrale Komponente der nationalen Rentensysteme, die in den Ländern der EU-25 sehr unterschiedlich gestaltet sind. Aufgrund dieser Vielfalt gibt es keine Patentlösung. Die grundlegenden Ziele Zugang, Angemessenheit und finanzielle Tragfähigkeit gelten zwar für alle Systeme, jedoch bestehen infolge der unterschiedlichen historischen Entwicklungen und aufgrund der unterschiedlichen Präferenzen in Bezug auf die Umverteilung bzw. Wahlfreiheit des Einzelnen erhebliche Unterschiede in der Gestaltung der Systeme auf nationaler Ebene.

## 2 Die Offene Methode der Koordinierung im Rentenbereich im Kontext der Lissabon-Strategie

Der Europäische Rat erklärte auf seiner Tagung in Laeken im Dezember 2001, dass die Intensivierung des Dialogs und der Zusammenarbeit bei der Reform der Rentensysteme erheblichen Nutzen bringen könnte. Der Rat sprach sich für gemeinsame Zielvorgaben – Angemessenheit, finanzielle Tragfähigkeit und Anpassungsfähigkeit – sowie für ein Arbeitsverfahren auf Basis der Offenen Methode der Koordinierung (im Folgenden OMK) aus.

In den ersten nationalen Strategieberichten (NSB), die im Jahr 2002 ausgearbeitet wurden, präsentierten die 15 Mitgliedstaaten ihre Herangehensweise an die Verwirklichung dieser Ziele. Auf der Grundlage dieser

NSB erstellten und verabschiedeten Kommission und Rat im März 2003 einen Gemeinsamen Bericht über angemessene und nachhaltige Renten.

Im Gemeinsamen Bericht 2003 heißt es schlussfolgernd: „Die meisten Mitgliedstaaten sehen die Rentenreform jedoch als einen kontinuierlichen Prozess, nicht als eine einmalige, gesonderte Aktion. [...] Die Schwungkraft des Reformprozesses zur Sicherung angemessener, nachhaltiger Renten muss beibehalten werden.“

Als Reaktion auf den Gemeinsamen Bericht forderte der Europäische Rat im März 2003 die Mitgliedstaaten

auf, die Reformanstrengungen fortzusetzen und die OMK im Bereich Renten weiterhin anzuwenden. Der Rat forderte für 2006 die Vorlage eines Fortschrittsberichts, der die neuen Mitgliedstaaten einbeziehen sollte. Der Kommissionsvorschlag für einen Gemeinsamen Bericht über Sozialschutz und soziale Eingliederung 2006 wird dieser Forderung gerecht.

Im Jahr 2005 schlug die Kommission eine Revision der Lissabon-Strategie für Wachstum und Beschäftigung und der Integrierten Leitlinien<sup>(3)</sup> vor. Der Rat billigte diesen Vorschlag. Die OMK in den Bereichen Sozialschutz und soziale Eingliederung soll demzufolge in die Lissabon-Strategie eingegliedert werden. Die Kommission strebt darüber hinaus an, durch eine Straffung der OMK in den Bereichen Renten, soziale Eingliederung, Gesundheitsversorgung und Langzeitpflege, beginnend mit dem Jahr 2006, die Koordination im Bereich Sozialschutz auf EU-Ebene effizienter zu gestalten. Ziel ist eine solidere, sichtbarere OMK mit einer stärkeren Fokussierung auf die Modernisierung und Umsetzung der Politik und einer positiven Interaktion mit der revidierten Lissabon-Strategie bei gleich-

zeitiger Vereinfachung der Berichterstattung und Intensivierung des politischen Austauschs.

Die gesonderte OMK-Berichterstattung wird parallel zu den nationalen Reformprogrammen der Mitgliedstaaten, die einen Gesamtüberblick über die zur Realisierung der Wachstums- und Beschäftigungsziele beitragenden Reformen geben, fortgesetzt. Gleichmaßen wird die Berichterstattung auf EU-Ebene mittels des Gemeinsamen Berichts über Sozialschutz und soziale Eingliederung in den jährlichen EU-Fortschrittsbericht einfließen.

In diesem Rahmen liefert das vorliegende Dokument die erforderliche Analyse zu den Rentenaspekten des Gesamtberichts über soziale Eingliederung und Sozialschutz 2006. Zu diesem Zweck legten die Mitgliedstaaten im Sommer 2005 ihre zweiten NSB vor. Die NSB wurden Mitte September 2005 unter Mitwirkung des Ausschusses für Sozialschutz und des Ausschusses für Wirtschaftspolitik einem Peer Review unterzogen. Der vorliegende Bericht ist eine Synthese des zweiten Berichtszyklus.

### 3 Die wichtigsten Lehren aus der zweiten Phase der Anwendung der offenen Methode der Koordinierung im Rentenbereich

#### 3.1 Die wichtigsten Entwicklungen im Bereich der Rentenreformen in den Mitgliedstaaten

Der Gemeinsame Bericht 2003 über angemessene und nachhaltige Renten unterstrich die Wechselwirkung zwischen finanzieller Tragfähigkeit und Angemessenheit der Renten im Kontext der Alterung der Bevölkerung und die Notwendigkeit umfassender Reformen mit dem Ziel, die Rentensysteme angemessen, zugänglich und finanziell tragfähig zu machen. Insbesondere wurden im Gemeinsamen Bericht die Mitgliedstaaten aufgefordert, stärkere Anreize für ältere Arbeitskräfte zur Verlängerung des Arbeitslebens zu

schaffen, Beiträge und Leistungen stärker aneinander zu koppeln und in Anbetracht der langfristigen Auswirkungen der steigenden Lebenserwartung auf die Rentenausgaben dafür zu sorgen, dass mehr private und öffentliche Mittel in die Altersvorsorge fließen.

Im Jahr 2050 wird die europäische Bevölkerung etwas abnehmen, dafür aber deutlich älter sein. Auf einen älteren Bürger werden nur noch zwei Arbeitskräfte kommen, während zurzeit das Verhältnis noch eins zu vier beträgt. Neuere, langfristige Prognosen zeigen, dass die wachsenden Rentenkosten in den meisten Mitgliedstaaten einen erheblichen Anstieg der öffentlichen Ausgaben bis zum Jahr 2050 zur Folge haben werden. Aufgrund des derzeitigen Standes der Politik

(3) Siehe insbesondere Leitlinie 2: „Die Mitgliedstaaten sollten [...] die Renten- und Gesundheitssysteme so reformieren, dass sie finanziell tragfähig sind – unter Wahrung der sozialen Angemessenheit und der Zugänglichkeit –, und die Beschäftigungsquoten und das Arbeitskräfteangebot erhöhen.“ Siehe auch Leitlinie 18: „Einen lebenszyklusbasierten Ansatz in der Beschäftigungspolitik fördern durch [...] Schaffung moderner Renten- und Gesundheitssysteme, die angemessen und finanziell tragfähig sind und sich an wandelnde Erfordernisse anpassen, um auf diese Weise die Erwerbsbeteiligung und die Verlängerung des Erwerbslebens zu fördern, einschließlich positiver Arbeitsanreize und Beseitigung frühverrentungsfördernder Negativanreize.“



wird für die EU-25 eine Erhöhung der öffentlichen Rentenausgaben um durchschnittlich 2,2 Prozentpunkte, bei einer breiten Streuung zwischen den Mitgliedstaaten, prognostiziert.

Bei der Reform der Rentensysteme sind seit dem Gemeinsamen Bericht 2003 erhebliche Fortschritte erzielt worden. Die Rentensysteme sind in den Mitgliedstaaten auch Gegenstand der nationalen Reformprogramme, die im Jahresfortschrittsbericht der Kommission bewertet werden. Negativanreize für eine Verlängerung des Arbeitslebens werden abgebaut und positive Anreize gestärkt, Beiträge und Leistungen werden enger aneinander gekoppelt und der Lebenserwartung wird in den Rentensystemen stärker Rechnung getragen. Darüber hinaus werden Zusatzrenten gefördert und der Rechtsrahmen verbessert. Einige Mitgliedstaaten bekämpfen die Altersarmut durch die Anhebung der garantierten Mindestrenten. Reformanstrengungen wurden für alle drei Schlüsselziele unternommen, die da lauten: ein angemessenes Renteneinkommen garantieren, die finanzielle Tragfähigkeit sichern und die Systeme an veränderte Bedingungen auf dem Arbeitsmarkt und in der Gesellschaft anpassen.

Einige Mitgliedstaaten sind dabei, umfassende Reformpakete umzusetzen. **Deutschland** hat ergänzend zu den Reformen im Jahr 2001 [die den Anstieg des Rentenniveaus der ersten Säule bremsen und die staatlich unterstützte kapitalgedeckte (freiwillige) Altersvorsorge der zweiten und dritten Säule begründeten] und im Rahmen des Nachhaltigkeitsgesetzes 2004 die Beitragssätze und die Höhe der Versorgungsleistungen einander angepasst. Außerdem wurde in die Rentenindexformel ein Nachhaltigkeitsfaktor eingebaut, der zusätzliche Anpassungen erforderlich macht, wenn sich das Zahlenverhältnis zwischen Beitragszahlern und Leistungsbeziehern verschlechtert. In **Frankreich** konnte die Reform im Jahr 2003 durch eine Anhebung der bis zum vollen Rentenanspruch zurückzulegenden Beitragsjahre (der künftige Anstieg der Lebenserwartung wird weitere Anhebungen nach sich ziehen) sowie durch stärkere Anreize für eine Verlängerung des Arbeitslebens die langfristige Nachhaltigkeit verbessern. Fortschritte wurden auch in der Gleichbehandlung von staatlichen und privaten Systemen erzielt. In **Österreich** wurde durch eine stärkere Kopplung von Beiträgen und Leistungen und eine Anhebung der bis zum vollen Rentenanspruch erforderlichen Beitragsjahre mit den Reformen im Jahr 2004 und 2005 ein wichtiger Schritt in Richtung eines nachhaltigeren Rentensystems getan. Durch ein so genanntes Bonus-

Malus-System wurden Anreize zur Verlängerung des Arbeitslebens verstärkt und Anreize für den früheren Renteneintritt abgebaut. Außerdem wurden die Rentensysteme im öffentlichen und im privaten Sektor viel stärker als bisher aneinander angepasst und im Jahr 2006 die Renten an den Preisindex gekoppelt. Die zum Großteil in den Jahren 2003 bis 2005 durchgeführte **finnische** Rentenreform schaffte durch höhere Steigerungsraten bei den Rentenansprüchen älterer Arbeitskräfte und eine Korrektur der Regelungen für den früheren Renteneintritt Anreize zur Aufnahme einer Erwerbstätigkeit. Ferner soll zur Anpassung künftiger Renten an die gestiegene Lebenserwartung ein „Lebenszeitkoeffizient“ eingeführt werden. **Litauen** (2004) und die **Slowakei** (2005) haben in ihrem sozialen Sicherungssystem eine kapitalgedeckte Komponente eingeführt, die auf lange Sicht die Nachhaltigkeit des gesetzlichen umlagefinanzierten Rentensystems stärken wird und es möglich macht, zusätzliche Rentenansprüche im Rahmen privater Altersvorsorgefonds zu erwerben.

Was betriebliche und private Rentensysteme angeht, so wurde der Rechtsrahmen insbesondere in **den Niederlanden** und dem Vereinigten Königreich verbessert. In den Niederlanden wurden im Jahr 2004 die Grundprinzipien für neue Leitlinien zur Bewertung der Finanzlage von Zusatzrentensystemen festgelegt. Darin werden die Auflagen, insbesondere zur Höhe der Rücklagen privater Rentenversicherungen auf Basis tariflicher Vereinbarungen, verschärft und Vorgaben zum Break-Even-Beitragssatz und den Verpflichtungen in Bezug auf die Indexierung, Finanzierung und Unterrichtung gemacht. Im Vereinigten **Königreich** wird die private Altersvorsorge durch eine gestraffte und vereinfachte Rentenregelung (überwacht von der neuen Rentenaufsichtsbehörde), eine vereinfachte Steuerregelung für Rentenfonds und einen effizienteren Schutz für Systeme, die auf einer Leistungsbemessung auf Grundlage des letzten Arbeitsentgelts basieren (Einrichtung des Rentenschutzfonds), gefördert.

Andere Mitgliedstaaten haben die Anpassung ihrer Systeme fortgesetzt. So haben z. B. **Belgien, Irland, Portugal** und **Spanien** das Niveau der garantierten Mindestrente über die gesetzlichen Indexerhöhungen hinaus angehoben, während das **Vereinigte Königreich** den Rentenzuschuss („Pension Credit“) eingeführt hat. **Portugal** hat die Anreize zur Verlängerung des Arbeitslebens erhöht und die Gleichbehandlung zwischen den verschiedenen Systemen gefördert. Eine Reihe weiterer Staaten hat Anreize zur Verlängerung

des Erwerbslebens geschaffen, darunter **Luxemburg**, **die Niederlande** (Steuervorteile bei früherem Renteneintritt wurden abgebaut und im Jahr 2006 wird eine innovative „Lebensverlaufregelung“ eingeführt, die bisherige Regelungen über den früheren Renteneintritt ersetzt) und **Italien** (in der Reform 2004 ist eine allmähliche Anhebung des Mindestrentenalters geplant). In **Dänemark** wird geplant, in Tarifverträgen die Beitragsätze anzuheben. **Schweden** hat das Informationsangebot durch die Einrichtung eines allgemein zugänglichen Rentenportals im Internet erweitert.

Die neuen Mitgliedstaaten wurden im Gemeinsamen Bericht 2003 über angemessene und nachhaltige Renten nicht berücksichtigt. Die meisten mittel- und osteuropäischen Mitgliedstaaten haben ihre Rentensysteme in den 90er Jahren umfassend reformiert. Eine neue Rentenarchitektur wurde geschaffen: eine Kombination von staatlichem Umlagesystem und privater kapitalgedeckter Vorsorge, die für Personen unterhalb eines bestimmten Alters obligatorisch und für ältere Menschen freiwillig ist. Dabei wurde das alte System für diejenigen beibehalten, die es ablehnten oder nicht verpflichtet waren, dem neuen System beizutreten. Private Vorsorge ist für die Neuzugänge auf dem Arbeitsmarkt in **Estland**, **Lettland**, **Polen**, **Ungarn** und **der Slowakei** obligatorisch, in **Litauen** freiwillig. Darüber hinaus wurde in **Lettland** und **Polen** das staatliche Umlagesystem in ein nominelles System mit Beitragszusage umgewandelt (NDC = notional defined-contribution). In verschiedenen Mitgliedstaaten wurden Sachverständigengruppen mit einer eingehenden Überprüfung des Rentensystems beauftragt oder es wurde eine derartige Überprüfung im Rahmen des sozialen Dialogs vorgenommen. Einige Rentengesetze machen regelmäßige Überprüfungen zur Voraussetzung für weitere Schritte im Reformprozess. So hat **Spanien** den Toledo-Pakt erneuert und damit die Bedeutung eines Dialogs mit den sozialen und wirtschaftlichen Partnern beim Monitoring gegenwärtiger und künftiger Reformmaßnahmen unterstrichen. Das Parlament überprüft alle fünf Jahre die erzielten Fortschritte und die geplanten Reformmaßnahmen. Spanien beabsichtigt, eine ständige Beobachtungsstelle mit dem Ziel einzurichten, die Entwicklung der sozialen Sicherungssysteme zu verfolgen, die Analysen vorzunehmen und Vorschläge für erforderliche Änderungen zu unterbreiten. Der Rentenausschuss im **Vereinigten Königreich** (dessen Vorsitz Lord Turner führt) hat in seinem zweiten, Ende November 2005 veröffentlichten Bericht Reformempfehlungen abgegeben. Die Regierung hat bestätigt, diese und weitere Empfehlungen zu prüfen, bevor sie im Frühjahr

2006 ihre Vorschläge vorlegt. In der **Tschechischen Republik** wurden bei der Reform des Rentensystems bestimmte Parameter, z. B. das Rentenalter und die Beitragsjahre, angepasst, andere aber unverändert gelassen (Rentenalter im Verhältnis zur Anzahl der Kinder, beitragsfreie Zeiten). Diese Systemmerkmale wurden in einem Mehrparteien-Sachverständigenausschuss geprüft, der sich für weitere Reformen ausspricht. Alle relevanten Akteure haben sich dazu verpflichtet, vor Beginn des nächsten Wahlkampfs im Jahr 2006 diese Empfehlungen in Rechtsvorschriften umzusetzen. **Malta** hat ein Weißbuch über die Rentenreformstrategie veröffentlicht, das gegenwärtig diskutiert wird. In **Dänemark** hat die Regierung einen Ausschuss eingesetzt und damit beauftragt, vor Ende 2005 konkrete Vorschläge zur Reform des dänischen Wohlfahrtsmodells, einschließlich der Renten und insbesondere der Regelungen über den früheren Renteneintritt, zu unterbreiten. Basierend auf der Analyse des Ausschusses und mit der Absicht, die langfristigen Wirtschaftsziele fortzuschreiben, wird die Regierung im Frühjahr 2006 einen neuen wirtschaftlichen Mehrjahresplan vorlegen, der mindestens den Zeitraum bis 2015 abdeckt. In **Irland** wird der Rentenausschuss voraussichtlich Ende 2005 seine Wertung des Rentensystems mit Vorschlägen für Reformmaßnahmen vorlegen. Man rechnet insbesondere mit Vorschlägen zur Förderung von Betriebsrenten. Auch in **Deutschland**, **Frankreich** und **Österreich** ist vorgesehen, die Entwicklung des Rentensystems einer regelmäßigen Überprüfung zu unterziehen.

### 3.2 Aus den nationalen Strategieberichten abzuleitende Kernpunkte

Die OMK im Bereich Renten basiert auf 11 Einzelzielen, die den Kategorien Angemessenheit, Nachhaltigkeit und Modernisierung zuzuordnen sind. Die detaillierte Analyse der bei der Verwirklichung dieser Ziele erzielten Fortschritte, wie sie den im zweiten NSB-Zyklus vorgelegten Berichten zu entnehmen sind, befindet sich im technischen Anhang. In einigen NSB (BE, DK, NL) wird auch darauf verwiesen, dass der Abbau der öffentlichen Verschuldung zur Nachhaltigkeit der Renten beiträgt: Er macht Mittel für die Rentensysteme frei und schafft dadurch einen Handlungsspielraum.

- Vier bereits im Gemeinsamen Bericht 2003 über angemessene und nachhaltige Renten hervorgehobene Aktionsschwerpunkte bleiben bestehen:



- Verstärkung der Anreize für eine Verlängerung des Arbeitslebens.
- Entwicklung eines den gesamten Lebenszyklus umfassenden Ansatzes und verstärkte Kopplung von Beiträgen und Leistungen unter Wahrung eines angemessenen Einkommensersatzes und Einbeziehung der durch die höhere Lebenserwartung bedingten Zwänge.
- Gestaltung der Rentensysteme mit dem Ziel, sie leichter den strukturellen Veränderungen anpassen zu können.
- Stärkung des Stellenwerts der Mindestrenten und der Solidarität in den Rentensystemen.

Zwei weitere Aspekte haben im Zuge jüngster Reformen an Bedeutung gewonnen:

- Die private Altersvorsorge soll die staatliche Vorsorge ergänzen und zum Teil ersetzen.
- Die Verbesserung der Governance der Rentensysteme.

### 3.2.1 Stärkere Anreize zur Verlängerung des Arbeitslebens

Wie bereits im Gemeinsamen Bericht 2003 hervorgehoben, ist es unerlässlich, dass die Menschen länger arbeiten. In einigen Ländern ist allerdings genauso wichtig, dass sie früher in den Arbeitsmarkt eintreten. Die Verlängerung des Arbeitslebens ist als Ziel im Lisbon-Prozess festgeschrieben. Dieses spiegelt sich wiederum in den folgenden beiden Teilzielen wider: Erhöhung der Beschäftigungsquote der älteren Arbeitskräfte (55- bis 64-Jährigen) auf 50 % sowie Anhebung des effektiven Erwerbsaustrittsalters um 5 Jahre. Eine Verlängerung des Arbeitslebens ist gleichbedeutend mit mehr Beitragsjahren und weniger Bezugsjahren, was unmittelbar zur Angemessenheit und Nachhaltigkeit der Rentensysteme beiträgt. Die Komponente der Versorgungsleistung macht die Rentensysteme zu einem wichtigen Element der Arbeitsmarktstruktur. Deshalb ist von größter Bedeutung, dass das Rentensystem der Beschäftigung förderliche Anreize beinhaltet.

Die Beschäftigungsquote der jungen Menschen (15- bis 24-Jährigen) in der EU beträgt gegenwärtig durchschnittlich 37% bei einer Spanne zwischen den Mitgliedstaaten von 20% bis 60%. Auch wenn die EU

### Kasten – Entwicklung der Abhängigkeitsquoten

Den jüngsten demografischen Prognosen zufolge werden sich die Altersabhängigkeitsquoten (Population der 65-Jährigen und Älteren im Verhältnis zu den 15- bis 64-Jährigen) im Zeitraum 2005-2050 mehr als verdoppeln (von 24 auf 51, was einem Anstieg um etwa 110 % entspricht).

Die wirtschaftliche Abhängigkeitsquote (Population der 65-Jährigen und Älteren im Verhältnis zur Zahl der Beschäftigten) wird den Schätzungen 2005 der Arbeitsgruppe „Alterung“ zufolge sich selbst dann um etwa 90 % (von 37 auf 70) erhöhen, wenn man von einem Anstieg der Gesamtbeschäftigungsquote von gegenwärtig 63 % auf 71 % bis zum Jahr 2050 ausgeht. Konkret bedeutet dies Folgendes: Während gegenwärtig noch drei Erwerbstätige auf einen Rentner kommen, werden es im Jahr 2050 nur noch 1,4 Erwerbstätige sein.

ausdrücklich das Ziel anstrebt, die Bildungsbeteiligungsquoten anzuheben, so legen diese Unterschiede doch nahe, dass es gilt, junge Menschen stärker in den Arbeitsmarkt zu integrieren und sie gegebenenfalls bei einer nicht linearen Berufsentwicklung – d. h. einem Wechsel zwischen Beschäftigung und Studium – zu unterstützen. Ein früherer Eintritt ins Erwerbsleben trägt dazu bei, dass sich das Arbeitsleben verlängert und höhere Rentenansprüche erworben werden, was letztlich sowohl den gesamtgesellschaftlichen als auch den individuellen Wohlstand steigert.

Die Beschäftigungsquote der älteren Menschen hat sich in jüngster Zeit erhöht, d. h., ein lang anhaltender entgegengesetzter Trend wurde umgekehrt. In konkreten Zahlen ausgedrückt bedeutet dies, dass sich die Beschäftigungsquote der älteren Menschen in der EU-15 von 36 % 1995 auf 42 % 2004 und in der EU-25 von 36 % im Jahr 2000 auf 41 % 2004 erhöht hat. Dessen ungeachtet liegt in einer Reihe von Mitgliedstaaten die Beschäftigungsquote der älteren Arbeitskräfte bei oder unter 30 % (AT, BE, IT, LU, HU, MT, PL, SI, SK). Zwischen 30 % und 45 % liegt sie in CZ, DE, EL, ES, FR und zwischen 45 % und 55 % in CY, EE, FI, IE, LV, LT, NL, PT. Nur in DK, SE und UK liegt sie über 55 %.

In nahezu allen Mitgliedstaaten haben jüngste Reformen die Anreize zur Verlängerung des Arbeitslebens

verstärkt (besonders in den gesetzlichen Systemen) und die Frühverrentung eingedämmt. Im Allgemeinen wird die Verlängerung des Erwerbslebens durch Rentenzuschläge „belohnt“ und die Frühverrentung durch versicherungsmathematische Abschläge „bestraft“. Außerdem wird eine größere Flexibilität in Bezug auf den Verrentungszeitpunkt, z. B. durch Altersteilzeit, eingeführt. Darüber hinaus werden die Regelungen zur Anerkennung von Behinderungen, Krankheiten und Berufsunfähigkeit verschärft, um den Zugang zu anderen Frühverrentungspfaden zu erschweren. Während in beitragsdefinierten Systemen wirksame Anreize bereits eingebaut sind, könnte es bei leistungsdefinierten Systemen erforderlich sein, die Anspruchsberechtigung und die Rentenparameter anzupassen (z. B. Altersbegrenzung bei Frührenten oder Sonderrenten, Bonus-/Malus-Koeffizienten usw.).

Ferner haben die Reformen der gesetzlichen Systeme, wie den Arbeiten der Untergruppe „Indikatoren“ über Ersatzquoten zu entnehmen ist, vielfach zu einer Abnahme der individuellen Ersatzquote bei einem gegebenen Verrentungsalter geführt. Jedoch haben viele Mitgliedstaaten die Steigerungssätze bei Verlängerung des Erwerbslebens erhöht, was als Anreiz für eine spätere Verrentung wirken dürfte.

Entscheidend für die künftige Entwicklung ist, dass die Reformen ausreichende Anreize zur Verlängerung des Erwerbslebens generieren, d. h., dass sie die Voraussetzungen dafür schaffen, dass die Lissabon-Ziele – Anhebung der Beschäftigungsquoten und des effektiven Renteneintrittsalters – realisiert werden. In Abhängigkeit davon, wie ausgeprägt die rentensystembedingten Anreize zur Verlängerung des Erwerbslebens sind, lassen sich erhebliche Unterschiede zwischen den Mitgliedstaaten feststellen. Dies legt nahe, dass in einer Reihe von Ländern die Anreizstruktur noch verbessert werden könnte. Besondere Aufmerksamkeit muss dabei in einigen Mitgliedstaaten den noch bestehenden Frühverrentungspfaden (Verrentung vor dem Regelrentenalter) gelten.

Von den Rentenreformen gehen starke Anreize für die Verlängerung des Arbeitslebens aus, und wenn sie gut strukturiert sind, dann „belohnen“ sie diese Verlängerung mit einem angemessenen Rentenniveau. Jedoch gilt sicherzustellen, dass die Menschen auch wirklich länger arbeiten können, worauf auch die Integrierte Leitlinie für Wachstum und Beschäftigung 18 (Förderung eines lebenszyklusbasierten Ansatzes) verweist. Wie bereits

im ersten Bericht der Kommission über die nationalen Reformprogramme unterstrichen, ist es unerlässlich, durch Beschleunigung der Arbeitsmarktreformen neue Beschäftigungsmöglichkeiten für ältere Menschen zu eröffnen (siehe KOM-Dokument, Jahresfortschrittsbericht zu Lissabon). Die Rentensysteme können eine spätere Verrentung begünstigen, doch ohne geeignete Beschäftigungsmöglichkeiten für ältere Arbeitskräfte könnten entsprechende Systemreformen ins Leere laufen.

### **3.2.2 Entwicklung eines lebenszyklusbasierten Ansatzes und stärkere Verknüpfung von Beiträgen und Leistungen bei Wahrung einer angemessenen Einkommensersatzquote und unter Einbeziehung der gestiegenen Lebenserwartung**

Das ausgewogene Verhältnis zwischen und die Kopplung von Beiträgen und Leistungen sowie die Transparenz dieser Kopplung sind sowohl für leistungsdefinierte (die staatlichen umlagefinanzierten Systeme gehören im Allgemeinen in diese Kategorie) als auch für beitragsdefinierte Rentensysteme, bei denen diese Kopplung inhärent ist, wichtig. Rentenreformen müssen den demografischen Entwicklungen und insbesondere der gestiegenen Lebenserwartung gerecht werden. Die steigende Lebenserwartung ist der Faktor, der künftig am stärksten zur Zunahme der Rentenausgaben beitragen wird. Wenn sich die höhere Lebenserwartung ausschließlich in einer entsprechenden Erhöhung der Ruhestandsjahre niederschlägt, dann wäre dies bei Wahrung der finanziellen Ausgewogenheit nur durch höhere Beiträge der Erwerbstätigen oder durch niedrigere Leistungen für die Rentner zu bewältigen. Gelingt es jedoch, die höhere Lebenserwartung auf Erwerbsjahre und Ruhestandsjahre aufzuteilen, dann wird sich daraus ein effizienteres Lebenszyklus-Gleichgewicht zwischen Beitragszahlung und Leistungsbezug ergeben. Die Reformen zur Stabilisierung der Rentensysteme sollen den zu erwartenden Anstieg der Lebenserwartung auffangen. Dabei ist zwischen Mechanismen zur automatischen Anpassung (wie in DE, FI, LV, PL und SE) und in regelmäßigen Abständen vorgenommenen Überprüfungen und Anpassungen (wie in AT, IT und FR) zu unterscheiden. Diese Anpassungen werden auch der Anwendung eines lebenszyklusbasierten Ansatzes förderlich sein.

Eine unzureichende Kopplung von Beiträgen und Leistungen kann zu einem Mangel an Effizienz und einer

unausgewogenen Belastung sowohl innerhalb als auch zwischen Generationen führen. Die Folge wäre insbesondere, dass die Menschen Beitragszahlungen viel mehr als allgemeine steuerliche Belastung und nicht als eine Investition in den Erwerb eigener Rentenansprüche empfinden. Eine Reform der Altersvorsorgesysteme und anderer Leistungssysteme kann als Anreiz dienen, länger zu arbeiten, und gleichzeitig helfen, die Schattenwirtschaft einzudämmen.

Bei einigen jüngst durchgeführten Rentenreformen wurde die Kopplung von Leistung und Beitrag in den Rentensystemen verstärkt. So führen kapitalgedeckte und fiktive beitragsdefinierte Systeme zu einer derartig ausgeprägten Kopplung. Auch in zahlreichen leistungsdefinierten Systemen wurde die Kopplung verstärkt. Erreicht wurde dies durch drei Maßnahmen: zum Ersten durch die Verlängerung der bis zum vollen Rentenanspruch zurückzulegenden Beitragszeiten; zum Zweiten durch Errechnung des vollen Rentenanspruchs auf Basis des Lebenszeiteinkommens und nicht des letzten Einkommens, was die Beitragszahlungen während der gesamten beruflichen Laufbahn und nicht nur die Lohnprogression in späteren Jahren widerspiegelt; zum Dritten durch versicherungsmathematische Abschläge/Zuschläge bei Frühverrentung/Spätverrentung, was auch dazu beiträgt, die Frühverrentung zurückzudrängen. Dies ist in einer Reihe von Mitgliedstaaten (AT, ES, FI, FR, IT, NL und PT) geschehen, während in vielen anderen (BE, DE und EE, HU, LU, LV, LT, PL, SE, SI und SK) die Kopplung bereits durch frühere Reformen gestärkt wurde.

Die stärkere Kopplung von Beiträgen und Leistungen muss jedoch mit einem sorgfältigen Monitoring der Anrechnung von Berufsunterbrechungen (Kindererziehung, sonstige Betreuungsaufgaben, Arbeitslosigkeit, Krankheit oder Bildungsurlaub) kombiniert werden, um bei Renteneintritt ein angemessenes und gerechtes Einkommensniveau zu garantieren.

### **3.2.3 Modernisierung der Rentensysteme durch effektivere Anpassung an den strukturellen Wandel**

Änderungen in der Struktur des Arbeitskräfteangebots erfordern anpassungsfähige Rentensysteme. Als Folge des Anstiegs der Erwerbsquoten und gesellschaftlicher Veränderungen gibt es immer mehr Menschen, deren Erwerbskarriere nicht dem Standardmuster einer lebenslangen Vollzeitbeschäftigung entspricht. Berufsunterbrechungen und Teilzeitarbeit werden immer häu-

figer, und immer mehr Menschen üben, zumindest vorübergehend, eine selbstständige Tätigkeit aus. Diese Trends erfordern Anpassungen im Rentensystem, um Anreize für eine Erwerbstätigkeit zu schaffen und ein angemessenes Rentenniveau für alle sicherzustellen, selbst wenn darunter die Transparenz des Systems leidet.

In den Mitgliedstaaten hat man damit begonnen, die Altersvorsorge für Arbeitskräfte in atypischen Arbeitsverhältnissen und von Selbstständigen daraufhin zu prüfen, wie der Zugang zu gesetzlichen Systemen und zu den Systemen der Zusatzversorgung erleichtert werden kann. In einigen Ländern, insbesondere in denjenigen, in denen die Kopplung von Beiträgen und Leistungen bereits stärker ausgeprägt ist, besteht die Möglichkeit, beitragsgünstig bzw. beitragsfrei Rentenansprüche zu erwerben und zwar bei befristeten Arbeitsverträgen kurzer Dauer, Teilzeitarbeit und Freiwilligenarbeit sowie bei Berufsunterbrechungen, bedingt z. B. durch Kindererziehung, Altenbetreuung, Ausbildung oder Arbeitslosigkeit. Dadurch soll erreicht werden, dass als Folge von Teilzeitarbeit, befristeten Arbeitsverträgen oder Arbeitslosigkeit die Rentenansprüche nicht über Gebühren verringert werden können.

Entgegen dem allgemeinen Trend, in umlagefinanzierten Systemen die künftigen Rentenleistungen zu beschneiden, wird in mehreren Mitgliedstaaten die Anrechnung von Berücksichtigungszeiten für Kindererziehung verbessert und eine entsprechende Regelung für die Altenbetreuung eingeführt. Die Modernisierung in diesem Bereich gestaltet sich offenbar schwierig, was darauf zurückzuführen sein könnte, dass Anreize zum Erwerb zusätzlicher Rentenansprüche durch Erwerbstätigkeit mit der Anrechnung unbezahlter Arbeit schwer zu vereinbaren sind.

Die meisten Mitgliedstaaten beseitigen Schritt für Schritt Unterschiede im Regelrentenalter zwischen Männern und Frauen. Andere Mitgliedstaaten beabsichtigen, offenbar aus geschlechtsspezifischen Gründen, Unterschiede im Rentenalter zumindest in den nächsten beiden Jahrzehnten beizubehalten. In einigen Mitgliedstaaten ist es nach wie vor möglich, dass Frauen, die Kinder großgezogen haben, früher in Rente gehen. Auffallend sind Änderungen bei den Hinterbliebenenrenten: Die herkömmliche Witwenrente wird als Folge der rasch zunehmenden Beschäftigungsmöglichkeiten für Frauen immer seltener vorkommen.

Für Arbeitskräfte, die häufig den Arbeitnehmer wechseln, sind die gesetzlichen Systeme von Vorteil, denn viele dieser Systeme sehen bereits besondere Regelungen für kurzfristige Beschäftigungsverhältnisse vor. In Bezug auf den Erwerb von Rentenansprüchen können die Zusatzrentensysteme dagegen mobile Arbeitskräfte (besonders, wenn sie an einen bestimmten Arbeitgeber gebunden sind) gegenüber langfristig beschäftigten Arbeitnehmern benachteiligen (insbesondere im Zusammenhang mit Wartezeiten und Unverfallbarkeitsfristen). In Anbetracht der zunehmenden Bedeutung der Zusatzrentensysteme haben einige Mitgliedstaaten (DE, DK, NL, UK) die Portabilität von Zusatzrentenansprüchen verbessert, soweit die entsprechenden Regelungen ein Hindernis für die Arbeitskräftemobilität darstellten. Diese Portabilität wird auf dem Arbeitsmarkt eine immer größere Rolle spielen. Um generell die Voraussetzungen für die Portabilität von Zusatzrentenansprüchen zu verbessern und die von einigen Mitgliedstaaten bereits eingeleiteten Initiativen zu unterstützen, hat die Europäische Kommission vor kurzem Vorschläge für eine Richtlinie zur Verbesserung der Portabilität angenommen.

### 3.2.4 Garantierte Mindestrente und Solidarität

Als Reaktion auf die Notwendigkeit, älteren Menschen ein angemessenes Renteneinkommen zu sichern, wurde in einigen Mitgliedstaaten die garantierte Mindestrente stärker erhöht als gemäß der gesetzlich vorgeschriebenen Indexbindung erforderlich (etwa in BE, ES, IE, IT und PT). Im Jahr 2003 hat das Vereinigte Königreich eine verbesserte einkommensbezogene Rentenbeihilfe („Pension Credit“) eingeführt, um die Anreize zu erhöhen, die dazu führen sollen, dass für den Ruhestand Vermögen gespart wird.

Bei der Reform der Mindestrente und den Mindestversorgungsleistungen für ältere Menschen im Allgemeinen stellt sich die Frage, wie sich diese auf Anreize zum Erwerb zusätzlicher Rentenansprüche auswirken. Das Verhältnis zwischen Mindestversorgungsleistungen, Indexierung und Anreizen sollte sorgfältig abgewogen werden.

Ferner stellt sich die Frage, ob Mindestrenten und Mindestversorgungsleistungen anders indexiert werden als einkommensbezogene Renten und ob dies unbeabsichtigte Auswirkungen auf die Einkommensverteilung zwischen Rentnern haben kann. Die jüngsten Entwick-

lungen zeigen, dass immer mehr Länder zu einer Preisindexierung oder zu einer der Preisindexierung sehr nahe kommenden Indexierung übergehen, und zwar sowohl bei einkommensbezogenen Systemen als auch bei den Mindestrentensystemen. Eine Preisindexierung der garantierten Mindestrenten bedeutet jedoch gewöhnlich, dass das Einkommen derjenigen, die eine Mindestrente beziehen, hinter der allgemeinen Einkommensentwicklung zurückbleibt, was das Risiko einer relativen Verarmung älterer Rentner mit sich bringt, auch wenn deren Kaufkraft erhalten bleibt. Um das Verarmungsrisiko abzuwenden, greifen Regierungen oft zu Korrekturmaßnahmen (was an sich dem Grundsatz einer nachhaltigen, sicheren, stabilen und vertrauenswürdigen Altersversorgung zuwiderläuft). Diese Frage sollte im umfassenderen Kontext der Eingliederung älterer Menschen betrachtet werden. Einige Länder bieten Mindesteinkommensgarantien, andere wiederum Geld- und Sachleistungen, wie z. B. Gesundheits- und Pflegeleistungen und Unterstützung für Wohnung und Transport.

### 3.2.5 Private Altersvorsorge als Ergänzung oder als teilweiser Ersatz für die staatliche Altersvorsorge

Einige Mitgliedstaaten betonen, welchen großen Beitrag die private kapitalgedeckte Altersvorsorge zur Sicherung eines angemessenen Renteneinkommens leisten kann. Dabei verweisen sie auch auf die positive Aufteilung des demografischen Risikos auf die öffentlichen und privaten Systeme. Die Alterung der Bevölkerung und insbesondere der Renteneintritt der Baby-Boom-Generation erfordern, dass man angesichts der erheblichen Veränderung der Abhängigkeitsquote die finanzielle Tragfähigkeit der Umlagesysteme im Auge behält. Jedoch werden auch kapitalgedeckte Systeme von der Alterung der Bevölkerung in Mitleidenschaft gezogen. Die neuen NSB befassen sich viel eingehender als die Berichte des vorherigen Zyklus mit der Frage der Zusatzrenten. In vielen Ländern wird die private Altersvorsorge als integraler Bestandteil der Gesamtaltersvorsorge betrachtet. In einigen Mitgliedstaaten ist dies schon seit längerer Zeit der Fall (etwa in DK, NL und UK). Die Bedeutung der privaten Altersvorsorge ist auch aufgrund der Einführung einer kapitalgedeckten Komponente in den gesetzlichen Systemen in mehreren Mitgliedstaaten (z. B. EE, HU, LV, LT, PL, SE und SK) gestiegen. Außerdem werden in vielen Ländern betriebliche und private Systeme, die die staatliche Altersvorsorge ergänzen, stärker unterstützt (AT, DE, IT).

Aus einer Studie des Ausschusses für Sozialschutz über die private Altersvorsorge geht Folgendes hervor: Ungeachtet der Tatsache, dass die private Altersvorsorge in den kommenden Jahrzehnten eine größere Rolle spielen wird, rechnet man damit, dass in nahezu allen Mitgliedstaaten die staatliche umlagefinanzierte Rente die Haupteinkommensquelle der Rentner bleiben wird. Dies wird es in den meisten Mitgliedstaaten ermöglichen, das zur Garantie eines fairen Alterseinkommens erforderliche Maß an Umverteilung und Solidarität zu gewährleisten und gleichzeitig auf individueller Ebene eine angemessene Risikodiversifizierung zu bewirken. In jedem Fall wird die garantierte Mindestrente nicht nur als Verpflichtung des Staates anerkannt, sondern auch generell im Rahmen staatlicher Systeme bereitgestellt. In diesem Kontext ist darauf hinzuweisen, dass der zunehmende Trend zur privaten Altersvorsorge dem Staat nicht erlaubt, sich aus diesem Bereich zurückzuziehen. Das Monitoring und die Regulierung der privaten Altersvorsorge werden zu einer immer wichtigeren und komplexeren Aufgabe für den Staat. Dabei sollte die Transparenz und die Wettbewerbsfähigkeit auf dem Finanzmarkt gefördert werden.

Soll sichergestellt werden, dass die private Altersvorsorge einkommensschwachen Menschen ein angemessenes Alterseinkommen bietet, so ist es unerlässlich, dass die Mitgliedstaaten eine gute Verwaltungsstruktur entwickeln. Einige Mitgliedstaaten (CZ, DE) bieten einkommensschwachen Menschen relativ günstige Bedingungen für eine private Altersvorsorge, wobei dies jedoch möglicherweise nicht ausreichend ist. Deshalb denken verschiedene Mitgliedstaaten darüber nach, das private Rentensparen als obligatorische Maßnahme einzuführen, insbesondere dann, wenn, wie in vielen neuen Mitgliedstaaten der Fall, die Altersvorsorge sich zum überwiegenden Teil auf die private Vorsorge stützt. Hat die private Vorsorge eine stark ausgeprägte freiwillige Komponente, wird sie in stärkerem Maße von den höheren Einkommensgruppen in Anspruch genommen. Dies könnte bewirken, dass sich insbesondere für ältere Rentenbezieher die Abnahme der individuellen Ersatzquoten in den gesetzlichen Rentensystemen noch stärker auswirkt.

Die Mitgliedstaaten müssen darauf achten, dass die private Altersvorsorge sich bedarfsgerecht entwickelt. Maßstab hierfür sind die Abdeckungsquote, das Leistungsniveau und die Verteilung nach Alter und sozioökonomischem Status. Außerdem müssen private Systeme und die Reservefonds von Umlagesystemen ein aus-

reichend hohes Maß an Sicherheit und Effizienz bieten. Regelungen zur Beschränkung von Investitionsrisiken und vorsichtige Schätzungen künftiger Erträge sind wirksame Sicherungsmechanismen, wenn sie ordnungsgemäß angewandt und sorgfältig überwacht werden. Effizienz bedeutet auch, dass die administrativen Kosten niedrig zu halten sind.

Zunehmend wichtig wird schließlich die Umwandlung des gesparten individuellen Rentenguthabens in sicherere garantierte Jahresrenten. Dies gilt insbesondere für die in letzter Zeit eingeführten Systeme, aus denen schon in wenigen Jahren, vielfach vor Ende des Jahrzehnts, erste Teilzahlungen zu leisten sein werden (wie etwa in PL, EE, HU, LV, LT und SK).

### 3.2.6 Verbesserte Governance der Rentensysteme

Regelmäßige oder Ad-hoc-Überprüfungen von Rentensystemen sowie die unter 3.2.2 genannten automatischen und halbautomatischen Anpassungsmechanismen tragen zur besseren Governance von Rentensystemen bei. In vielen Fällen beziehen sie die Erfordernisse der höheren Lebenserwartung und andere Veränderungen, die die Rentenparameter beeinflussen, z. B. im Bereich Beschäftigung und Wachstum, mit ein. Die NSB berichten über die Schaffung unabhängiger Überwachungseinrichtungen für Rentensysteme. Diese Entwicklungen verdeutlichen die Notwendigkeit, die Dauer des Erwerbslebens und die Dauer des Ruhestands sowie das Einkommensersatz- und das Beitragsniveau in ein ausgewogenes Verhältnis zu bringen, um die grundlegenden Ziele der Angemessenheit und Nachhaltigkeit der Renten zu realisieren. Dies ist in der Tat eine interessante Entwicklung, denn somit wird die Transparenz der Rentensysteme gesteigert und die Entscheidungsfindung auf eine breitere Konsensbasis gestellt.

Die Flexibilisierung des Rentenalters in gesetzlichen Rentensystemen, die engere Kopplung von Beitrag und Leistung sowie die Entwicklung der privaten Altersvorsorge – all dies verlangt von den künftigen Leistungsempfängern zunehmend schwierige Entscheidungen.

Wie von einigen Mitgliedstaaten unterstrichen (z. B. DK, IE, IT, NL, SE und UK), erfordert diese Entwicklung auch, dass man die Öffentlichkeit angemessen über die künftigen Rentenniveaus informiert, stärker



für Rentenfragen sensibilisiert und das Verständnis der Finanzdienstleistungen fördert. Wichtig ist dabei allerdings zu erkennen, dass Information an Grenzen stößt, wenn man von Menschen komplexe individuelle Entscheidungen über die Altersvorsorge erwartet. Die meisten Berichte verweisen auf große Anstrengun-

gen, die Öffentlichkeit zu informieren und die finanzielle Kompetenz zu verbessern. In der Tat ist es wichtig, durch qualitativ hochwertige Informationen Beitragszahler und Leistungsempfänger über ihre Rechte aufzuklären.

## 4 | Schlussfolgerung

### 4.1 Angemessenheit, Nachhaltigkeit und Modernisierung als kohärentes Ganzes betrachten

Die zweite NSB-Runde bestätigt, dass die drei Hauptziele der Rentenpolitik -Angemessenheit, Nachhaltigkeit und Modernisierung – als Orientierung für die Formulierung der Reformstrategien zur Bewältigung der Herausforderung im Bereich der Renten in Europa dienen können.

Die NSB verweisen auf Querverbindungen, Synergien und Trade-Offs zwischen diesen drei grundlegenden Zielen. Sollen die Reformstrategien erfolgreich sein, so müssen alle drei Elemente als Ganzes gesehen werden.

Wenn es der Sozialpolitik nicht gelingt, Angemessenheit und Nachhaltigkeit in ein ausgewogenes Verhältnis zu bringen, sind die Risiken beträchtlich. Unhaltbare Rentenversprechen gefährden die Angemessenheit der Alterseinkommen. Unzureichende Rentenanwartschaften und ein niedriges Rentenniveau (oder die Absenkung eines zuvor zugesagten Rentenniveaus) würden einen nicht vorhersehbaren Druck auf die Tragfähigkeit der öffentlichen Finanzen ausüben: Zunehmende Forderungen nach einer Ad-hoc-Aufwertung von Rentenansprüchen und unerwartete Forderungen nach anderen (selbst bedürftigkeitsabhängigen) Sozialleistungen können zu höheren Staatsausgaben führen. Derartige Situationen könnten die Glaubwürdigkeit der Rentensysteme stark erschüttern und Konflikte heraufbeschwören.

Eine größere Transparenz der Rentensysteme ist sowohl für Einzelpersonen (sie brauchen Informationen und Klarheit, um Entscheidungen mit Langzeitwirkung zu fäl-

len) als auch für Regierungen (sie müssen Monitoringinstrumente für das Langzeitmanagement von Rentensystemen entwickeln) wichtig. Ein besonders interessantes neues Element in den jüngsten Rentenreformen ist die Einführung automatischer und halbautomatischer Mechanismen, die zum regelmäßigen Monitoring verschiedener Unsicherheitsfaktoren, insbesondere der demografischen Entwicklung, beitragen und somit die Ausgewogenheit und zeitliche Planung von Reformen erleichtern.

### 4.2 Beitrag von Rentenreformen zu Beschäftigung und Wachstum

Wie in zahlreichen NSB hervorgehoben, müssen Rentenreformen in einem breiteren gesellschaftlichen und wirtschaftlichen Kontext gesehen werden. Die von den Mitgliedstaaten in ihren nationalen Reformprogrammen dargestellten Maßnahmen können durch Rentenreformen unterstützt werden, während andererseits stärkere Volkswirtschaften auch bessere Rentenleistungen erbringen können. Die Verbesserung der Beschäftigungsmöglichkeiten für ältere Menschen ist sowohl zur Realisierung der Lissabon-Beschäftigungsziele als auch zur Förderung des nachhaltigen Wachstums unerlässlich. Gleichzeitig garantiert sie ein hohes Sozialschutzniveau in einer alternden Gesellschaft. Rentenreform, Beschäftigung und Wachstum stehen demzufolge in einer Wechselwirkung.

Zum einen machen Rentenleistungen in nahezu allen Ländern einen großen Teil der öffentlichen Ausgaben aus. Ein finanziell solides staatliches Rentensystem ist Voraussetzung für die Tragfähigkeit der öffentlichen Finanzen insgesamt, die ihrerseits ein wichtiger Faktor für die Wachstums- und Wirtschaftsperspektive ist. Dagegen kann eine erfolgreiche Umsetzung der Lissa-

bon-Strategie mit ihren positiven Auswirkungen auf Wettbewerbsfähigkeit und Produktivität mehr Handlungsspielraum für Rentenreformen schaffen.

Zum anderen sind Rentensysteme und Arbeitsmarktpersonen eng miteinander verknüpft. Rentensysteme beinhalten Anreize, die sich auf das Angebot an älteren Arbeitskräften auswirken, und ein hohes Beschäftigungsniveau bedeutet hohe Beitragszahlungen. Die zur Finanzierung der Rentensysteme erforderlichen Beiträge wirken sich auf die Arbeitskosten und folglich auch auf die Arbeitskräftenachfrage aus. Höhere Beitragssätze können die Arbeitskräftenachfrage beschneiden, während großzügige Sozialleistungen das Arbeitskräfteangebot verknappen. Beides erhöht die Ungleichgewichte auf dem Arbeitsmarkt. Es muss analysiert werden, wie die Leistungen und die Beiträge sich auf das Funktionieren des Arbeitsmarkts auswirken.

### 4.3 Kernpunkte, die ein Monitoring erfordern

Seit dem Jahr 2003 haben viele Mitgliedstaaten substantielle Rentenreformen durchgeführt, und dies oftmals gegen den Widerstand der öffentlichen Meinung. Betrachtet man das Ausmaß der Reformen, so haben einige Mitgliedstaaten offenbar umfangreiche Reformen realisiert, wohingegen andere ihre Reformanstrengungen intensiviert haben und wieder andere sich noch in einer Frühphase des Reformprozesses befinden. Während in den letztgenannten Ländern das Reformtempo beschleunigt werden muss, gilt es in den meisten Mitgliedstaaten, das Reformtempo aufrechtzuerhalten.

Eine Auswertung aller NSB ergibt, dass die folgenden Aspekte ein sorgfältiges Monitoring erfordern:

- Die Rentenreformen müssen durch die Korrektur bzw. Verstärkung von Anreizen zur Verlängerung des Erwerbslebens und durch eine Überprüfung der Beitragssätze und des Leistungsniveaus auch weiterhin das gute Funktionieren des Arbeitsmarkts unterstützen. Die Arbeitsmarktreform muss weiter vorangebracht werden, wobei bei den Arbeitgebern in Bezug auf die Weiterbeschäftigung bzw. Wiederbeschäftigung älterer Arbeitskräfte ein Umdenken stattfinden muss.
- Die Gestaltung der Rentensysteme muss der höheren Lebenserwartung Rechnung tragen. Die verän-

derte Lebenserwartung und ein lebenszyklusbasierter Ansatz müssen in die Systeme integriert werden.

- Die Modernisierung muss neuen Entwicklungen besser Rechnung tragen. Das gilt für neue Beschäftigungsformen, Flexibilisierung der Arbeit, Berufsunterbrechungen, Betreuungsleistungen und Systeme, die es Frauen ermöglichen, eigene Rentenanwartschaften aufzubauen.
- Die Garantie eines angemessenen Mindestrenteneinkommens gewinnt zunehmend an Bedeutung, doch gilt es, bei Indexierungsregeln umsichtig zu verfahren und Negativanreize für die Aufnahme einer Erwerbstätigkeit oder für die private Vorsorge zu vermeiden.
- Die finanzielle Tragfähigkeit der staatlichen Rentensysteme und deren Auswirkung auf den Staatshaushalt sind sorgfältig, unter Berücksichtigung der möglichen Auswirkungen privater Rentensysteme auf die öffentlichen Finanzen, zu beobachten. Die Staatsverschuldung sollte abgebaut werden, um Manövrierraum für die zu erwartende Erhöhung der altersbezogenen Ausgaben zu schaffen.
- Die private Altersvorsorge kann die staatliche Altersvorsorge ergänzen oder zum Teil ersetzen, d. h., sie kann die Risikodiversifizierung auf individueller Ebene fördern. Dabei sind jedoch Sicherheit und Ausgewogenheit zu garantieren.
- Wichtig sind mehr Transparenz und eine bessere Aufklärung der Öffentlichkeit über Rentenfragen.
- Mechanismen zur regelmäßigen Überprüfung und Anpassung sind nicht nur für die Systemanpassung an sich, sondern auch zum besseren Verständnis des Reformbedarfs vor dem Hintergrund der demografischen Herausforderungen wichtige Neuerungen.

### 4.4 Weitere Schritte im Rahmen der Offenen Methode der Koordinierung

Die OMK hat sich für die Union und die Mitgliedstaaten als wirksames Instrument erwiesen, um durch die Festlegung gemeinsamer Ziele, die Bewertung der erreichten Fortschritte und die Förderung eines Lernprozesses den Rentenreformen eine klarere Zielrich-



tung zu geben. Die in der Mitteilung der Kommission vom 22. Dezember 2005 – „Zusammen arbeiten, zusammen mehr erreichen: ein neuer Rahmen für die offene Koordinierung der Sozialschutzpolitik und der Eingliederungspolitik in der Europäischen Union“ – umrissene neue OMK ist dank ihrer integrierten Struktur und der engeren Verknüpfung mit der Lissabon-Strategie für Wachstum und Beschäftigung geeignet, die Mitgliedstaaten in ihren Bemühungen zu unterstützen, die Rentenreform voranzubringen. Künftige Arbeiten sollten sich an den folgenden beiden Verfahrensgrundsätzen ausrichten:

- Fortsetzung des Monitorings der Fortschritte bei der Verwirklichung der gemeinsamen Ziele unter Vermeidung einer übermäßigen Belastung der Mitgliedstaaten durch den Berichterstattungsaufwand. Wie in der Mitteilung der Kommission dargestellt, wird eine Gleichschaltung mit dem Lissabon-Drei-Jahres-Zyklus (2005-2008) vorgenommen. Von den Mitgliedstaaten wird nicht verlangt, dass sie in den dazwischen liegenden Jahren nationale Strategien vorlegen. Die OMK wird sich in diesen Jahren auf die eingehende Analyse von Einzelfragen, auf die Verbreitung der Ergebnisse und auf die Bewertung von Indikatoren für die Fortschritte bei der Realisierung der gemeinsamen Ziele konzentrieren.
- Hervorhebung der prioritären Fragen bei der Politikanalyse und dem Austausch von Best Practices. Als Ergänzung zu den laufenden Arbeiten bezüglich der Ersatzquoten und gestützt auf die im vorliegenden Dokument skizzierten Herausforderungen könnten künftige horizontale Arbeiten vorrangig folgenden Themen gewidmet werden:

- Modalitäten eines Mindesteinkommens für ältere Menschen (einschließlich der Kopplung von Renten und sonstigen Leistungen, die Ruheständlern gewährt werden).
- Stärkere Kopplung von Beiträgen und Leistungen (unter Einbeziehung der beitragsfreien Anrechnungszeiten und der Geschlechterdimension).
- Verknüpfung von Flexibilität im Rentenalter und Verlängerung des Erwerbslebens.
- Entscheidende Elemente bei der Entwicklung privater Rentensysteme (effizienter Rechtsrahmen, ausgewogene Abdeckung, Sicherheit, Information, Transaktionskosten, Beitrag privater Rentensysteme zur finanziellen Tragfähigkeit).
- Entwicklung von Mechanismen für die regelmäßige Überprüfung und Anpassung.

Für einschlägige Arbeiten bieten sich spezielle Studien und Workshops an. In einigen prioritären Bereichen könnte auch das bei der sozialen Eingliederung so erfolgreich angewandte Peer-Review-Verfahren genutzt werden. Über die Ergebnisse solcher Arbeiten könnte man dem Sozialschutzausschuss und dem Wirtschaftspolitischen Ausschuss in geeigneter Form Bericht erstatten. Der Sozialausschuss könnte erwägen, der Kommission und dem Rat zu einigen Fragen Berichte vorzulegen. Die Arbeitsmethoden, die nationale Berichterstattung und horizontale Studien sind wichtige Inputs für die künftigen Gemeinsamen Berichte über Sozialschutz und soziale Eingliederung und tragen dazu bei, dass die OMK einen nützlichen Beitrag zur Lissabon-Strategie für Wachstum und Beschäftigung leistet.

## Part II – Horizontal analysis

### Methodological note – Background statistics for the Synthesis report on pensions

**At-risk-of-poverty rates** are defined as the share of persons with an equivalised disposable income below an at-risk-of-poverty threshold. Equivalised disposable income is defined as the household's total disposable income divided by its 'equivalent size' to take account of its size and composition<sup>(4)</sup>. The at-risk-of-poverty threshold is set at 60% of the national median equivalised disposable income. It must be noted that income generated from owner-occupied housing or housing at below-market rents – i.e., imputed rent – is not included in the definition of income. Inclusion of this element of income could make significant difference in the measurement of risk-of-poverty rates.

**Data sources**<sup>(5)</sup> generally refer to the socio-demographic circumstances of individuals and their income situation in 2003. Data were collected in 2004 at the latest reflecting income situations in 2003, or earlier depending on Member States. Sources used are SILC (2004, income data 2003) for Belgium, Denmark, Greece, Spain, France, Ireland, Italy, Luxembourg, Austria, Portugal, Finland and Sweden and for other Member States national sources, income data also from 2003 (except Germany the Czech Republic and the Slovak Republic from 2002, and Malta from 2000).

**Inequality of income distribution (or income quintile ratio)** is defined as the ratio of total income received by the 20% with the highest income within a given population (top quintile) to that received by the 20% of the same population with the lowest income (lowest quintile). Income must be understood as equivalised disposable income and is defined as the household's total disposable income divided by its 'equivalent size'. The definition of income does not include imputed rent.

For the indicator on **income of people aged 65 and over as a ratio of income of people aged 0–64**, income is also understood as equivalised disposable income as defined above.

The indicator on **median pensions relative to median earnings** relates the median individual pension income of retirees aged 65–74 to the median earnings of employed persons aged 50–59, including/excluding social benefits other than pensions received by both age groups. Pension income covers pensions and benefits relating to old age or retirement from public and private pension schemes, early retirement, means-tested welfare schemes as well as survivors' benefits. Social benefits include unemployment-related, family-related, invalidity and sickness benefits, education-related allowances and other personal social benefits.

The figures for current and prospective **theoretical pension replacement rates** are based on the methodology developed by the Indicators Sub-Group of the Social Protection Committee. The results are based on the baseline assumption of a hypothetical person (male if gender matters), retiring at the age of 65 after a 40 years full-time work career with a flat earnings profile at average earnings with contributions to the most general public pension scheme as well as to occupational and private pension schemes for some Member States. The replacement rate represents the individual pension income during the first year of retirement relative to the individual income received during the year preceding retirement. Calculations were conducted by the Member States.

**The 'pension expenditure'** aggregate according to the ESSPROS definition goes beyond that of public expenditure to also include expenditure by private social protection schemes. 'Pension expenditure' is the sum of seven different categories of benefits, as defined in the ESSPROS Manual 1996: disability pension, early-retirement benefit due to reduced capacity to work, old-age pension, anticipated old-age pension, partial pension, survivors' pension and early retirement benefit for labour market reasons. Some of these benefits (for example, disability pensions) may be paid to people who have not reached the standard retirement age.

(4) The data use the modified OECD scale which gives a weight of 1.0 to the first adult, 0.5 to other household members aged 14 or over and 0.3 to each child aged less than 14.

(5) See chapter 1, box 1.1 – Poverty measure and income and living conditions data.

**Factors determining the evolution of public pensions expenditure (2000–50):** the projected total increase in public pension expenditure between 2000 and 2050, expressed in percentage points of GDP, is decomposed into its main determining factors. The algebraic sum of these contributions, plus a residual, corresponds to the total.

These projections provide estimates of the impact of population ageing on public pension expenditure. The baseline scenario, the results of which are presented in the tables, assumes unchanged policies in the pension system. The underlying assumptions of population and macroeconomic developments were commonly agreed within the Ageing Working Group of the EPC, while it was recognised that a considerable degree of uncertainty is inherently involved in such calculations covering a very long time span. A number of sensitivity analyses were made to test the impact of different assumptions on the results. Overall, these tests led to the conclusion that the results of the baseline scenario are robust and provide an adequate representation of magnitude of the demographic challenge ahead. Moreover, even if the figures for 'public pensions' in these calculations refer to all public revenues for older persons and not only to old-age pensions, the coverage of the projections may slightly differ across countries. Furthermore, some very recent reforms in some Member States may not be reflected in the projections.

## Data sources and methodology

Many income-based and other indicators were initially specified to be calculated on the basis of the *European Community Household Panel* (ECHP). Information on the characteristics of that survey and availability of data issued from it can be found at the following address: <http://forum.europa.eu.int/irc/dsis/echpanel/info/data/information.html>

However, this survey expired in 2001 and is currently being replaced by data collection under the *Community Statistics on Income and Living Conditions* (EU-SILC) framework regulation (No 1177/2003 of 16 June 2003) and associated implementing regulations<sup>(6)</sup>.

EU-SILC will become the EU reference source for income and social exclusion statistics, and for the commonly agreed indicators of social cohesion in particular. EU-SILC was launched in 2003 for six Member States, and by 2005 it is expected to cover all 25 EU Member States together with many neighbouring countries. During the transition to EU-SILC, indicators are being calculated using national sources, ex post harmonised for maximum comparability. Logically, given the similarities between the indicators concerned, the same sources should be used to produce the Pensions Indicators as are used to produce the Laeken indicators of social inclusion.

**Table 1** presents the different sources used for recent rounds of data collection.

(6) Details of the regulations issued to date can be found in the Official Journal, Nos L.165 (3.7.2003), L. 298 (17.11.2003), L.5 (9.1.2004) and L.5 (7.1.2005).

Table 1. – Sources

Country	Source	Survey year	Income year
<b>BE</b>	ECHP	2001	2000
	EU-SILC	2003, 2004	2002, 2003
<b>CZ</b>	Survey on Social Situation of the Household (Sociální Situace Domácností)	2001	2000
	Microcensus	2003	2002
<b>DK</b>	ECHP	2001	2000
	EU-SILC	2003, 2004	2002, 2003
<b>DE</b>	ECHP	2001	2000
	GSOEP (Sozio-oekonomische Panel)	2002, 2003, 2004	2001, 2002, 2003
<b>EE</b>	Household Budget Survey (Leibkonna Eelarve Uuring)	2000, 2001, 2002, 2003	2000, 2001, 2002, 2003
<b>EL</b>	ECHP	2001	2000
	EU-SILC	2003, 2004	2002, 2003
<b>ES</b>	ECHP	2001	2000
	Household Budget Survey (Encuesta Continua de Presupuestos Familiares)	2002, 2003	2001, 2002
	EU-SILC	2004	2003
<b>FR</b>	Tax Survey (ERF: Enquête Revenu Fiscaux)	2001, 2002, 2003	2000, 2001, 2002
	EU-SILC	2004	2003
<b>IE</b>	ECHP	2001	2000
	EU-SILC	2003, 2004	2002, 2003
<b>IT</b>	ECHP	2001	2000
	EU-SILC	2004	2003
<b>CY</b>	Household Budget Survey (FES: Family Expenditure Survey)	2003	2003

Table 1. – Sources (continued)

Country	Source	Survey year	Income year
<b>LV</b>	Household Budget Survey (Majsaimniecību Budžetu Pētījums)	2000, 2002, 2003	2000, 2002, 2003
<b>LT</b>	Household Budget Survey (Namų ūkių biudžetų tyrimas)	2000, 2001, 2002	2000, 2001, 2002
<b>LU</b>	ECHP	2001	2000
	EU-SILC	2003, 2004	2002, 2003
<b>HU</b>	Household Budget Survey (Háztartási Költségvetési Felvétel)	2000, 2001, 2002, 2003	2000, 2001, 2002, 2003
<b>MT</b>	Household Budget Survey (Household Budgetary Survey)	2000	2000
<b>NL</b>	Income Panel Survey (IPO: Inkomenspanelonderzoek)	2000, 2001, 2002, 2003	2000, 2001, 2002, 2003
<b>AT</b>	ECHP	2001	2000
	EU-SILC	2003, 2004	2002, 2003
<b>PL</b>	Household Budget Survey (Badania Budżetów Gospodarstw Domowych)	2000, 2001, 2002, 2003	2000, 2001, 2002, 2003
<b>PT</b>	ECHP	2001	2000
	Reduced ECHP sample. Only limited indicators are available (at-risk-of-poverty rates before and after transfers at level of total population; S80/20 income quintile share ratio at level of total population).	2002, 2003	2001, 2002
	EU-SILC	2004	2003
<b>SI</b>	Household Budget Survey (Anketa o porabi v gospodinjstvih)	2000, 2001, 2002, 2003	2000, 2001, 2002, 2003
<b>SK</b>	Microcensus	2003	2002
	Extrapolation from Microcensus	2004	2003
<b>FI</b>	Income Distribution Survey (Tulonjakotilasto)	2001, 2002, 2003	2000, 2001, 2002
	EU-SILC	2004	2003

Table 1. – Sources (continued)

Country	Source	Survey year	Income year
SE	Income distribution survey (HEK: Hushållens ekonomi, formerly HINK: Hushållens Inkomstfördelningsundersökningen)	2001	2001
	Survey of Living Conditions (ULF: Undersökning av levnadsförhållanden)	2002	2002
	EU-SILC	2004	2003
UK	Household Budget Survey (FRS: Family Resources Survey)	2000-01,2001-02, 2002-03,2003-04	2000, 2001, 2002, 2003

### Some limitations of the data sources

Typically, coverage of these data sources is restricted to private households and excludes certain hard-to-reach groups of the population such as persons who are homeless or nomadic, and persons living in institutions. This latter exclusion may distort comparisons between countries where certain traditions favour caring for frail elderly people within their families, whilst others favour institutional care arrangements. Whilst it is considered to be the best basis for such analyses (for example it avoids the moral hazard of actual expenditure choices), income is acknowledged to be an imperfect measure of consumption capabilities and welfare as amongst other things it does not reflect access to credit, access to accumulated savings or ability to liquidate accumulated assets, informal community support arrangements, aspects of non-monetary deprivation, differential pricing and other aspects. These factors may be of particular relevance for persons at the lower extreme of the income distribution. The bottom 10% of the income distribution should not, therefore, necessarily be interpreted as having the bottom 10% of living standards.

### Income definition

Under the EU-SILC, household total disposable income is taken to be all net monetary income received by the household and its members during the income reference year – namely all income from work (employee wages and self-employment earnings), private income from investment and property, transfers between

households plus all social transfers received directly, including old-age pensions, net of any taxes and social contributions paid. No account is taken of indirect social transfers. Until 2007, no account has to be taken of income-in-kind (with the exception of company car), mortgage loan interest payments and imputed rent. To the extent that younger households are more likely to be indebted than older households, the omission of interest payments may introduce a distortion.

Although certain countries (e.g. DK) are already able to supply income including imputed rent, for reasons of comparability, the income definition underlying the calculation of indicators currently excludes imputed rent, i.e. the money that one saves on full (market) rent by living in one's own accommodation or in accommodation rented at a price that is lower than the market rent. This could have a distorting effect in comparisons between countries, or between population sub-groups, when accommodation tenure status varies.

For the EU-10 countries, income-in-kind is included in the total income definition, as it is considered to be a more substantial component of household disposable income for these countries than is the case for EU-15 Member States, meaning that its exclusion would significantly underestimate the actual situation. 'Income-in-kind' covers goods produced directly by the household through either a private or a professional activity. For countries using national sources, in order to approximate as closely as possible to the EU-SILC income definition, adjustments are typically necessary to the standard information collected in the data

source concerned. The impact of these on reported values can sometimes be significant.

Given the sensitivity of the topics covered by the different sources, care is needed when interpreting results. In countries using surveys, the limited sample size and the fact that data on disposable income are based on information provided by respondents, rather than from administrative registers or other sources, can sometimes raise concerns about data quality. This is particularly the case for information on income at the two extremes of the income distribution. It is also the case for certain components of income, namely income from self-employment, capital income or income from the hidden economy.

### *Equivalisation*

Once total household income is collected, the figures are given per 'equivalent adult', in order to reflect differences in household size and composition. In other

words, the total household income is divided by its equivalent size using the so-called 'modified OECD' equivalence scale. This scale gives a weight of 1.0 to the first adult, 0.5 to any other adult household member aged 14 and over and 0.3 to each child aged 0 to 13. The resulting figure is attributed to each member of the household, whether adult or child.

### *EU averages*

Group-of-country averages are calculated as population-weighted averages of the available national values. However, indicators are not presented for any given year when data is not available for countries representing 25% or more of the population of the group concerned.

Due to the relative approach, and the differences identified between national data sources, care is needed when making comparisons between countries and to the group-of-country averages.



## ADEQUACY

## Objective 1 – Preventing social exclusion

Ensure that older people are not placed at risk of poverty and can enjoy a decent standard of living; that they share in the economic well-being of their country and can accordingly participate actively in public, social and cultural life.

### 1.1. Poverty position of older people in Member States today

The provision of a guaranteed minimum level of income to older people is an important aspect of European social protection systems and the general objective of providing a minimum income to prevent poverty in old age is widely supported throughout the Member States (more than 90% of Europeans agree that pension systems should protect against the risk of poverty)<sup>(7)</sup>, though a number of equally decisive other policies aiming at social inclusion are developed by Member States within their National Strategy Reports.

Older people are generally exposed to a similar level of poverty risk as the population as a whole (see table 1.1): the risk of older person poverty is generally only slightly higher than for younger cohorts. However, some Member States acknowledge a significantly higher poverty risk among older people in comparison to the population as a whole (Belgium, Denmark, Greece, Spain, Ireland, Cyprus, Portugal and the United Kingdom). In only two Member States are both the poverty risk of older people and that of the general population low (the Czech Republic and the Netherlands), while in a number of other Member States, poverty risk of both the old and the general population are at moderate levels (Germany, France, Latvia, Luxembourg, Hungary, Sweden).

Poverty risks vary considerably from one country to another, though women, without exception, are at a greater risk of being in poverty than men: women generally have lower retirement incomes, while men over 65 are on the whole no more exposed to the risk of poverty than their younger counterparts. The introduction of a new minimum guarantee, the increase in the level of this guarantee or the inclusion of non-cash benefits as part of an individual's assessment can change the picture substantially. Poverty rates have decreased in recent years by a few percentage points in some Member States as a result of recent measures (such as Pension Credit in the United Kingdom). Unfortunately, effects of better minimum income guarantees may not be shown in this report due to time lags in income survey data. This affects Member States which introduced substantial changes to their minimum income guarantees since 2003.

The oldest cohorts (aged 75 and over) tend to be more at risk of poverty than those over 65 (see box 1.1, table 1.2.) and women represent a majority of these older pensioners. Higher poverty risk among the oldest pensioners is linked to several factors. Older cohorts have often accrued lower pension entitlements, due for instance to employment in sectors with less well-developed pension provision, while past social security legislation sometimes offered less generous provision at the time they retired and in some countries the indexation of these pensions entitlements with prices typically translated into a progressive lag behind the general evolution of income. Moreover, the opportunity to accrue full pension rights has traditionally been much lower amongst women, reflecting previous societal gender roles. There are generally more single-person households of widows and widowers relying on survivors' benefit amongst the oldest pensioners.

(7) As recorded for EU-15 by the Eurobarometer 56.1 from autumn 2001.

Table 1.1. – Risk of poverty amongst older people

Poverty rate of people aged 65+ (ceiling at 60% of the median)				Poverty rate of people aged 0-64 (ceiling at 60% of the median)
	Men	Women	Total	Total
BE	20	21	21	14
CZ	1	6	4	9
DK (*)	16 (8)	18 (8)	17 (8)	10 (10)
DE	11	19	16	15
EE	7	22	17	19
EL	26	30	28	18
ES	27	32	30	18
FR	14	17	16	13
IE	34	45	40	19
IT	13	18	16	20
CY	48	55	52	10
LV	7	17	14	17
LT	5	15	12	15
LU	6	6	6	12
HU	6	12	10	12
MT	19	21	20	14
NL	6	7	7	13
AT	13	20	17	12
PL	4	7	6	18
PT	29	30	29	19
SI	11	23	19	9
SK	12	13	12	22
FI	11	20	17	10
SE	9	18	14	11
UK	21	27	24	17
EU-25	15	20	18	16

Note: (\*) Income definition including imputed rents in brackets.

Source: see box 1.1.

### Box 1.1 – Poverty measure and income and living conditions data

Levels of pensioner poverty amongst Member States are mixed and a number of reforms or increases to minimum income guarantee schemes for the elderly have been introduced recently and are currently being implemented. This should be borne in mind when analysing the latest available data on income and living conditions which do not always reflect the most recent reforms, as available data were collected in 2004 at the latest reflecting income situations in 2003 or earlier depending on Member States. Sources used are SILC (2004, income data 2003) for Belgium, Denmark, Greece, Spain, France, Ireland, Italy, Luxembourg, Austria, Portugal, Finland and Sweden and for other Member States national sources, income data also from 2003 (except Germany, the Czech Republic and the Slovak Republic income data from 2002, and Malta from 2000).

A wide range of benefits in kind that are available to the elderly in some Member States are not covered as they are generally not included in sources on income (this includes, in particular, health and social services, free public transport, reduced prices for various goods and services such as telephone connections, energy, etc.). Moreover, the taking into account of the effect that many pensioners have the propriety of their housing (imputed rents) is lacking. In the case of Denmark, however, the calculation was already possible on the basis of EU-SILC database, including imputed rents (both calculations are provided in table 1.1).

It should also be noted that income data are assessed for households and then individualised using a general equivalence scale (though the measure of income equivalence of scale may be slightly different for elderly people). Thus, income data are not individual incomes of men and women or of older or younger people, but a share of the household income in which these individuals live.

Poverty risk is measured by reference to an income threshold (e.g. 60% of median income). The definition of poverty used is relative: the poverty rate among older people reflects their relative income situation towards the general level of income. This can give an incomplete picture of the situation. For instance, a minimum income guarantee set just above the income threshold will translate into very low risk-of-poverty rates, even though the actual income situation would be only marginally different than a corresponding minimum income guarantee set slightly below the threshold. Such an effect may explain the more important gap in several Member States between the proportion of people living in households with less than 60% of median income and households with less than 50% of median income (see table 1.2.). Besides, high unemployment or low employment levels translate into a high rate of dependants among the working-age population and thus reflected a relatively higher relative income of pensioners who benefit from more fixed income.

The use of a relative definition of poverty means for instance that when the poverty rate of older people remains constant over time, the average income of more modest pensioners evolves in line with the general evolution of income in the population (it can in particular increase and some Member States have indicated in their NSR that keeping the poverty threshold constant over time, in price levels, would translate into a decrease of the poverty rate). On the reverse, an increase of the poverty rate can result from a slower increase in pension than in the general income, in particular for Member States with high growth of wages, or where pensions are indexed on prices.

Table 1.2. – Poverty risk of older people

	Poverty rate of people aged 65+ according to the ceiling as % of the median equivalised income				Poverty rate of older people compared with younger people (ceiling as 60% of the median equivalised income)		
	40%	50%	60%	70%	60+	65+	75+
BE	5	11	21	34	19	21	21
CZ	0	1	4	15	4	4	7
DK (*)	2 (4)	5 (6)	17 (8)	38 (15)	14 (7)	17 (8)	23 (9)
DE	3	8	16	27	15	16	17
EE	3	6	17	31	16	17	18
EL	10	19	28	38	27	28	35
ES	8	17	30	39	27	30	34
FR	2	5	16	27	15	16	18
IE	4	11	40	58	38	40	44
IT	3	7	16	26	15	16	16
CY	15	35	52	63	43	52	67
LV	1	4	14	27	13	14	16
LT	1	4	12	23	12	12	15
LU	1	3	6	15	6	6	8
HU	1	3	10	21	9	10	14
MT	Nd	9	20	34	18	20	21
NL	1	2	7	22	7	7	7
AT	6	11	17	26	15	17	18
PL	1	3	6	12	6	6	6
PT	7	15	29	42	28	29	35

Table 1.2. – Poverty risk of older people (continued)

Poverty rate of people aged 65+ according to the ceiling as % of the median equivalised income					Poverty rate of older people compared with younger people (ceiling as 60% of the median equivalised income)		
	40%	50%	60%	70%	60+	65+	75+
<b>SI</b>	3	9	19	28	16	19	25
<b>SK</b>	1	6	13	20	9	12	20
<b>FI</b>	1	5	17	34	14	17	25
<b>SE</b>	2	6	14	30	12	14	20
<b>UK</b>	5	14	24	41	24	24	30

Note: (\*) Income definition including imputed rents in brackets.

Source: see supra. Income year 2003 (except Germany, the Czech Republic and the Slovak Republic 2002, and Malta 2000).

## 1.2. Minimum income guarantees

Provisions and types of minimum income guarantees vary between Member States. It can be a part of the statutory scheme, or separate from it and in some Member States both variants are present. Minimum income guarantees generally provide benefits to people that have not accrued sufficient pension entitlements in public and/or private schemes to remain financially independent of their relatives or State social assistance. Minimum income schemes are therefore acting as a social safety net for those with incomplete careers (e.g. women, carers and immigrants) or very low earnings throughout their working lives.

Recent and extensive reforms of minimum pension guarantee benefits reflect the growing attention given to providing adequate incomes in retirement and reducing poverty amongst older people. In a number of Member States, the level of minimum pensions has been increased quicker than the general evolution of pensions or wages (Ireland, Spain, Portugal, and Belgium). In Portugal, new reforms (Solidarity Supplement for the elderly) will provide minimum incomes to those aged 80 or over, and then progressively to the over 65s. In other Member States, new benefits have been introduced recently, either replacing former ones (Pensions Credit in the United Kingdom), as supplements to existing benefits (in Denmark, Supplementary Pension Benefit in 2003), or by making access to the benefits easier (Basic Insurance for the elderly in Germany).

A number of Member States (including Germany, France, Austria, Ireland, Spain and Finland) stress that the quantum of those relying on minimum provision declined substantially over recent decades as a result of better pension entitlements accrued through the pension system, or by an expansion of social insurance coverage over recent decades. This is in marked contrast to other countries, who have seen increases to those eligible for minimum income guarantees due to recent reforms and increases in generosity to their systems.

The design of minimum guarantees are also significantly different between Member States, most notably in regard to the use of means testing, i.e. the way other income is taken into account and links with pension entitlements from public and/or private schemes.

Some Member States (Denmark and the Netherlands) provide a universal, flat rate (neither means-tested nor earnings related) to all persons who have been resident pre-pension age. In the Czech Republic, access to the universal pension system includes a minimum flat-rate guarantee.

In a number of Member States, the minimum guarantee is means-tested only against income from the statutory earnings-related pension scheme (like in Sweden and Finland), which can result in broad levels of coverage. In other countries, tighter means tests may only apply to top-up benefits in order to raise incomes to the guaranteed minimum levels. However, comprehensive means testing may have a disincentive effect on saving

for retirement or act as disincentives to work longer for workers with modest wages.

Due to the diversity of minimum income guarantee systems (see table 1.3.) direct comparisons between Member States are difficult. A majority of Member States offer top-up payments to raise earnings-related pension entitlements to a specified minimum level. These mechanisms are usually sufficient to provide an

adequate minimum except for people with incomplete insurance careers. In such cases, fully means-tested social assistance benefits are available. The level of minimum guarantees in some Member State's are linked to the level of minimum wages (the Netherlands, Portugal), which may imply an indexation matching developments of income in real terms, thus ensuring pensioners are protected from the erosion of their income in old age.

Table 1.3. – Minimum income guarantees for older people

	Type of income guarantee	Amount <sup>1</sup>	Means-test	Beneficiaries <sup>2</sup>
BE	Minimum pensions (minimum 30 years insured full-time employment)	Depends on career length. Maximum per year for salaried worker: EUR 12 990.85 (household) or EUR 10 395.95 (single), for self-employed worker: EUR 11 306.45 (household) or EUR 8 537.09 (single). Automatic price indexation.		1/3 of pensioners
	Minimum pension entitlement for each career year (minimum 15 years of employment; at least 1/3 of full-time)	Calculated on the basis of minimum guaranteed pay for a 21-year old (EUR 1 234.22 per month).	Entitlement only if total monthly pension does not exceed EUR 1 084.53 (household) or EUR 867.63 (single).	
	Social assistance for the elderly over 64 (65 from 2009 onwards) (GRAPA)	Per year single EUR 8 234.87 Couple EUR 5 489.91 (per individual) Linked to prices (discretionary adjustments possible every two years).	Household income and wealth	
CZ	Minimum pension amount	About 17% of the average net wage	No	
	The subsistence level (not only for elderly) which complements the basic pension insurance scheme.	Subsistence level 2005 CZK 4 300 for an individual which is 34% of the average net wage.	Yes	

Table 1.3. – Minimum income guarantees for older people (continued)

	Type of income guarantee	Amount <sup>1</sup>	Means-test	Beneficiaries <sup>2</sup>
DK	Residence-based state pension (Folkepension)	Linked to private sector earnings. Single: EUR 14 190 Living in a couple: EUR 10 390 per year	The basic amount is reduced on the basis of income from work earned by the beneficiary. The pension supplement is reduced on the basis of total earnings.	99% of all pensioners
	Supplementary Pension (ATP)	EUR 2 732 per year for full-time employment and after having paid contributions since 1964.	No	68% of all pensioners
DE	Basic Insurance for the elderly	Around EUR 7 500 per year.	Income and wealth of beneficiary and partner	Around 186 000 in 2000
EE	National pension payable to persons 63 years old and not having the pensionable service or accumulated period required for the old-age pension and having lived in Estonia at least 5 years (may also be provided in case of disability or survivorship)	Since July 2005 1 156.38 EEK.	No	9 438 in 2005, national pension payable due to age: 3 182
EL	Minimum pensions (different from fund to fund) and dependent on insurance period (before or after 1 January 1993). Pension supplement given subject to a means-test (EKAS) for all non-rural pensioners		Top-up of low pensions to minimum level without means test. Means-tested pension supplement.	Primary IKA pension: some 70% of pensioners receive the minimum pension.
	Basic pension (equal to the rural pension) for all uninsured people over 65		Yes, for uninsured people	700 000 individuals for OGA pension; 34 000 for the uninsured.

Table 1.3. – Minimum income guarantees for older people (continued)

	Type of income guarantee	Amount <sup>1</sup>	Means-test	Beneficiaries <sup>2</sup>
ES	Guaranteed minimum contributory pension for persons having contributed for at least 15 years	>65 years: EUR 385.50 per month or EUR 453.98 per month with dependant spouse (14 payments per year, i.e. EUR 5 397 and 6 356 respectively). <65 years: EUR 343.87 per month or EUR 406.16 per month with dependant spouse (14 payments per year i.e. EUR 4 814 and 5 686 respectively).	Yes	20% of pensions paid by the general scheme in 2001 (25% in 1995)
	Non-contributory pension 'social wage'	EUR 258.68 (14 payments per year, i.e. EUR 3 621).	Yes	Around 470 000 in June 2002
FR	Old-age minimum ('minimum vieillesse') for people over 65	Single: EUR 6 835 Couple: EUR 12 257 per year	Yes	Around 766 000 in 2000
IE	Contributory flat-rate old-age pension	Single: EUR 147.30 per week (EUR 7 660 per year).	Yes	60% of new pensions (expected to rise to 86% by 2016)
	Non-contributory flat-rate social welfare pensions for people aged 66+	Single: EUR 134 (weekly, EUR 6 968 per year) to be raised to EUR 200 by 2007 (EUR 10 400 per year).	Yes	40% of new pensions
IT	Minimum pension supplement (integrazione al trattamento minimo)	EUR 5 558.54 per year		About 39% of people over 65
	Minimum pensions for older people on low incomes	EUR 7 167.55 per year		About 1.8 million people
	Old-age benefit for people over 65 without any other income (assegno sociale and pensione sociale)	EUR 4 962.36 per year plus age-dependent top-up	Yes	About 6.2% of people over 65



Table 1.3. – Minimum income guarantees for older people (continued)

	Type of income guarantee	Amount <sup>1</sup>	Means-test	Beneficiaries <sup>2</sup>
CY	Minimum pension to persons with insufficient insurance record	For 2003, Cyprus GBP 144.5 for a beneficiary without dependants, Cyprus GBP 192.67 with one dependant, Cyprus GBP 216.75 with two dependants and Cyprus GBB 240.83 with three or more dependants (Cyprus GBP 1=1.70 Euro).	No	For 2003: 19 966 persons or 22% of old age, widows and invalidity pensioners of the Social Insurance Scheme
	Social Pension Scheme guaranteeing pension to 65+ not entitled to pension from other sources	For 2003, Cyprus GBP 137.70 for a beneficiary without dependants.	No	For 2003: 15 234 persons or 17.5% of persons 65+
LV	Minimum pension, depending on the length of insurance record and coefficients are applied	35 LVL times the coefficients depending on the insurance record.	No	In 2004 37.3% of persons to whom pensions were granted
	State social security benefit to people with insufficient qualification period for old-age pension	35 LVL	No	In 2004 1 400 recipients
	Guaranteed minimum income benefit and apartment allowances		Yes	In 2004 114 800 people or 23.8% of pensioners
LT	Social assistance pension for people with no sufficient insurance record, upon reaching the retirement age (also for the disabled and orphaned children)	180 LTL in 2005	Pension and other income	System started from 2006
	Social allowance for persons whose family income per person is lower than state supported income	Up to LTL 135	Yes	
LU	Minimum pension (depending on number of insurance years; full amount after 40 years)	EUR 1 190 maximum per month (EUR 14 280 per year)	No	15.4% of all pensioners in 2000
	Guaranteed minimum income	Single: EUR 942 per month (EUR 11 304 per year) Couple: EUR 1 413 per month (EUR 16 956 per year).	Yes	0.9% of all pensioners in 2000

Table 1.3. – Minimum income guarantees for older people (continued)

	Type of income guarantee	Amount <sup>1</sup>	Means-test	Beneficiaries <sup>2</sup>
HU	Guaranteed minimum pension in case of at least 20 years service period (based on contributions including in case of casual work, part-time work, childcare allowances etc.)	In 2005 HUF 24 700	No	1 300 persons (around 3% of new old-age pensions in 2003)
	Non-contributory old-age allowance for 62+ or people who have reached retirement age and couple's per capita income is lower, than 80% of the minimum pension, if living alone lower than 95% of minimum pension	In 2005 HUF 19 760 for people living in couples and HUF 23 465 for people living alone or it supplements income to this level.	Yes	6 679 recipients in 2003 (thus 32 recipients per 10 000 persons above 60)
MT	Minimum Pension Guarantee since 2004	Around 50% of the average wage and is calculated at 80% of the National Minimum Wage in the case of married persons and two thirds in case of any other person.	No	
	Non contributory 'age pension', payable to persons aged more than 60.		Yes	
NL	Residence-based state pension	Single person: EUR 869/month (EUR 10 428 per year). Married and unmarried persons, both 65 and over (also 2 men or 2 women sharing a household): EUR 598/month for each person (EUR 14 352 per year for the couple).	None	100% (of those with full residence records)
AT	Minimum pension ('compensation supplement')	Single: EUR 690 Couple: EUR 1 056 (monthly, 14 payments per year, i.e. EUR 7 560 and 10 800 per year)	Pension and other income	11.6% of pensioners in mid-2002 (14.4% in 1989)

Table 1.3. – Minimum income guarantees for older people (continued)

	Type of income guarantee	Amount <sup>1</sup>	Means-test	Beneficiaries <sup>2</sup>
PL	Guaranteed minimum pension for people who have attained retirement age and have the required insurance period (20 women, 25 men)	Supplements to the pension, up to the sum of PLN 562.58.	Yes	
	Regular allowance to persons whose income does not reach the income threshold due to age or disability	Raises the net income up to PLN 461 for single persons and to PLN 316 per person in a family.	Yes	
PT	Minimum pension (percentage of the minimum wage net of social insurance contribution. Level depends on career length.	65-100% of net minimum wage	No	58.8% of pensioners in the general scheme (invalidity and old-age)
	Minimum pension – special social security scheme for agricultural workers	60% of net minimum wage	No	13.5% of pensioners covered by the public social security system
	Social Pension (non-contributory)	50% of net minimum wage	Yes	5.9% of pensioners covered by the public social security system
FI	Residence-based national pension	Single: EUR 485 or EUR 505 depending on the place of residence Spouses: EUR 428 or EUR 445 depending on the place of residence.	Means-tested against other pension income only	Full amount: 8% of pensioners Partially paid for 52% of pensioners
	Social assistance	Mainly as a supplement to low pensions for exceptional expenses.	Yes	5-6% of people aged 65 and over

Table 1.3. – Minimum income guarantees for older people (continued)

	Type of income guarantee	Amount <sup>1</sup>	Means-test	Beneficiaries <sup>2</sup>
<b>SI</b>	Minimum pension percentage for calculating old-age pension benefits differs with the sex of the insured person	Men aged 65 and over are granted pension in the amount of 35% of the pensionable earning, while women aged 59 years and 8 months in 2004 (61 years after 2008) are granted 38% of the pensionable earning (40% before 2000)	No	All insured with at least 15 pensionable service.
<b>SK</b>	Social assistance – aid in material need composed of basic amount, healthcare allowance, housing allowance and protecting allowance for those at pensionable age	In 2005 Single: maximum SKK 4 670 per month Couple: maximum SKK 8 360 per month	Yes	8 082 persons at pensionable age
<b>SE</b>	Residence-based guarantee pension for people aged 65+	Single: maximum SEK 82 200 Couple: maximum SEK 146 600 per year	Only public earnings-related pension taken into account	Approximately 830 000 pensioners
	Maintenance support for elderly persons age 65+ (social assistance supplemented by housing allowance)	Single: maximum SEK 57 000 Couple: maximum SEK 42 700 per year	All incomes, wealth	Some 11 000 pensioners (2/3 non-Swedish). For those with an insufficient total income after housing costs are paid.

Table 1.3. – Minimum income guarantees (continued)

	Type of income guarantee	Amount <sup>1</sup>	Means-test	Beneficiaries <sup>2</sup>
UK	Basic state pension	GBP 82.05 per week in 2005-06 (GBP 4 267 per year)	No	96%-98% of pensioner units have income from it (in 2005)
	Pension Credit is an income-related benefit ensuring a minimum income guarantee for people aged 60+. It replaced the Minimum Income Guarantee (MIG) from October 2003.	Single: GBP 109.45 per week (GBP 5 691 per year) Couple: GBP 167.05 per week (GBP 8 687 per year per couple).	Yes. But income tests are less tough than previous Minimum Income Guarantee, especially for incomes between the basic State pension and the minimum income guarantee.	Over 2.7m pensioners out of 11.8m benefited from the Pension Credit in 2005.
	Saving credit element of Pension Credit ensures that pensioners over 65 who have modest savings are rewarded.	Single: GBP 151 per week (GBP 7 852 per year) Couple: GBP 221 per week (GBP 11 492 per year per couple).	Yes, but Pension Credit has reduced the number of persons who are affected by capital rules. The first GBP 6 000 of savings are disregarded.	Up to 1.9m benefited from Saving Credit in 2005.

Note: Information from National Strategy Reports and MISSOC.

(<sup>1</sup>) The minimum income guarantee levels are not comparable for different Member States. Non-cash benefits and the provision of housing benefits (not included in the amounts in this table) have considerable effects on the effective minimum income guarantee provided to older people.

(<sup>2</sup>) The numbers or shares of older people/pensioners in this column do not necessarily refer to people who can only rely on the minimum income level. Actual incomes will be higher depending on the type of means test associated with the minimum benefit. In particular, in countries with universal flat-rate benefits, the share of beneficiaries will be high, but most will receive income from other sources in addition to the guaranteed public pension.

### 1.3. Challenges of poverty reduction

Most Member States expect that minimum guarantee schemes will continue to play a residual role and will not have to cater to a large proportion of the pensioner population. The future need for, and hence cost of, these minimum guarantees will depend on whether future pensioners will have accrued sufficient pension entitlements under public and private schemes to lift

them above the guaranteed minimum levels and poverty lines. Structural change, in some Member States should progressively result in more people having completed long careers with good pension insurance coverage. Increased female labour-force participation will translate into higher women's individual pension entitlements. In that respect, the general coverage of the current active population by pension schemes is a key driver of future adequacy.

### 1.3.1. Keeping pensioners out of poverty

It should be noted that inflation generally erodes the purchasing power of an individual pension benefit, since the time when it was first claimed and induces pensioners' income to lag behind the general evolution of income. Indeed when the indexation rules of minimum pensions and earnings related or private pensions are different, a less favourable minimum pension indexation can have unintended consequences on the distribution of income and on poverty risks among older people, though indexation on prices preserves the purchasing power of minimum benefits. This can be particularly harmful for people relying on minimum guarantees in their older ages. Conversely, where minimum income guarantees keep pace with average earnings there may be fewer incentives to save or work longer.

### 1.3.2. Unintended consequences of minimum income guarantees

For working-age people, the interaction of means-tested social assistance schemes and incentives to work is generally an element of a comprehensive strategy towards favouring employment (see objective 4). In the case of pensioners, such concerns are less relevant, which contributes to the current situation where older people generally enjoy a better level of minimum protection than younger people, in particular working-age people. Nevertheless, care must be taken to ensure that means tests applied to pensions do not weaken incentives to save and work before retirement.

The United Kingdom is addressing this problem with the new 'Pension credit' that 'rewards' people for their private saving. The introduction of a smoother means test (dramatically reducing the number of people who

face 100% withdrawal on their private saving) reduces potential disincentives but conversely increases the numbers who are eligible for the benefit. Current projections suggest that the number of those eligible will increase significantly in the coming years; this may be a cause for concern in the future.

## 1.4. Conclusion – eliminating poverty risks in old age

Through different types of provisions, Member States provide minimum levels of income to older people who have not accrued sufficient pension entitlements in their own right. As a result, older people, face in general about the same risk of poverty as people below the age of 65. In several Member States, however, poverty risks are significantly higher for older people and in all Member States older women are at a greater risk of experiencing higher poverty rates. This probably results from lower pension accrual throughout their working lives, but also to indexation rules of minimum incomes in payment.

Reforms of minimum income provisions for older people have been introduced in several Member States in recent years, which will improve minimum pension levels and probably reduce poverty amongst this cohort. Nevertheless, care must be taken to ensure that means tests applied to pensions do not weaken incentives to save and work before retirement and that minimum pensions are associated with adequate indexation rules.

Finally, it remains to be seen to what extent the dynamics of pension systems (translating into more pensioners with full careers) can reduce poverty risks over the coming years, in particular for Member States with significantly high poverty rates among older people who have not introduced reforms of their minimum guarantees.

## Objective 2 – Enabling people to maintain living standards

Provide access for all individuals to appropriate pension arrangements, public and/or private, which allow them to earn pension entitlements enabling them to maintain, to a reasonable degree, their living standard after retirement

achieved during their working lives. Earnings-related pensions are essential in that respect and they will continue to provide the main source of pension to retired people in the future.

To evaluate the relative position of pensioners, only monetary income (notably deriving from the pension system) is taken into account.<sup>(8)</sup> Thanks to pension entitlements that generally provide around 70% of individual's retirement income (in particular statutory pension schemes and binding collective agreements), older people have a living standard that is relatively close to that of the general population, generally ranging between 75% and 90% of that of the 0-64 population (see table 2.1).

### 2.1. Current income situation of older people

Pension systems not only aim at ensuring that older people do not have to live in poverty, but more generally provide arrangements to allow people to maintain, to a reasonable degree, the living standard they

Table 2.1. – Income of people aged 65 or more (in percentage points)

	Relative median equivalised income of people aged 65+ compared to those aged 0-64			Source of household income of people aged 65+			
	Total	Men	Women	Pensions	Other social benefits	Income from work	Other sources
BE	76	76	76	84	4	11	3
CZ	83	85	82	78	4	14	4
DK	71	74	71	76	23	0	0
DE	88	Nd	Nd	Nd	Nd	Nd	Nd
EE	76	80	72	60	6	24	10
EL	78	81	77	71	4	24	4
ES	77	79	76	78	3	19	3
FR	90	93	89	91	4	4	5
IE	62	63	61	70	10	18	2
IT	95	98	94	83	2	14	3
CY	55	58	54	70	3	25	2
LV	80	84	78	61	3	31	5
LT	89	96	85	62	6	31	1
LU	101	99	101	77	4	17	5
HU	87	92	84	75	1	20	4

(8) The wealth of pensioners, in particular house ownership, and private savings, which have a strong effect on the income distribution of pensioners, are not taken into account, as well as other non-monetary benefits (These include free healthcare, transport, etc., See also box 1.1 under the first objective concerning income and living conditions data).



Table 2.1. – Income of people aged 65 or more (in percentage points) (continued)

	Relative median equivalised income of people aged 65+ compared to those aged 0-64			Source of household income of people aged 65+			
	Total	Men	Women	Pensions	Other social benefits	Income from work	Other sources
<b>MT</b>	90	96	86	45	4	14	38
<b>NL</b>	84	88	83	74	1	13	1
<b>AT</b>	93	98	90	79	3	18	2
<b>PL</b>	113	122	107	Nd	Nd	Nd	Nd
<b>PT</b>	76	77	75	72	5	22	3
<b>SI</b>	87	94	83	71	2	21	6
<b>SK</b>	89	89	89	Nd	Nd	Nd	Nd
<b>FI</b>	75	81	72	82	7	10	0
<b>SE</b>	77	83	73	83	7	8	3
<b>UK</b>	74	76	73	69	2	17	12

Source: see box 1.1 in chapter 1.

In some Member States, this level is significantly below 70% (Ireland and Cyprus), reflecting relatively low pension entitlements as well as fast economic growth which mainly benefits people of active age. In a number of Member States, relative income of older people is between 70% and 80% (Belgium, Denmark, Estonia, Spain, Portugal, Finland and United Kingdom), while a number of Member States acknowledge levels higher than 90% (France, Italy, Luxembourg, Austria, and Poland). There are also significant differences between men and women. This information is based on household and not individual incomes (it is assumed that individual income is pooled and equally shared within the household) this should therefore be taken into account when interpreting these results.

ured empirically reflecting actual current situations or theoretically reflecting the design of pension systems for different typical cases. These can then be used in order to analyse future adequacy of pensions and in particular the effects of enacted pension reforms.

Two measures of the effect of pension on the adequacy of income situation are used here: empirical measures of income, relating median pensions to median income and theoretical replacement rate (see box 2.1.). The former are used to describe the current situation, while the latter are used to describe the effect of enacted reforms on future replacement rates provided by pension systems.

## 2.2. Current replacement rates and likely evolution

Future levels of pensions in relation to earnings (income replacement levels) will depend firstly on the pace of accrual of pension entitlements (which is linked to evolutions in the labour market, see chapters 4, 5 and 9) and the maturation of pension schemes. Levels of pensions in relation to earnings can be meas-

### Box 2.1. – Current and prospective replacement rates, empirical and theoretical measures

Pension adequacy indicators based on income data from household surveys allow an assessment of the poverty risk and income conditions of older people relative to those of people below retirement age. An empirical measure of income replacement evaluates individual pensions for a cohort of people over the retirement age relative to individual work earnings using household survey data. This measure takes individual median earnings of people aged 50-59 years as the denominator. Individual median pensions (excluding other social benefits) received by people aged 65-74 are the numerator.

Empirical measures of replacement rates through income data bases generally comprise other sources of income of households on which elderly people can draw, either through their own entitlement or through sharing of resources with other household members. As a consequence, the specific contribution of pension schemes to the income individual situation of the elderly cannot be completely gauged. Moreover, income provided today by current pension systems does not necessarily inform about the income situation of future generations of elderly people, since pension systems are being reformed in many countries.

These indicators need then to be complemented by another type of information, more specifically focused on the pension systems themselves and their future evolution, i.e. theoretical replacement rates. Theoretical replacement rates refer to the replacement of income obtained when people retire: it is at the moment of take-up, the ratio of pension income on the first year of retirement divided by work income during the last year before retiring. The framework developed by the Indicators Sub Group (hereafter ISG) (see 2004 progress report to SPC on replacement rates, further work was carried out in 2005, notably with a refining of the methodology first elaborated within an ad-hoc group of the ISG), refers in its base case to a worker retiring at 65 after a career of 40 years at the average wage. Some Member States have included funded occupational and voluntary schemes in their base case Belgium (occupational pensions), Denmark (occupational, SP and ATP schemes), Germany (occupational or Riester Pensions), Ireland (occupational pensions), Italy (diverting of TFR to pension funds), the Netherlands (occupational pensions, results presented refer to the case of indexation of 80% on wages), Sweden (occupational pensions) and the United Kingdom (occupational pensions). Other cases are also taken into account (but are not referred to here, for brevity's sake). First of all, a pension-wage ratio after 10 years of retirement is presented, as a complement to the base case. This provides an assessment of the evolution of the relative position of the individual, typically reflecting pension indexation. Several variants are also included: with respect to earning profiles (linear profile from 80% to 120% and from 100% to 200% and concave profile from 75% to 105%) as well as for one low-wage pensioner (flat 66% of the average), but also considering the variant of a broken career or of early and deferred retirement.

General assumptions are the same as those used by the Ageing Working Group of the Economic Policy Committee (hereafter AWG) in the framework of pension expenditure projections (although the type of pensions considered may not always be exactly the same as those considered by Member States in the expenditure projections) and include administrative costs on real rates of returns for private pensions. Assumptions used on long-run rates of return are of 2.5% (3% of gross real rates of return minus 0.5% of administrative charges; the Netherlands and Denmark used 0.25% of administrative charges, reflecting lower administrative costs enabled by large scale pension schemes).

The theoretical replacement rates and the empirical measures of pension adequacy based on income data are complementary and should be looked at together for a better understanding of a national pension system. Work is in progress in the ISG of the Social Protection Committee to develop a full set of indicators enabling assessment in a more comprehensive manner current and future adequacy.

Replacement rate calculations give a picture of national and overall EU pension adequacy and their projected evolution. It should be underlined that, by construction, the exercise of calculation of theoretical

replacement favours comparisons for a given Member State of replacement rates in different cases and for different dates (base case and different variants). Given that assumptions used are common, comparison between Member States of expected trends provide useful information on projected trends, but one should also bear in mind other factors such as the expected evolution in employment or expenditures. The most complex dimension is probably the comparability between Member States of current replacement rates, as the replacement rate methodology used refers to a theoretical case, whose representativeness differs considerably between Member States. In order to facilitate the interpretation of results, it is essential to dispose of information concerning background information on representativeness.

It should be underlined that individual projected theoretical replacement rates provide elements for different typical cases, which cannot directly be compared with the evolution of future average pension related to average earnings, which reflects several structural effects and general trends (such as the maturing of pensions systems).

It is also important to take into account taxation, as this generally raises the relative living standard of older people: replacement rates net of taxes and social contributions are higher than gross replacement rates. This reflects essentially the fact that pensioners generally pay lower social contributions (and generally no social contributions for pensions) and that income tax is progressive, while there can be special tax provision for pensioners and older people.

Pension schemes (in particular statutory ones and widely-developed private ones) on the whole, currently manage to ensure adequate income replacement levels after a full career in most Member States (see table 2.2). However, in certain cases, current average

pension levels turn out to be low compared to current earnings, reflecting low coverage or low income replacement from statutory schemes as well as maturing pension systems and incomplete careers or under-declaration of earnings in the past.

Table 2.2. – Median pension relative to median earnings

	Total	Men	Women
BE	0,61	0,60	0,61
CZ	Nd	Nd	Nd
DK	0,38	0,38	0,39
DE	Nd	Nd	Nd
EE	0,68	0,70	0,68
EL	0,60	0,62	0,57
ES	0,63	0,64	0,62
FR	0,72	0,72	0,74
IE	0,63	0,64	0,62
IT	0,74	0,76	0,71
CY	0,42	0,44	0,41
LV	0,54	0,62	0,54
LT	0,63	0,68	0,61
LU	0,67	0,64	0,77
HU	0,71	0,68	0,72
MT	0,67	0,75	0,53

Table 2.2. – Median pension relative to median earnings (continued)

	Total	Men	Women
NL	0,42	0,43	0,42
AT	0,58	0,57	0,60
PL	Nd	Nd	Nd
PT	0,58	0,57	0,60
SI	0,68	0,74	0,61
SK	Nd	Nd	Nd
FI	0,53	0,52	0,54
SE	0,67	0,66	0,69
UK	Nd	Nd	Nd

Note: Median individual pension income of retirees aged 65-74 in relation to median earnings of employed persons aged 50-59 excluding social benefits other than pensions.

Sources: Cf. box 1.1 chapter 1.

### 2.3. Reforms generally translate in a decline of replacement rates at a given age

Prospective theoretical replacement ratios describe the predicted evolution of pension income of retired people, taking into account any recent reforms. They should allow an assessment of adequacy of income, which is essential both at a general level and for individuals who need to make decisions on their future income. Comparison between Member States of projected trends provide useful information on expected trends, but one should also bear in mind that other factors are also at play, such as the expected evolution in employment or rates of returns, as well as the general development of pension expenditures.

As illustrated by the work carried out on replacement rates by the Indicator Sub-Group, reforms of statutory schemes will often lead to a decrease of replacement rates at given retirement ages (see table 2.3), which also reflects the trend towards an increase of life expectancy at 60 or 65. Indeed, it should be noted that all types of pension provision have to adapt to the trend of such increases (be they pay-as-you-go, funded defined contribution or defined benefit schemes).

As the replacement rate representativeness differs considerably between Member States, it should be noted that in order to ensure a better comparability between Member States and facilitate the interpretation of results, it is essential to dispose of information concerning background information on representativeness (last columns of table 2.3).

Table 2.3. – Evolution of theoretical replacement rates from 2005 to 2050

	Change in theoretical replacement rate in percentage points (2005-50)				Assumptions and background information				Decline in the net replacement rate, 10 years after retirement (in percentage points) (*)
	Net (Total)	Gross replacement rate			Statutory pensions		Occupational and voluntary pensions		
		Total	Statutory pensions	Occupational and voluntary pensions	Cover- age rate (%)	Contribu- tion rate (%)	Cover- age rate (%)	Contribu- tion rate (%)	
BE	7	4	-2	6	68	46.3a	40-45	4.25	-4
CZ	-9	-8	-8	:	100	28	:	:	-13
DK	5	15	-6	21	100	0.9 b	78	12.7	-3
DE	4	5	-9	15	Na	19.5	70	4	0
EE	2	3	3	:	100	22	:	:	-2
EL	-9	-11	-11	:	Na	20	:	:	-16
ES	-5	-6	-6	:	89	28.3	:	:	-15
FR	-17	-17	-17	:	Na	20	:	:	-12
IE	0	0	3	-3	100	9.5	52	20.5	-1
IT	4	1	-15	16	100	32.7	11.4	6.91	Nd
CY	18	11	11	:	Na	16.6	:	:	-7
LV	-7	-7	-7	:	100	20	:	:	-7
LT	-4	2	2	:	83	26	:	:	-6
LU	1	0	0	:	92	24	:	:	1
HU	-1	12	13	:	100	26.5	:	:	-13
MT	-27	-19	-19	:	:	20	:	:	:
NL	-2	-2	0	-2	100	7	91	14-15	-10
AT	14	5	5	:	100	22.8	:	:	-10
PL	-34	-27	-27	:	77	36.9	:	:	-26
PT	1	-5	-5	:	82	32.6	:	:	-10
SI	-22	-25	-25	:	100	24.35	92	0-5.8	:
SK	1	1	1	:	Na	Na	:	:	:
FI	-1	-5	-5	:	100	21.6	:	:	-8
SE	-14	-12	-13	0	100	17.2	90	13.7	-10
UK	3	3	2	0	100	14.75 – 10.9	56	23.7	-6

Note: Source see box 2.1. (:.) stands for not applicable or not available. Coverage rates refer to the coverage of the labour force and contribution rates to overall contribution rates as a share of gross wages (from employees and employers) used as assumptions for the calculation of theoretical replacement rates (coverage rates may differ from currently observed figures displayed in table 2.4; contribution rates may also differ from current levels reflecting for instance projected increases in contribution rates). (a) For Belgium, this refers to the overall Social Security contribution rate, due to its global management (b), for Denmark this does not include transfers from the general budget. The column referring to statutory pensions includes for some Member States (Estonia, Latvia, Lithuania, Hungary, Poland, Slovakia and Sweden) the mandatory funded tier, which is a defined contribution scheme. The column referring to occupational or voluntary schemes generally refers to defined contribution schemes, with the exception of Ireland, the Netherlands, Sweden and the United Kingdom, where defined benefit schemes have been considered.

The first four columns provide the evolution of theoretical replacement rates in percentage points from 2005 to 2050, for a worker retiring at 65 after 40 years on average earnings (net or gross, total, and contributions from statutory scheme and, from occupational or individual schemes). The following four columns provide background information (coverage levels) and information on contribution rates used for statutory schemes and also possibly occupational or private schemes included in the base case, thus giving elements on the representativeness associated with the base case. The last column indicates the decline of the replacement rates after 10 years of retirement and in percentage points in the base case for a worker retiring in 2005.

As pensions in payment are generally indexed on prices (or on an aggregate of wages and prices, with various weights), they often lag behind the evolution of wages. This can translate into significant declines of the level of theoretical replacement rates during the period of retirement (see last column of table 2.3, which refers to the decline after 10 years of retirement of the net ratio of pension in payment in relation to wages of people at the age of retirement).

However, it should be stressed that trends in individual theoretical replacement rates will not directly translate into equivalent changes in future pensioners' income in terms of household income. Rising female labour force participation in all Member States will result in higher average pensions. In southern or New Member States, economic modernisation and corresponding employment changes will also lead to better pension outcomes in the future. Due to these structural evolutions, the trend towards less generous benefit rules could be counter-balanced to a significant extent. However, other factors could also work in the opposite direction, for example further postponement of entrance to the labour market or an increase of periods of unemployment.

The tendency towards a decline in prospective replacement rates at a given age is a result of various adjustments. The evolution of the overall (net) replacement rate reflects different revenue streams – the statutory schemes (either pay-as-you-go or funded tiers where relevant) and in some Member States, private pension schemes (occupational or individual see box 2.1; in these Member States, this income will only benefit those who are actually covered by these schemes – see table 2.3 outlining coverage – and thus a significant share of pensioners will rely on statutory schemes only).

Most Member States have statutory pension schemes providing earnings-related pensions. Benefits under these pension schemes are related to earnings either during a specified number of years towards the end of

the career or increasingly during the entire career. The contribution period taken into account in the calculation of pensions, as well as the pace of revalorisation of past wages (no revalorisation, revalorisation on prices, on wages, or a mix) and the pace of indexation of current pensions are very different among Member States and are generally the target of adjustments during recent reforms.

Several countries extended – or are still in the process of extending – the period of an individual's earnings history that is used for calculating the pension entitlement (e.g. Austria, Spain, France, Hungary, Portugal, Finland and Italy). Thus, instead of using the years of highest earnings towards the end of the career, earnings during a much longer period or even the entire career (in notional defined contribution schemes like in Sweden or Poland) are taken into consideration. This will usually lead to lower pension levels, particularly if past earnings are not fully adjusted for (nominal) wage growth. This also has implications in terms of the mechanics of redistribution of pension systems, as more homogeneous career profiles will benefit from such changes more than careers with rising earnings in later years.

Pension levels can also be lowered through adjustments in the formula used to calculate benefits. One significant development has been the introduction of a demographic adjustment factor. In the Swedish and Italian pension schemes (as well as in the Finnish scheme from 2009 onwards) rising life expectancy will lower the replacement rate unless people postpone their retirement. In Germany, France and Austria recent reforms have also introduced mechanisms to take into account future demographic trends and in particular increases in life expectancy. Thereby, they provide strong incentives for people to postpone their retirement in accordance with rising life expectancy and offer opportunities for achieving adequate or improved pension levels.

## 2.4. Responses to the projected decline in replacement rates

Member States generally do not have explicit targets regarding the level of living standards after retirement compared to pre-retirement, but in a number of Member States explicit targets of replacement rates have been agreed, whilst implicit levels can arise from the calculation of pension entitlements.

In France, the general scheme has a target of 50% replacement rate of the reference wage (including the mandatory supplementary schemes), while the 2003 reforms predict an increase of net replacement rates for those earning the minimum wage to 85% by 2008. The German government committed itself to make adjustments, should pension benefits fall below the minimum projected pre-tax replacement rate of 46% until the year 2020 and 43% until the year 2030 (based on a legally defined 'standard pensioner' with 45 years of contributions at average earnings, the current level of the pre-tax replacement rate was 53% in 2004). In the Netherlands, an implicit target can be deduced from the overall design of pension entitlements (including occupational pension schemes and taxes), as contributions to pension schemes are generally only deductible from earnings up to a certain amount. This is limited to what is needed to achieve a gross replacement level of 70% of gross final earnings after a 40-year career.

Two major policies have been developed by Member States to cater for the projected decline in replacement rates at a given age; the strengthening of incentives to work longer and the development of private pensions. All Member States have increased the accrual of pension rights if people work longer and these should act as incentives to work longer, thus going some way to compensate for the projected decrease of replacement rates. Moreover, in a number of Member States, the development of privately-managed pension provision is also projected to play a role in compensating future decreases in replacement rates. Furthermore a number of Member States (such as Belgium) have embarked on a strategy of public debt reduction, creating room for manoeuvre in order to finance adequate pensions in the future.

### 2.4.1. Strengthening the incentives to work longer

Since 2003, a number of reforms have strengthened the benefit-contribution link of pension systems. In defined-benefit schemes, the link has been strengthened

through a longer contribution period required for a full pension, while applying actuarial reductions for early pensions and increases in pension rights for deferred retirement. Some Member States are implementing or have already implemented major reform packages that have substantially modified their statutory schemes. In Germany, in addition to the 2001 reform, measures of the Sustainability Act in 2004 introduced a sustainability factor in the pension indexation formula, requiring additional adjustments if the ratio between contributors and beneficiaries worsens. In France the 2003 reform proposes an increase in the number of contributory years that are required for a full pension (which will be further increased in line with any future increase in life expectancy) as well as strengthened incentives to work longer and a maintenance of the indexation of pensions to prices. In Austria, the 2005 reform increased the contributory years needed for a full pension and strengthened incentives to work longer through a 'bonus/malus' system. It also introduces a far more uniform pension system across the public and private sectors and introduces the indexation linked to prices from 2006. The Finnish pension reform, implemented mainly in 2003-05, introduced a life expectancy coefficient, with the effect of adjusting future pensions to the increase in life expectancy and increased incentives to work by higher accrual of pension rights for older workers. The reforms also overhauled early retirement arrangements. In 2005, Italy introduced further incentives to postpone retirement, allowing workers that can already retire to continue working and accumulate additional pension contributions on a tax exempt basis until 2008. At this point the minimum retirement age will be further increased.

Notional defined contribution schemes (such as in Sweden and Poland) also build on a strong link between contributions and benefits. Since the end of the 1990's, following the Swedish reform that introduced the premium pension, a number of Member States have also introduced statutory funded pension schemes (Poland, Hungary, Estonia, and Latvia). These have been followed by Lithuania (in 2004) and Slovakia (in 2005).

### 2.4.2. Development of privately-managed pension provision

In Member States where statutory pensions provide a relatively modest level of income replacement, the abil-



ity to maintain one's living standard after retirement depends to a large extent on access to funded tiers of the statutory scheme or to private occupational or personal pension provision (such as in Denmark, the Netherlands, Ireland, United Kingdom). In some Member States the funded tier of the statutory scheme is expected to contribute significantly to the future income of pensioners (Poland, Estonia, Latvia, Lithuania, Hungary, Slovakia). A number of countries have also increased provisions for occupational or private schemes that complement public pensions (Belgium, the Czech Republic, Germany, Italy, Austria).

In these countries achieving good coverage rates of private schemes (i.e. the number of employees actually making contributions) and adequate benefit levels are particularly important goals for policy-makers. Instruments for promoting private pension provision are diverse and include collective bargaining, tax incentives or direct financial support in the form of subsidies (as introduced by the latest German pension reform, or also in the Czech Republic), or rules that make membership in such schemes mandatory (or quasi-mandatory). In Lithuania, access to the funded tier of statutory scheme is voluntary, but once individuals are members they don't have the option of opting-out. In the United Kingdom, the 'State second pension' provides a compulsory earnings-related additional pension which is particularly beneficial to people on

low incomes or people with interrupted careers. Opting out of this system is possible, but only into a private or occupational scheme that has fulfilled certain criteria which provide at least the benefits of the foregone state scheme. The silent assent introduced in the Italian TFR appears to be half way house between mandatory and voluntary membership.

It should be noted that tax incentives alone generally do not translate into comprehensive coverage, and several Member States rely on the collective bargaining or mandatory membership to achieve better coverage rates. Table 2.4 summarises information about the current importance of private pension provision, through the funded tier of statutory schemes, occupational schemes and voluntary schemes.

It should also be noted that an increasing reliance on private provision also has to be accompanied by appropriate contributions paid to these forms of pension provision. For instance, some Member States assumed in the calculations of theoretical replacement rates that workers will contribute over 10% of their wage and in a few cases more than 20% of salary (see table 2.3).

Social partners have a particularly important role to play in occupational schemes. In the Netherlands, Denmark and Sweden, social partners conclude collective agreements on occupational pension provision

**Table 2.4. – Percentage of employees contributing to a private pension scheme**

<b>BE</b>	About 40-45% for occupational pensions and for individual provisions
<b>CZ</b>	Around 40% for individual provision
<b>DK</b>	Around 95%
<b>DE</b>	About 60% of people covered by the first pillar scheme are also covered by occupational schemes and about 13% make individual provision according to the Riester legislation.
<b>EE</b>	Around 75% of the employed population for the mandatory funded scheme and 8% for individual provision.
<b>EL</b>	Nearly no coverage for occupational schemes.
<b>ES</b>	Around 44% of the employed for the second or third pillar were estimated in 2004 (10% for occupational provisions).
<b>FR</b>	Around 10% for occupational provision and around 8% have subscribed a life insurance plans specifically for retirement purposes.
<b>IE</b>	About 52% of the workforce, including occupational and individual schemes.
<b>IT</b>	Around 8% of the employed population for occupational schemes and 2% for individual provision
<b>CY</b>	Around 27% of the population in employment for provident funds in the private sector and 13% for occupational pensions in the public sector

Table 2.4. – Percentage of employees contributing to a private pension scheme (continued)

<b>LV</b>	Around 45% of the employed population for the mandatory funded defined contribution scheme and around 3% for individual provision
<b>LT</b>	Around 54% of the employed population for the statutory funded pension schemes and around 8% for individual schemes
<b>LU</b>	Around 20% of the employed population for occupational schemes and 5% for individual provision
<b>HU</b>	About 60% of the employed population are members of the funded tier of the first pillar and about 31% have voluntary pension plans
<b>MT</b>	Negligible for occupational schemes (SPPS), not available for other private schemes (TPPS)
<b>NL</b>	Around 90% of employees for occupational pension schemes.
<b>AT</b>	Around 35% for occupational provision and around 10% for individual provision
<b>PL</b>	Around 49% of the workforce for mandatory and occupational provision
<b>PT</b>	Around 4% of the employed population for occupational schemes and 1.5% for individual provision
<b>SI</b>	Around 51% of the workforce is covered by occupational schemes
<b>SK</b>	About 27% of the population in employment are covered by SPF schemes
<b>FI</b>	Around 5% of the population aged 15-64 for occupational schemes and 12% for individual provision
<b>SE</b>	About 90% of the workforce for occupational schemes and 40% for individual schemes
<b>UK</b>	Around 50% of the employed population currently contribute to supplementary pension schemes (about 45% contribute to occupational and about 14% to personal pensions).

Source: National Strategy Reports and Social Protection Committee special study on privately-managed pension provision.  
Note: Figures for coverage from different types of schemes do not necessarily add up (there can be double counting).

at the level of sectors and membership in these schemes is mandatory. As a result, coverage rates of such schemes are particularly high, up to 91% of employees in the case of the Netherlands. Other countries are also now following this approach (Belgium). Social partners are also increasingly seeing pensions as a central part of the employer employee contract and are increasingly taking action in order to protect workers pension rights.

Membership of pension provision can also be based on voluntary decision, as employees may be free to decide whether to contribute to an employment-related pension scheme or to save in a personal retirement scheme unrelated to their employment status (for instance inactive people). In the United Kingdom pension schemes are voluntary for the employee, but employers above a certain size (five or more employees) have to make pension products available if they are currently not offering an appropriate occupational pension scheme (the 'stakeholder pensions'). A similar arrangement is present in Ireland with the 'Personal retirement savings

accounts'. In Germany (Riester pension), the Czech Republic (State Supplementary voluntary pension), and Spain, private individual pensions are also developing. Offering supplementary pension provision within an employment context is particularly meaningful given the objective of income replacement.

Regarding private pension provision, it can be expected that their contribution to incomes will rise in some Member States. In particular a number of Member States are developing a funded tier within their statutory schemes (Sweden, Estonia, Latvia, Lithuania, Poland, Hungary, Slovakia), which will contribute to the replacement rates delivered to future pensioners from these schemes (first payments will occur at the end of the decade for many of these). The development of occupational pension schemes, even in countries with high coverage rate, is still recent (by the standards of pension systems), which will translate into a significant increase of the number of pensioners with entitlements for a complete career over the coming decades. Some countries plan to partly compen-

sate for the decline in statutory replacement rates by the development of privately-managed pension provision (in particular Germany, Italy, Denmark and to a lesser extent Belgium). It should be emphasised that in order to deliver according to expectations, it is essential to monitor the evolution of coverage and contribution rates to such schemes (see chapter 8).

## 2.5. Conclusion

Future levels of pensions in relation to earnings will depend first of all on the pace of accrual of pension entitlements (which is linked to evolutions in the labour market) and the maturation of pension schemes. They will also be affected by recent reforms, which often lead to a decrease of replacement rates at given retirement ages. This also reflects the trend towards an increase of life expectancy at 60 or 65. However, it should be noted that trends in individual replacement

rates will not directly translate into equivalent changes in future households of pensioners income.

Two major policies have been developed by Member States to cater this projected decline in individual replacement rates at a given age. Firstly through promoting longer working lives, to the extent that employment rates of older people increase (see also chapter 5) and secondly by sustaining or increasing the development of private pensions, (ensuring that in particular they are accessible and meet required standards, see also chapters 8 and 11). Additionally a number of Member States (such as Belgium) have engaged in a strategy of reduction of public debt, which can create room for manoeuvre for financing adequate pensions (see also chapter 6). However, while the expected contribution of privately-managed pension schemes is projected to increase in the coming decades, in most Member States the public pay-as-you-go pension schemes are expected to remain the principal source of income for pensioners.

## Objective 3 – Promoting solidarity

Promote solidarity within and between generations.

### 3.1. Solidarity within generations in public pension systems

Member States highlighted a range of features ensuring redistribution within their pension systems. While the principles of private insurance including freedom to make contracts, risk assessment and risk-related premium calculations leave very little scope for redistribution<sup>(9)</sup>, social insurance systems in contrast (characterised by compulsory membership and uniform regulations) usually include solidarity elements such as risk-sharing and redistribution in favour of specific groups.

#### 3.1.1. Risk-sharing

In public pension insurance systems as well as in unemployment and healthcare insurance systems, individual contributions are not defined by individual risks (such as state of health, profession or life style). Individuals with high risks do not pay higher contributions. In public pension systems pooled mortality risk means that those who die early subsidise those who draw a pension longer than the average. In addition, healthier insured persons contribute to invalidity pensions and unmarried persons pay for survivors' pensions. There are good reasons in favour of risk-sharing between insured persons. Firstly, individuals cannot know in detail whether or not they will be in the groups of higher risk. Risks are multiple and may change suddenly; risk-sharing allows everyone the chance to be beneficiaries of the system. Secondly, societies have chosen to share visible risks such as illness as an act of solidarity.

#### 3.1.2. Reduction of income inequality

Besides risk-sharing, the current design of public pension systems also contributes to reductions in income inequalities amongst the pensioner population. The spread between incomes of the top 20% of the

distribution and the bottom 20% is, generally, more even among the total population over 65 than for the age group 0–64. Exceptions are Luxembourg (equal spread), Denmark, Austria, the Czech Republic and Slovenia, where the inequality of income distribution is slightly higher within the older age groups.<sup>(10)</sup>

The most significant measure to prevent old-age poverty for all is to guarantee minimum pensions or to guarantee income from another source such as social benefit for the elderly (see table 1.2 in chapter 1). Luxembourg, Sweden, Greece, Poland, Cyprus, Hungary and Latvia pointed out the explicit role of the greater relative value of more or less flat-rate-benefits for the population in lower income brackets. Several Member States made efforts to increase the minimum pension level or introduced new means-tested benefits for older people since the first round of National Strategy Reports (Ireland, Belgium, Spain, the United Kingdom, Denmark and Portugal). Progressive pension formulas, as evidenced in the Czech Republic or Belgium's 'minimum pension entitlement per career year' as well as the design of the state Second Pension in the United Kingdom, do, on the whole, result in increased retirement pension for pensioners who had been poorly paid and/or had short or part-time careers. In addition, several Member States like Belgium, Lithuania and Slovenia pointed out the redistributive effect of an unlimited contribution obligation where pension calculations are based on upper earnings limits.

Beyond minimum provisions, Member States compensate for specific unpaid or low-paid periods in their public earnings-related pension systems. Paying credits for periods of unpaid family work, education, sickness or unemployment is therefore a common tool of solidarity within generations. Against the overall trend to reduce future pension benefits in pay-as-you-go schemes, several Member States implemented or improved the crediting of family care periods in the last two decades. Such pension credits may help not only parents (especially women, see chapter 10) to build up adequate pension rights but also other individuals with career breaks or atypical working careers

(9) See report by the Social Protection Committee: 'Privately managed pension provision', February 2005, p.15.

(10) Inequality of income distribution based on equivalised income; income share ratio 80th percentile/20th percentile, Source: Eurostat, Income data used see box 1.1 in Objective 1.

(see chapter 9). Pension credits in case of sickness and unemployment are viewed as an important benefit within health and unemployment insurance, even in times of budgetary restrictions. Consideration should also be given to facilitate job flexibility and lifelong training, within crediting systems.

### 3.1.3. Indexation

Indexation of pension payments is an important feature for avoiding increased poverty rates within older pensioner cohorts relative to younger ones. Recent developments show, however, that more and more countries have switched to price or close to price indexation both for earnings-related schemes and for minimum pension schemes. The calculations of theoretical replacement rates in the base case after ten years, verify the notion that low indexation of pensions in payment increases inequalities in the incomes of older pensioners compared to the population as a whole.

## 3.2. Solidarity aspects in supplementary pension schemes

Several Member States announced their concern that income inequality will grow due to the increased relevancy of supplementary pension provision. The OECD-study 'Income Distribution and Poverty in the OECD Countries in the second half of the 1990s' reinforces these concerns. It clearly pointed out that the slight increase in the share of private pensions and capital income in total incomes of the elderly over the recent years was primarily found in the richer and middle income groups in most of the countries the OECD looked at private capital income of current pensioners (which includes private and occupational pensions) is far more unequally distributed than pensioner income from state sources.<sup>(11)</sup>

The Commission study 'Privately managed Pension Provisions' confirmed that achieving adequate pensions will increasingly depend on access to private pension provision to supplement public pensions.<sup>(12)</sup> In that respect it should be stressed that only three Member States (Denmark, the Netherlands and Sweden) currently reach coverage rate rates higher than 90% of the workforce. All other Member States are some way

away from comprehensive coverage. More than half of them are still a long way below 50%, though a significant number of countries project greater coverage, especially for younger cohorts, by the implementation of mandatory or highly-subsidised supplementary provisions. As a Member State with a longer tradition of broad supplementary pension coverage, Denmark stated that for low-earners supplementary schemes are only now becoming available, while for highly-paid employees they have been available for 10-20 years. Ensuring access and reasonable contribution rates to supplementary pension schemes remains a challenge in most of the Member States. Mandatory participation in supplementary schemes, opt-out models or highly subsidised schemes (especially for low-earning groups) offer possibilities of broader coverage and, or, more equitable supplementary income results.

A certain degree of risk-sharing in supplementary schemes is also possible as well. This is particularly evident in more mandatory supplementary schemes such as the Danish, Dutch and Portuguese models and in privately-managed pension funds carved out of the funded tier of statutory pension schemes (Sweden, Poland, Estonia, Latvia, Lithuania and Slovakia). In these examples the sharing of biometric risks take place (longevity, invalidity, income protection for survivors in the event of early death). Furthermore common annuities for all employment sectors are planned. In addition, coverage for periods of unpaid family work, sickness or unemployment are also present in some supplementary schemes, Belgium, Austria, Poland and Sweden (in the funded tier of first-pillar provisions).

The savings capacity and tax incentives are usually more limited for low-income earners. Therefore ways of subsidising supplementary pension arrangements for the economically weakest, as demonstrated in Germany (through their mainly third-pillar 'Riester-contracts'), could be ways in which redistributive elements in supplementary pension schemes can be introduced. However, labour market participation and wages define supplementary pension provisions far more than in first-pillar schemes due to the fact that solidarity elements remain weak in most of these schemes.

(11) OECD Working Paper No 22, Michael Förster and Marco Mira d'Ercole (2005), p.43.

(12) Report by the Social Protection Committee, February 2005, p. 17.

### 3.3. Solidarity between generations

Member States seek to ensure that people in retirement have a decent income relative to the population as a whole. The relative income position of people aged 65 and more to the age group 0-64 generally ranges between 75% and 90%, while in Ireland and Cyprus it is lower (see table 2.1 in chapter 2). In this respect, most Member States report that the current relative income situation of older people is generally satisfactory. The situation in Ireland reflects the fact that Ireland is currently the only Member State without some

form of compulsory income-related pension provision for the majority of workers. In Cyprus the earnings-related, partially-funded part of the pension system implemented in 1980 will only approach maturity in the future.

Equitable spreading of the costs of ageing between active persons and pensioners are one of the most important challenges in an ageing society which are closely linked to solidarity aspects between generations. This aspect is discussed in further detail in chapter 7.

## SUSTAINABILITY

### Objective 4 – Raise employment rates

Achieve a high level of employment through, where necessary, comprehensive labour-market reforms, as provided by the European Employment Strategy and in a way consistent with the BEPG.

#### 4.1. Current employment situation

Raising the activity and employment rates of the presently inactive or unemployed in the working-age population is an important way in which Member States can alleviate the problems arising from the shrinking of the workforce that will result when the baby-boom cohorts begin to retire. The negative impact of demographic developments on employment and economic growth potentials can be alleviated by lower levels of unemployment and more persons of working age participating in the labour market (and therefore contributing to both State and supplementary pension provision). Sustainability of pension systems is linked to the economic dependency ratio, i.e. the number of pensioners in relation to the number of contributors. Europe has considerable scope for improving this economic dependency ratio by first achieving the employment goals set by the Lisbon and Stockholm European Councils and then by going beyond them in the longer term.

Raising the activity and employment rates of those aged between 15 and 64 will go a long way to compensating for demographic trends. The mean employment rate currently stands at 63.3%, which is still far from the 70% employment target set for 2010 (see table 4.1.). The enlarged EU is more than 20 million jobs short of this ambition.

Member States' performances against this measure vary greatly. Four Member States are already well above the 2010 employment target (Denmark, the Netherlands, Sweden and the United Kingdom), whereas another four (Cyprus, Austria, Portugal and Finland) are close. Countries with the lowest overall employment rates are Italy, Slovakia, Hungary, Malta and Poland.

Nevertheless, even if the 70% employment rate target is reached, the number of working people will start to decline due to demographics and the dependency ratio will increase. Increasing productivity growth is an option to alleviate the pressure of ageing societies; however, productivity growth over the last years has been slow. For example, comparisons with the US show that annual productivity growth has been about 2 p.p. lower (though the US experienced a more favourable macro-economic cycle). The productivity slowdown in the EU suggests broader underlying difficulties of the EU economies to foster and absorb innovation.

The recent rise in employment is mainly due to women participating in increasing numbers in the labour market (reaching 55.7% in 2004), and also to the increase of older workers continuing in employment (see chapter 5). However, the contribution to this increase in employment by working age men and young people has been neutral or even negative, which is a concern. In the light of a declining workforce employment levels have to be raised in all groups. Moreover, active ageing policies require early intervention (well before 50) and throughout an entire career.

Table 4.1. – Progress towards the Lisbon and Stockholm targets

	Total employment rate (15-64)			Female employment rate (15-64)		
	2004	Change 2001-04	Change 1995-01	2004	Change 2001-04	Change 1995-01
BE	60.3	0.4	3.8	52.6	1.6	6.0
CZ	64.2	-0.8	:	56.0	-0.9	:
DK	75.7	-0.5	2.8	71.6	-0.4	5.3
DE	65.0	-0.8	1.2	59.2	0.5	3.4



Table 4.1. – Progress towards the Lisbon and Stockholm targets (continued)

	Total employment rate (15-64)			Female employment rate (15-64)		
	2004	Change 2001-04	Change 1995-01	2004	Change 2001-04	Change 1995-01
EE	63.0	2.0	:	60.0	2.6	:
EL	59.4	3.1	1.6	45.2	3.7	3.4
ES	61.1	3.3	10.9	48.3	5.2	11.4
FR	63.1	0.3	3.3	57.4	1.4	3.9
IE	66.3	0.5	11.4	56.5	1.6	13.3
IT	57.6	2.8	3.8	45.2	4.1	5.7
CY	68.9	1.1	:	58.7	1.5	:
LV	62.3	3.7	:	58.5	2.8	:
LT	61.2	3.7	:	57.8	1.6	:
LU	61.6	-1.5	4.4	50.6	-0.3	8.3
HU	56.8	0.6	:	50.7	0.9	:
MT	54.0	-0.3	:	32.7	0.6	:
NL	73.1	-1.0	9.4	65.8	0.6	11.4
AT	67.8	-0.7	-0.3	60.7	0.0	1.7
PL	51.7	-1.7	:	46.2	-1.5	:
PT	67.8	-1.2	5.3	61.7	0.4	6.9
SI	65.3	1.5	:	60.5	1.7	:
SK	57.0	0.2	:	50.9	-0.9	:
FI	67.6	-0.5	6.5	65.6	0.2	6.4
SE	72.1	-1.9	3.1	70.5	-1.8	3.5
UK	74.7	0.2	2.9	70.0	0.6	3.3
<b>EU-25</b>	<b>63.3</b>	<b>0.5</b>	<b>:</b>	<b>52.6</b>	<b>1.4</b>	
<b>2010 target</b>		<b>70%</b>			<b>More than 60%</b>	

Source: Labour Force Survey.

## 4.2. Main measures envisaged for raising employment levels

As set out in the revised Lisbon strategy, the integrated Guidelines for growth and employment are built around three key priority areas: attracting and retaining more people in employment, adaptability, and more and better investment in human capital. These priorities demand a comprehensive and interactive approach.

### 4.2.1. Attracting and retaining more people in employment

In the National Strategy Reports, most attention is given to policies to strengthen work incentives in Member States tax and benefit systems.

Such policies can include reductions in taxes or exemptions of social contributions for (low-paid) work and the introduction of in-work benefits, but they can also include aspects more closely related to benefit systems, such as benefit levels, enforcement of eligibility criteria, stimuli for recipients to take up training or

engage in job searching, and active support (training, job search courses etc). Bringing benefit recipients back into the labour market obviously supports the sustainability of social protection systems. By modifying the dynamics of employment and exclusion from the labour market, it can both reduce expenses and increase resources of social protection systems. On the other hand, reductions of taxes or social contributions and in-work benefits can be costly, and better management of benefit systems requires institutional investments.

Some Member States introduced financial incentives to encourage employment (Belgium, France, the Netherlands, Poland, Slovakia and the United Kingdom). Others concentrate on in-work benefits (Spain). Only a small number of Member States undertook a systematic reassessment including taxes, benefits and work incentives inherent in benefit systems. The German Hartz package looks into levels and duration of benefits as well as personalised support. The Netherlands are adapting their social protection system by reducing benefits for the long-term unemployed and implementing stricter criteria for incapacity benefit recipients with the potential to return to work. Employers and benefit recipients are given assistance to reintegrate back into the labour market. Other countries (the United Kingdom, Poland, and Slovenia) are seeking ways to ensure that there are correct labour market incentives for people with health or disability problems or simply restricting disability schemes that have become the main de facto exit from the labour market. A considerable number of countries facing particularly heavy sustainability challenges due to high numbers of long-term benefit recipients have nevertheless failed to develop comprehensive strategies to develop work incentives.

Most countries also present improvements in their active labour market policies such as job search training, personal integration plans and skills updates. Finland focuses on a hard core of structurally unemployed jobseekers by setting up special service centres offering personalised career paths, including labour market subsidies and support for improving job seeking competencies.

In line with the Youth Pact, most Member States pay considerable attention to young people, presenting measures for building employment pathways combining work/apprenticeship with education and training.

This is in response to the ambition of offering a new start to every young jobseeker within the first 6 months of unemployment.

Measures taken by Member States to promote the employment of women and to reflect modern working patterns are not as widespread as should be expected, considering the large contribution they could make to more sustainable social protection systems. Measures that have been taken include improving childcare facilities and encouragements for parents to return to the labour market after the birth of a child. The United Kingdom introduced a right for parents of young children to ask for flexible working hours, Child and Working Tax Credits and a New Deal for Lone Parents aimed at bringing lone parents back to the labour market. Some Member States have nevertheless failed to address disincentives for female participation in their tax system (Germany). Taking better care of the working generation's health may have a strong positive impact on labour market participation. Three countries (Denmark, Germany and Sweden) refer to the need to improve the health of employees throughout their careers. Denmark includes measures to reduce average sick leave, Germany's occupational healthcare is given greater status and is more geared to the maintenance and recuperation of work capacity and Sweden tries to reabsorb increases in sick leave by the implementation of a broad programme aimed at promoting health at work.

#### 4.2.2. Adaptability

Improving adaptability of workers and enterprises received less attention in the responses of the Member States. This is worrying given the increasingly segmented nature of some labour markets. Measures to improve the functioning of the labour market and deliver employment-friendly labour costs are often vague. The core of adaptability lies in finding the right combination of flexibility and security to reduce labour market segmentation.

Many Member States approach this priority by emphasising flexibility for the employer. Policies to address labour market segmentation are given less attention. The concept of 'flexicurity' is a response to the needs of both employers and workers in a rapidly changing labour market, in particular by providing adequate bridges between jobs, from unemployment back into employment, and also transitions into more stable contractual relationships. Flexibility in work arrangements targeted to older people is discussed on chapter 5.

### 4.2.3. More and better investment in human capital

Measures designed to improve the skills and productivity of the workforce are discussed in almost half the NSRs. Member States concentrate on qualitative reforms in education systems, whereas reforms to stimulate adult learning, particularly for the low-skilled, and to improve the link between school and work are less visible. Increasing productivity per worker or per hour worked increases the scope for pension contributions. Ireland increasingly places the quality of its workforce at the heart of its sustainability strategy and focuses on the development of competencies of low-skilled workers in vulnerable professions. Others present lifelong learning strategies, such as Lithuania which aims to encourage those who do not have elementary, secondary or vocational training, to study. Lithuania aims to make sure that at least 15% of working age people are taking part in education at any given time.

### 4.3. Financial impact of the envisaged employment rate growth on pensions systems

As mentioned above, more employment will increase revenues from contributions to pension systems. It will also generate additional pension rights in the future, thereby resulting in higher pension entitlements, notably for women, and hence increased pension expenditure. The mobilisation of labour reserves among women and older workers is also likely to require extra investments and spending (e.g. training, childcare facilities). On the other hand, there will be

tax and contribution revenues not giving rise to new entitlements (e.g. health insurance contributions), savings on transfer payments and a larger GDP. So the effect on public finances and the overall economy is clearly positive. As more women enter the labour force, or work longer, they build their own pension rights resulting in a higher level of social protection and a reduction in existing derived expenditure.

### 4.4. Conclusions

National Strategy Reports on pensions contain a general presentation of efforts to raise employment, as an element of the long-term strategy for sustainable pensions. Efforts to raise employment are concentrated on improvements in the tax and benefit systems in combination with active labour market policies. However, most Member States only present broad measures that are usually not part of a comprehensive reform strategy taking into account in a coherent way - taxes, social contributions, in-work benefits, benefit levels, enforcement of eligibility criteria and stimuli for activation.

The potential contribution of employment policies to the sustainability of pension systems could be more fully exploited. Meeting the employment objective of 70% in 2010 can contribute to pension sustainability, and it is clear that some Member States need to step up their activities during the coming five years in order to achieve this target. Reaching this objective alone will not, however, solve the issue of financial sustainability of pension systems, and countries will, in the long run, need to go beyond the Lisbon targets.

## Objective 5 – Extend working lives

Ensure that, alongside labour market and economic policies, all relevant branches of social protection, in particular pension systems, offer effective incentives for the participation of older workers, that workers are not encouraged to take up early retirement and are not penalised for staying in the labour market beyond the standard retirement age and that pension systems facilitate the option of gradual retirement.

As highlighted in the Joint report by the Commission and the Council on adequate and sustainable pensions of 2003, a significant factor in meeting the pension challenge in an ageing society is to ensure that people work longer and average retirement ages continue to increase. While in the 1960s it was normal to retire well after 60, employment of older workers declined in the 1970s and 1980s in many countries and only recently started to increase: average ages of leaving the labour market are still below the levels of the late 1960s.

This decline in average retirement age, accompanied by an increase in the age of entering the labour market, runs contrary to the substantial increase in life expectancy in the same period. Life expectancy at 60 for the EU-25 rose from 15.8 years to 19.3 years from 1960 to 2000 for men (an increase of 3.5 years), and from 19 years to 23.6 years for women (an increase of 4.6 years). The target set by the Stockholm European Council for employment rates of people aged 55-64 years is 50% by the year 2010. The EU has a long way to go to reach this goal, currently the employment rate is around 41%. A second target related to older workers was set by the Barcelona European Council in spring 2002. It focuses on the average labour market withdrawal age which is to rise by five years by 2010. The average labour market exit age is currently (2003) an estimated 61 years<sup>(13)</sup>. As set out in the previous chapter, achieving the employment goals set by the Lisbon and Stockholm European

Councils, in particular for older workers, are essential, but in the long run the sustainability of pension systems will only be achieved by going beyond these targets. However, progress on performance for raising employment rates and average exit ages has been modest so far.

A particular policy objective for all Member States is to reduce the period of inactivity before retirement. For many Member States their main focus will be on the age group 55-59, a group where the employment rate is already falling considerably (see table 5.1 below). However this should be seen as the first step. Improving employment rates for those aged 60-64 will also be necessary in order to contribute to future sustainability. Furthermore early retirement should no longer be seen as a way to make room for young people or reduce unemployment. A culture shift is required placing a greater emphasis on enhancing working capacity and employability of older workers.

Continued vocational training offers a tremendous opportunity for older workers to acquire new skills and to actualise qualifications throughout his or her professional life. Many Member States have reported their commitment to improve life-long learning, in accordance with the principles agreed in Lisbon. It remains to be seen how this translates into discernable improvements in the employment prospects of older workers. Although this chapter concentrates on design features of social security systems that facilitate later retirement and longer working lives, it is essential for Member States to provide suitable access for older workers for appropriate employment; otherwise incentives provided by social security systems are unlikely to be particularly effective. Progress in this area is set out in detail in the Annual Report of the Commission on the National Reform Programmes of 25 January 2006. Evidence highlighted in the report shows that **comprehensive ageing strategies can achieve good results**, though few Member States address ageing as an integral part of the lifecycle approach to work.

(13) The estimation is based on labour market exit probabilities between age 50 and 70. It can be noted that the methodology can result in spurious variations from one year to the next which can make it difficult to monitor progress over time.

### 5.1. Employment trends of older workers and effective average age of exit from the labour market

The Stockholm target is in part predicated on an increase of employment rates for 55-64 year olds. However, there are different challenges to increase employment in this age cohort, than in younger cohorts.

People who are not employed are either unemployed or inactive (the status of unemployed implies that the person is available and looking for work). Labour Force Survey data show that in the 25 EU Member States 32% of people aged 55-64 were inactive in 2004. The lowest rates of inactivity were registered in Ireland (21.8%) and the highest in Austria (42.6%). The survey therefore suggests that more focus should be targeted on increasing activity rates, rather than purely relying on traditional active labour market measures to find jobs for the unemployed.

In spite of recent improvements, in a number of Member States the employment rate of older workers lies below or around 30% (Belgium, Italy, Luxembourg, Hungary, Malta, Austria, Poland, Slovenia and Slovakia), or between 30% and 45% (the Czech Republic, Germany, Greece, Spain and France), while it lies between 45% and 55% in some others (Latvia, Lithuania, the Netherlands, Estonia, Ireland, Cyprus, Portugal and Finland), and exceeds 55% in only a

few (Denmark, Sweden and the United Kingdom). This clearly indicates the need for a better coordination of efforts to reach the target employment rates of 2010.

Nevertheless, employment rates of older workers have increased in recent years, reversing a long declining trend as shown in table 5.1. The employment rate of older workers has increased from 36% in 1995 to 42% in 2004 for EU-15, while the increase for the EU-25 ranges from 36.6% in 2000 to 41% in 2004. However, the evolution shows significant discrepancies between Member States.

The varying levels of employment for older workers among the 25 Member States reflect different levels of general employment and different rates of decline in employment with age (table 5.1, the two last columns). However, the pace of the decreases in employment rates at 55 and 60 varies greatly among the countries: while on average, the employment rate of 55-59 is 17 p.p. lower than that of 50-54, the decrease varies from about 5 p.p. (Denmark and Sweden) to more than 25 p.p. (Luxembourg, Poland, Slovenia, Austria and the Slovak Republic). It should be noted that Member States where the decline is moderate from 50-54 to 55-59 do not necessarily register a higher than average decline for the transition from 55-59 to 60-64 (as shown in Sweden, Portugal and the United Kingdom).

Table 5.1. – Evolution of older workers' situation in the labour market

	Employment rate of 55-64 (2004)	Change 1995-2001	Change 2001-04	Decline of employment rate from 50-54 to 55-59	Decline of employment rate from 55-59 to 60-64
BE	30	2	5	-22	-30
CZ	43	*0	6	-23	-38
DK	60	7	2	-3	-38
DE	42	0	4	-13	-36
EE	52	*-2	4	-9	-30
GR	39	-2	1	-18	-18
ES	41	7	2	-14	-19
FR	37	3	5	-23	-41
IE	50	7	3	-12	-19
IT	31	-1	3	-24	-22
CY	50	No data	1	-19	-17

Table 5.1. – Evolution of older workers' situation in the labour market (continued)

	Employment rate of 55-64 (2004)	Change 1995-2001	Change 2001-04	Decline of employment rate from 50-54 to 55-59	Decline of employment rate from 55-59 to 60-64
LV	48	*1	11	-12	-26
LT	47	*-1	8	-14	-30
LU	31	1	5	-26	-34
HU	31	*6	8	-22	-33
MT	32	No data	2	-10	-31.5
NL	45	11	5	-16	-36
AT	29	-1	0	-27	-36
PL	26	*-5	-1	-20	-15
PT	50	5	0	-15	-16
SI	29	*2	4	-27	-28
SK	27	*0	4	-30	-31
FI	51	11	5	-14	-35
SE	69	4	2	-6	-20
UK	56	5	4	-11	-26
EU-25	41	*2	4	-17	-29

Source: Employment in Europe 2005 and last two columns from LFS 2004 2<sup>nd</sup> quarter.

\*Indicates data available from 1998-2001

It should also be noted that if all Member States registered a decline of the employment rate from 50-54 to 55-59 comparable to the levels of those Member States with the best records (about 5 p.p.), employment rates among 55-59 would increase by about 10 p.p. If this could be maintained for the 55-59 to 60-64 cohorts, employment rates among 55-64 would increase by about 10 p.p., reaching the 50% objective. This highlights that achieving an increase in the employment rate of older workers to meet agreed targets can be attained, on the whole, by reducing early exits from the labour market.

## 5.2. Main reasons for exiting the labour market

According to the latest Labour Force Survey almost 60% of inactives in the age group 55-64 say that the reason for their inactivity is taking retirement. Around 15% of those questioned state long-term illness or disability and another 15% mention 'other reasons'. Less

than 10% indicate family responsibilities (this is almost exclusively women) and around 5% say they are actively discouraged from re-entering the labour market.

Retirement is clearly the most common cause for inactivity which is even the case when looking at the working age population as a whole. Here retirement ranks as the second most likely reason for inactivity (20.5%) after education or training (31%) with. This phenomenon, to a large extent, can be attributed to attractive and overly generous early retirement schemes. Where early exit opportunities are provided by the State, they often create demand for them well beyond the original intention. This was the experience following the first oil price shock in the early 1970s in most EU-15 countries. More recently early retirement options have been used by the State in order to reduce unemployment, as has been seen in Hungary and **other new Member States** - reversal of these trends is difficult but necessary. It should be noted that measures to restrict early retirement can result in alternative means of early exit



such as long-term illness or invalidity. In **Cyprus**, qualifying conditions for the award of a pension (currently 10 years of which only 3 years of actual contributions are required), may act as an incentive for early withdrawal from employment. In **Estonia** around 40% of individuals were granted a state pension before the general retirement age, most of whom applied for old age pensions from special pension schemes (providing in addition to earlier retirement as well as often being with greater benefits). System design plays a part even in **Sweden**, for example the collectively bargained defined-benefit occupational pensions may give an incentive to stop working prematurely for those with wages above the income ceiling in the national pension system.

### 5.3. Measures to encourage longer working lives

Most Member States outlined measures (especially in their statutory schemes) to increase older employee participation in the workforce. Working longer is generally encouraged by providing pension supplements and leaving earlier discouraged by actuarial reductions, restrictions to early retirement schemes and a review of access to disability and incapacity schemes.

#### 5.3.1. Implementing strict rules for eligibility for old-age pensions

Several Member States (Austria, Lithuania, Sweden, Germany and the United Kingdom) mention the increase of statutory retirement age as one of the measures to keep people in the labour market longer. Austria raised the statutory retirement age by 18 months in 2000 as part of their reform package and that has already contributed to a steady increase of the employment rates of the 55-64 age group. At the same time the average actual retirement age of those retiring between 2000 and 2003 rose by about one year. However, the number of those starting to draw invalidity benefits was growing during the same period. **Lithuania** is going to increase their retirement age to 65 by 2026. Raising retirement ages in **Sweden's** system, differs due to the construction of the annuitisation divisor (that takes into account life expectancy). Individuals who wish to retire on a certain income must take into account changes in longevity. As longevity increases, individuals in Sweden need to work longer in order to achieve a specific level of pension. In the

**United Kingdom** the age in which women can receive a State Pension age will be gradually equalised with men's beginning in 2010 and reach 65 by 2020. The earliest age at which a private or occupational pension can be taken will also be raised from 50 to 55 by 2010. In **Germany**, the age of eligibility to a state pension will be increased from 65 to 67 between 2012 and 2035.

There are also countries that have implemented measures other than the raising of retirement ages in order to increase employment in old age. **Greece** has set stricter preconditions, combining a retirement age limit with the completion of a certain number of contributing years. In France there is a certain employment period required in order to be eligible for a pension, which in 2003 was set on 160 trimesters and is set to increase by one trimester per year until 2012. Portugal has raised the statutory retirement age for civil servants from 60 to 65 years (phased in until 2015) and the years of insurance from 36 to 40 years.

#### 5.3.2. Rewarding deferred retirement and discouraging early retirement

Motivating people to make their own choices about when they retire can be considered even more efficient than restricting the exit from labour markets by statutory retirement ages or financial disincentives. A number of Member States have reported in their National Strategy Reports mechanisms to reward deferred retirement and discourage early retirement.

Some Member States reward later retirement through, for example, higher accrual factors. For instance the Czech Republic offers a more generous accrual rate (1.5% for each 90 days rather than the annual 1.5%) for deferring retirement (i.e. this can amount to an 8% annual increase, in the old age pension) beyond the statutory pension age. In **Luxembourg** the increase after the official retirement age is 3% per year, in Germany and Hungary 6%, in **Slovenia** 7.5%. **Denmark** has also adopted a supplement for deferred public old-age pension. In **Portugal** people can earn 10% for each calendar year worked after the statutory retirement age of 65 (if they have accumulated 40 years of registered earnings) up to the age of 70. The **United Kingdom** is offering unlimited deferral and an incremental rate of 10.4% for each full year of postponed retirement and, for the first time, the choice of a lump sum instead of an enhanced weekly State Pension for



those who defer their State Pension for 12 months or longer. Estonia is offering a high of 11% per year of deferring. However, this has not been widely taken up, probably due to the limited promotion of this option.

Differing approaches to reward later retirement can be observed in the Member States, for example, in **Greece** 35 years of insurance are required in order to be guaranteed a replacement rate of 70%. Insured persons who remain in service for the full period of 35 years, can from 65 to 67 years of age, accumulate an additional 3% for every year worked, so that for 37 years of service the replacement rate reaches 76%.

To discourage early exits from the labour force, Member States have either abolished early retirement schemes or substantially reduced any benefits received. These measures are reported in the National Strategy Reports of Slovakia, Estonia, Poland, Finland, Greece, Hungary, the Netherlands and Germany. **Slovakia** decreases pensions by 0.5% for every 30 days taken before normal retirement age, and the right to early old-age pension does not arise at all where the pension fails to reach the prescribed minimum amount. **Poland** has set rules for the reduction or suspension of early retirement pensions when someone achieves an income covered by social insurance.

**Germany**, besides reducing benefits for early retirement, has implemented several measures in order to limit and further eliminate such schemes being open to the unemployed (this has also occurred in **Hungary**). According to proposals, the statutory pension insurance will, in the future, only offer the possibility of an old-age pension before the age of 65 for individuals with disabilities or those with long contribution histories, (though with reductions in benefits). In **Finland** early retirement is no longer available for those born after 1943 and from now on, the nature of any disability will be taken into consideration when assessing the right of an employee over 60 to a disability pension. Furthermore, the unemployment pension will be abolished and the minimum age for continued unemployment allowance will rise by two years to 59 years. The **Netherlands** no longer allow contributions for early retirement schemes to be tax deductible.

In order to encourage later retirement, employment opportunities must be made available. The value of older workers needs to be recognised by employers throughout Europe, and barriers to later working removed. The implementation of European age discrimination legislation will warrant close monitoring to assess the impact on employer practices in the coming years.

#### Box 5.1. – Directive 2000/78/EC

Directive 2000/78/EC prohibits unjustified forms of age discrimination in employment preventing disadvantaged age groups from participating fully in the labour market. It establishes a general framework for equality in employment, occupation and vocational training.

The directive prohibits direct and indirect discrimination, harassment and instructions to discriminate on grounds of age, disability, sexual orientation and religion or belief in relation to:

- access to employment, self-employment and occupation;
- access to vocational training and guidance;
- employment and working conditions, including dismissals and pay.

The Member States had until 2 December 2003 to transpose the requirements of the directive into national law. However, in order to take account of particular conditions, Member States could, if necessary, have an additional period of up to 3 years from 2 December 2003 to implement the provisions of the directive on age discrimination. The United Kingdom, Germany, Sweden, Belgium and the Netherlands made use of this extra time and for this reason are not obliged to bring into force the prohibition on age discrimination until December 2006 (although the Dutch legislation is fact already in force).

Non-discrimination legislation is necessary to remove structural barriers to the employment of older people, and to ensure that they are not discriminated against in employment, for example in the provision of training. But not all differences of treatment will be unlawful, as they may be justified under national labour market policy and the attempt to increase the employment opportunities of older workers.

### 5.3.3. Providing flexibility in retirement

Work time reduction can be essential in facilitating and encouraging remaining at work after 60. Although scientific studies have shown, that workers over 60 are as effective and productive as their younger colleagues, working full-time in later ages may not be suitable for all kinds of workers. Eroding the cliff-edge between working and retirement (which has had negative impacts for generations of workers) is an important element of increasing employment rates for older workers. **Germany, Finland and France** have had success with part-time work practices before the standard retirement age but in the longer term flexibility should also be closely associated with working beyond statutory retirement ages.

**Sweden** is an exemplar of flexible work arrangements. Here an individual can continue working, taking a partial pension (25%, 50% or 75% of the full pension amount) and also accrue additional unlimited pension rights. **Spain** and **Finland** have also made efforts to increase the flexibility in their systems. In **Luxembourg** gradual retirement is granted to employees aged 57 if they agree to switch from full-time to part-time work.

It should also be noted that these measures for flexible retirement also need to be appropriately publicised and have correct incentives in order to ensure their efficacy.

## 5.4. Conclusions

Working longer is essential for increasing employment rates in general, and making a significant contribution towards improved adequacy and financial sustainability of social security systems. It can be realised by Member States by both increasing activi-

ty levels in the pre-retirement age group as well as promoting working beyond statutory retirement ages. A key question for the future is whether the reforms carried out since the last OMC exercise are sufficiently thorough to ensure efficient incentives to work longer so that the Lisbon targets for employment rates and the increase in the effective retirement age can be achieved. Important differences can be observed among Member States according to the strength of incentives to work longer, depending on the design of the pension system and the policies used to help people back into the labour market. This suggests that the structure of incentives could be further revised in a number of Member States. In particular, attention needs to be paid in a number of Member States to paths of early exit (before the standard retirement age) from the labour market.

Pension reforms give strong incentives to work longer and when well-designed they reward doing so with adequate pensions. However, there is a need to ensure that people can work effectively, longer – as is underlined in Integrated Guideline for growth and jobs 18 (promoting a life-cycle approach to work). As analysed in the Annual Report on the National Reform Programmes, opening up employment opportunities for older workers through accelerating labour market reforms is essential. It is necessary that pension systems are reformed to be supportive to ongoing employment, but to be effective there also needs to be ongoing labour market reforms which ensure suitable access for older workers to appropriate employment.

## Objective 6 – Making pension systems sustainable in a context of sound public finances

Reform pension systems in appropriate ways taking into account the overall objective of maintaining the sustainability of public finances. At the same time, sustainability of pension systems needs to be accompanied by sound fiscal policies, including, where necessary, a reduction of debt. Strategies adopted to meet this objective may also include setting up dedicated pension reserve funds.

A dominant proportion of total pension provision in almost all Member States is organised within the general government sector and, thus, affects the public finances to a great extent. It is necessary to ensure that rising public spending on pensions due to the ageing of the population does not jeopardise sustainable public finances and that appropriate strategies are in place for ensuring the long-term commitments of pension systems. At the same time, sound management of public finances can provide room for manoeuvre as regards the budgetary pressures of ageing populations.

The Commission and the Council, in a joint report<sup>(14)</sup> to the Stockholm European Council on the quality and sustainability of public finances and their contribution to growth and employment, outlined a three-pronged strategy to tackle the budgetary implications of ageing populations:

- Member States should reduce public debt levels at a faster pace.
- Member States should undertake comprehensive labour market reforms, including tax and benefit systems, in order to reach higher employment rates, in particular among older workers and women.
- Member States should undertake appropriate reforms of pension systems in order to contain pressures on public finances, to place pension systems on a sound financial footing and ensure a fair intergenerational balance.

This section focuses on the scope for meeting the budgetary consequences of ageing through pension reforms. It examines what budgetary challenges Member States are confronted with via their pension systems, how Member States are planning to reform them and, finally, how the reforms help to meet the overall objective of financial sustainability of pension systems and, thereby, contribute to the financial sustainability of public finances as a whole.

### 6.1. The current and expected impact of public pension systems on public expenditure

In 2004, the public pension spending varied from 4.7% of GDP in Ireland to 14.2% of GDP in Italy. The low levels of public spending on pensions in Ireland and the United Kingdom stem from the fact that the public pension schemes provide primarily flat-rate pensions while occupational pensions play an important role in the total provision of pensions. Public pension spending is clearly below the EU average also in a number of new Member States such as Estonia, Latvia, Lithuania, and the Slovak Republic. This can be attributed partially to the fact that the current pensions are relatively flat-rate as most of the pensioners have acquired the pension rights before the collapse of the communist regime and partially to the fact that in recent years the economic growth rate has been rapid. In contrast, high percentages of public spending in countries such as France, Austria, Poland and Italy reflect the fact that the pension provision mainly relies on social security schemes and that the main scheme is an earnings-related scheme.

The projections of pension expenditures developed by the AWG (the Ageing Working Group of the Economic Policy Committee, see table 6.1. and box 6.1.) indicate that very different rises in public pension spending over the period between 2004 and 2050 can be

(14) Council of the European Union (2001), 'The contribution of public finances to growth and employment: improving the quality and sustainability', report of the Commission and the (Ecofin) Council to the European Council (Stockholm 23-24.03.2001), 6997/01.

expected, ranging from a decrease of 5.9 percentage points of GDP in Poland to an increase of 9.7 p.p. of GDP in Portugal and 12.9 p.p. in Cyprus.

- On average, in the EU-15, public spending on pensions is projected to increase by 2.3 percentage points of GDP between 2004 and 2050. In the EU-10 new Member States, public pension expenditure is projected to decrease by 1 p.p. of GDP by 2030 and then to rise by 1.3 p.p. by 2050, with an overall increase of 0.3 p.p. of GDP between 2004 and 2050.
- In the EU-15 Member States, public pension spending is projected to rise in all other countries except in Austria. In Austria, the projected decrease, after the spending peak around 2035, can be attributed to the latest reforms since 2000. In Italy and Sweden, the projected increases are very small, which is linked to the fact that the schemes are contribution-defined and, thus, the spending on pensions is driven by the accumulation of contributions primarily.
- Relatively moderate increases (between 1.5 and 3.5 percentage points) in public pension expenditure are projected in a great number of old Member States such as Germany, the United Kingdom, France, Finland, Denmark and the Netherlands. Somewhat larger increases are projected in Belgium (5.1 p.p.) and Ireland (6.4 p.p.).
- The largest challenges on pension expenditure in the EU-15 are faced by Portugal (an increase of 9.7 p.p. of GDP), Luxembourg (7.4 p.p.) and Spain (7.1 p.p.).
- In the EU-10 Member States, public pension expenditure is projected to show very diverse trends: from a decrease of 5.9 p.p. of GDP in Poland to an increase of 6.7 p.p. in Hungary, 7.3 p.p. in Slovenia and 12.9 p.p. in Cyprus. Without
- Poland, in the remaining nine new Member States, the projected increase in public pension spending is 4.9 p.p. of GDP.
- The projected decreases in Poland, Estonia and Latvia, as well as small increases in Lithuania and Slovakia, stem partly from the pension reforms during the last 10 years. These countries have switched a part of the public old-age pension scheme into a private funded scheme. Thus, the public provision of pensions will decrease while the private part will increase. Another reason for a projected decrease in terms of the percentage of GDP is that the GDP growth is anticipated to be relatively high in particular during the next two decades. This growth rate is projected to be higher than the increase in the level of pensions, due to their indexation only partially (or not at all) to wages. This alone will lead to a decrease as a ratio to GDP.
- In Malta, the projected decrease in pension spending after 2020 stems from the current parameters of the pension scheme, notably, the indexation of the maximum pensions to prices, which would lead to relatively flat-rate pensions over time.
- The challenges faced by Cyprus, Slovenia, Hungary and the Czech Republic are among the biggest in the whole EU. While Slovenia and the Czech Republic undertook parametric reforms in their pension system during the 1990s, the systems remain fully as pay-as-you-go public pension schemes. The large increase in the Slovenian pension system is largely due to the fact that pensions are indexed to the net wage growth as of 2006. In Hungary, the dynamic effect of the increasing wage levels is a major driving force for higher new pensions and thereby higher spending level. In Cyprus, a notable increase in the pension levels is a significant contributor to aggregate spending increase.

**Table 6.1. – Gross public pension expenditure as a share of GDP between 2004 and 2050 according to the 2005 projections**

Country	Public pensions, gross as% of GDP								Change 2004-30	Change 2030-50	Change 2004-50
	2004	2010	2015	2020	2025	2030	2040	2050			
<b>BE</b>	10.4	10.4	11.0	12.1	13.4	14.7	15.7	15.5	4.3	0.8	5.1
<b>CZ</b>	8.5	8.2	8.2	8.4	8.9	9.6	12.2	14.0	1.1	4.5	5.6
<b>DK</b>	9.5	10.1	10.8	11.3	12.0	12.8	13.5	12.8	3.3	0.0	3.3
<b>DE</b>	11.4	10.5	10.5	11.0	11.6	12.3	12.8	13.1	0.9	0.8	1.7
<b>EE</b>	6.7	6.8	6.0	5.4	5.1	4.7	4.4	4.2	-1.9	-0.5	-2.5
<b>GR</b>											
<b>ES</b>	8.6	8.9	8.8	9.3	10.4	11.8	15.2	15.7	3.3	3.9	7.1
<b>FR</b>	12.8	12.9	13.2	13.7	14.0	14.3	15.0	14.8	1.5	0.5	2.0
<b>IE</b>	4.7	5.2	5.9	6.5	7.2	7.9	9.3	11.1	3.1	3.2	6.4
<b>IT</b>	14.2	14.0	13.8	14.0	14.4	15.0	15.9	14.7	0.8	-0.4	0.4
<b>CY</b>	6.9	8.0	8.8	9.9	10.8	12.2	15.0	19.8	5.3	7.6	12.9
<b>LV</b>	6.8	4.9	4.6	4.9	5.3	5.6	5.9	5.6	-1.2	-0.1	-1.2
<b>LT</b>	6.7	6.6	6.6	7.0	7.6	7.9	8.2	8.6	1.2	0.7	1.8
<b>LU</b>	10.0	9.8	10.9	11.9	13.7	15.0	17.0	17.4	5.0	2.4	7.4
<b>HU</b>	10.4	11.1	11.6	12.5	13.0	13.5	16.0	17.1	3.1	3.7	6.7
<b>MT</b>	7.4	8.8	9.8	10.2	10.0	9.1	7.9	7.0	1.7	-2.1	-0.4
<b>NL</b>	7.7	7.6	8.3	9.0	9.7	10.7	11.7	11.2	2.9	0.6	3.5
<b>AT</b>	13.4	12.8	12.7	12.8	13.5	14.0	13.4	12.2	0.6	-1.7	-1.2
<b>PL</b>	13.9	11.3	9.8	9.7	9.5	9.2	8.6	8.0	-4.7	-1.2	-5.9
<b>PT</b>	11.1	11.9	12.6	14.1	15.0	16.0	18.8	20.8	4.9	4.8	9.7
<b>SI</b>	11.0	11.1	11.6	12.3	13.3	14.4	16.8	18.3	3.4	3.9	7.3
<b>SK</b>	7.2	6.7	6.6	7.0	7.3	7.7	8.2	9.0	0.5	1.3	1.8
<b>FI</b>	10.7	11.2	12.0	12.9	13.5	14.0	13.8	13.7	3.3	-0.3	3.1
<b>SE</b>	10.6	10.1	10.3	10.4	10.7	11.1	11.6	11.2	0.4	0.2	0.6
<b>UK</b>	6.6	6.6	6.7	6.9	7.3	7.9	8.4	8.6	1.3	0.7	2.0
<b>EU-15<sup>1</sup></b>	10.6	10.4	10.5	10.8	11.4	12.1	12.9	12.9	1.5	0.8	2.3
<b>EU-10</b>	10.9	9.8	9.2	9.5	9.7	9.8	10.6	11.1	-1.0	1.3	0.3
<b>EU-12<sup>1</sup></b>	11.5	11.3	11.4	11.8	12.5	13.2	14.2	14.1	1.6	0.9	2.6
<b>EU-25<sup>1</sup></b>	10.6	10.3	10.4	10.7	11.3	11.9	12.8	12.8	1.3	0.8	2.2

(1) Excluding Greece.

Source: Economic Policy Committee (2006), 'Age-related public expenditure projections for the EU-25 Member States up to 2050', European Economy, Special Reports.

### Box 6.1. – Pension expenditure projections

In 2004, the Economic Policy Committee commissioned a working group (the Ageing Working Group, AWG, consisting of experts from national administrations) to carry out updated projections for age-related expenditure in all 25 EU Member States. The projections had to be based on a common methodology, on revised population projections reflecting censuses of 2000 and common agreed assumptions on the macroeconomic framework with the aim of achieving a good comparability of projections across Member States. Additionally, the Ageing Working Group has coordinated the coverage and disaggregation of pension schemes in the projections, broadened projections beyond public pensions to statutory private pensions and occupational pensions as well as to contributions and pension assets in comparison with the previous exercise of 2001<sup>(15)</sup>. Also, the projection methodologies have been improved in a number of countries. The 2005 projections take into account the estimated impact of pension reforms that have been legislated by mid-2005, for instance, in the projections of labour force participation, the take-up of pensions and pension expenditure.

Gross social security and other public pensions correspond conceptually to the coverage of the 2001 projections of public pension expenditure. The coverage by the projection exercise regarding public pension schemes can be considered very good for all countries, including all significant schemes and also minimum pension schemes for most countries and covering pension benefits with the same definition of benefits.

The revised population projections have revealed for some countries that the pension challenge can in fact be greater than what was estimated up to now. Also, improved projection methodologies and a better consistency between population, labour force and macroeconomic projections have contributed to uncovering unexpectedly large challenges. In fact, the demographic challenge alone would lead to significantly higher increases in pension expenditure than what the current projections show. Other factors, largely thanks to pension reforms undertaken, will offset a major part of pressures caused by the ageing. In particular, benefit ratios (i.e. average pensions relative to average wages) are projected to decline in almost all countries and this is estimated to have the strongest offsetting effect. Also the take-up of pensions is projected to decrease, thanks to reforms that have tightened access to early pensions, increased statutory retirement ages and incentives to work longer. Finally, also increasing employment is projected to counterbalance demographic pressures.

The Ageing Working Group carried out several sensitivity scenarios in order to find out how sensitive the projection results are for various assumptions such as a higher life expectancy, higher employment rates, higher or lower labour productivity and higher or lower interest rates. It was concluded that the public pension expenditure projections are the most sensitive to the assumptions of the life expectancy and the labour productivity growth, while the assumptions on the higher/lower employment rates and interest rates appeared to have only a minor impact on the overall results of the projections. However, it is worth noting that the impact of different assumptions depends significantly on the design of the pension system and, thus, varies across countries.

A higher life expectancy, which was assumed as an increase in the life expectancy at birth by 1–1.5 years by 2050, was projected to increase pension spending by between 0.1 and 0.7 percentage points of GDP over the period of 2004–50 in comparison with the baseline projection. A pension system design which adapts the benefits to the expected lifetime in retirement leads virtually to no increase while in the usual defined-benefit design generally results directly in higher total expenditure.

(15) The commonly agreed projection methodologies and underlying assumptions have been published in European Commission (2005), 'The 2005 EPC projections of age-related expenditure (2004–50) for the EU-25 Member States: underlying assumptions and projection methodologies', Economic Policy Committee, European Economy, Special Report No 4/2005.

### Box 6.1. – Pension expenditure projections (continued)

A higher/lower labour productivity by 0.25 percentage points was projected to result in somewhat more diverse reductions/increases in pension spending. In most countries, the effect was not more than 0.5 percentage points. However, in Germany, after the introduction of the sustainability factor, the changes in this assumption do not affect the pension spending in terms of GDP. The magnitude of the effect of the change in labour productivity growth depends on how closely pensions are indexed to wages, as real wage growths are assumed to be equal to the labour productivity growth rates. If pensions are indexed to wages, a change in the assumption of labour productivity growth would not have a major impact on pension spending as percentage of GDP. In contrast, if pensions are indexed to prices (or to an index with a partial weight of real wage growth), it results in lower pension spending in terms of percentage of GDP. The impact of higher employment either in overall employment rates or in the employment rates of older workers on pension spending depends on how the gain in higher employment rates is achieved and whether the employment increases the pension rights of the person concerned. An assumption of 1 p.p. higher employment rate, gained through decreased unemployment, is projected to decrease pension spending only marginally (on average, in the EU, by 0.1 p.p. of GDP), in comparison with the baseline scenario. This result can be understood by the fact that while employment increases contributors, it also increases the accrual of pension rights and, consequently, the balance between pensions and contributions or between pension expenditure and GDP can change only marginally in the long run. However, in the medium and short run additional contributions should occur earlier than additional pensions entitlement, which should enable a relatively more favourable situation in that respect. The increase of employment appears to impact the adequacy of pensions, resulted from the accrual of pension rights when in employment. When considering the change in the employment rate of older workers, the size and sequence of the impact depend critically on the extent to which this increases pension rights. While in the case of actuarial pension schemes (such as in pure DC schemes) the effect is negligible, it can be notable in the case of non-actuarial schemes, if gained through a lower take-up of non-actuarial early pensions in defined-benefit schemes. Higher/lower interest rates have no impact on pension spending in countries with fully pay-as-you-go systems. Only in countries with funded schemes, the interest rate matters. A higher interest rate helps the financing of the pension scheme and would result in a higher accumulation of the funds while also increasing the pension expenditure if it is a defined-contribution scheme. In contrast, in a funded defined-benefit scheme, the pension expenditure would not be affected but lower contributions would be requested to meet the targeted pensions, thereby resulting in a lower accumulation of the fund.

#### Comparison of the 2004 projections of gross public pension expenditure as a share of GDP with the 2001 projections

Country	2004 projections			2001 projections		
	2004	2050	2004-50	2005	2050	2005-50
BE	10.4	15.4	5.0	9.5	13.3	3.8
CZ	8.5	14.0	5.6			
DK	9.5	12.8	3.3	11.3	13.3	2.0
DE	11.4	13.1	1.7	11.4	16.9	5.5
EE	6.7	4.2	-2.5			
GR	/	/	/	12.2	24.8	12.4
ES	8.6	15.7	7.1	8.8	17.3	8.5
FR <sup>1</sup>	12.8	14.7	1.9	12.2	15.81	3.6
IE <sup>2</sup>	3.6	8.4	4.8	4.52	9.02	4.5



### Box 6.1. – Pension expenditure projections (continued)

Country	2004 projections			2001 projections		
	2004	2050	2004-50	2005	2050	2005-50
IT	14.2	14.7	0.4	13.8	14.1	0.3
CY	/	/	/			
LV	6.8	5.6	-1.2			
LT	7.2	9.2	2.0			
LU	10.0	17.4	7.4	7.4	9.3	1.9
HÚ	10.4	17.1	6.7			
MT	7.4	7.0	-0.4			
NL	7.7	11.2	3.5	8.3	13.6	5.3
AT	13.4	12.2	-1.2	14.5	17.0	2.5
PL	13.9	8.0	-5.9			
PT	11.1	20.8	9.7	10.9	13.2	2.3
SI	11.0	18.3	7.3			
SK	7.2	9.0	1.8			
FI	10.7	13.6	3.0	10.9	15.9	5.0
SE	10.6	11.2	0.6	9.2	10.7	1.5
UK	6.6	8.6	2.0	5.3	13.3	-0.9

(1) FR: 2040 in the 2001 projection.

(2) IE: as % of GNP in the 2001 projection, corresponding to approximately 3.8 and 7.7% of GDP.

Source: Economic Policy Committee (2006), 'Age-related public expenditure projections for the EU-25 Member States up to 2050', European Economy, Special Reports.

The comparison between the results of the 2004 and 2001 projections can be made only for the old EU-15 Member States because only they were included in the 2001 projection exercise. Before comparing the projected increases, account should be taken of the changes in the starting positions. It is more appropriate to compare the 2004 base year in the current projection with the projection for 2005 in the 2001 projection than the base year of 2001. In about half the countries (DE, ES, FR, IE, IT, NL, PT, FI), the level of public pension expenditure is broadly the same as in the 2001 projections, while in most of the remaining countries the starting level is one or two percentage points higher. In many cases, this difference can be attributed to a broader coverage of pensions such as the inclusion of public sector employees' pensions (in Luxembourg and the United Kingdom). In Sweden, the disability pensions have been added in the 2004 projection. In contrast, Danish spending is almost two percentage points lower due to the exclusion of supplementary occupational pensions (ATP) from the government sector. Besides, the comparison of the level of gross pension spending across countries is distorted by the fact that Member States tax pension benefits differently.

### Box 6.1. – Pension expenditure projections (continued)

The comparison between the two projections can be concluded as follows:

- In half the EU-15 Member States (DE, ES, FR, NL, AT, FI and SE), the projected increase in public pension spending between 2005 and 2050 according to the current projections is smaller than according to the 2001 projections. The diminished increase can be attributed mainly to pension reforms undertaken in most of these countries since 2001.
- In Italy and Ireland, the projected increase is virtually the same, while Belgium, Denmark, Luxembourg, Portugal and the United Kingdom project larger increases. The projected larger increase in public pension spending in the United Kingdom is largely due to the reforms which have increased the level of social insurance pensions. In Portugal and to a smaller degree also in Denmark, revised population projections, notably the increased life expectancy, will push projected public pension spending upwards.
- In Luxembourg and Portugal, the 2004 and 2001 projections differ greatly from each other and the difference cannot be attributed only to changes in pension systems or population projections. Also projection methodologies have been improved.

## 6.2. Projections for total pension expenditure

In a number of Member States, a significant share of the pension provision comes from occupational and private statutory schemes as well. And more importantly, their share of the total pension provision will increase in the future. Occupational pensions provide an equivalent to earnings-related social security schemes in Denmark, the Netherlands, Ireland and the United Kingdom. In other countries, they can complement the earnings-related social security provision, thereby increasing the total level of retirement income for the pensioners. Further, a part of the statutory social security pension scheme has

been switched into private schemes by a number of countries. These countries are Estonia, Latvia, Lithuania, Hungary, Poland, the Slovak Republic and Sweden.

It can be noted that occupational and private statutory pension provision plays an increasingly important role in the future in all countries where such provisions are in place. In particular, in the Netherlands, occupational pensions are projected to amount to 8.7% of GDP in 2050, accounting for over 40% of the total pension provision. Private statutory pension schemes in the new Member States are projected to increase the level of total pension expenditure by 1.3–3.1% of GDP at the end of the projection period.

Table 6.2. – Total pension expenditure as a share of GDP between 2004 and 2050

Country	Total pension expenditure, gross as % of GDP								Change 2004-30	Change 2030-50	Change 2004-50
	2004	2010	2015	2020	2025	2030	2040	2050			
<b>LV</b>	6.8	4.9	4.6	5.0	5.6	6.0	7.0	8.3	-0.8	2.3	1.5
<b>LT</b>	6.7	6.6	6.6	7.1	7.8	8.3	9.2	10.4	1.6	2.1	3.7
<b>LU</b>	10.0	9.8	10.9	11.9	13.7	15.0	17.0	17.4	5.0	2.4	7.4
<b>HU</b>	10.4	11.1	11.6	12.6	13.3	13.9	17.6	20.3	3.6	6.3	9.9
<b>MT</b>	7.4	8.8	9.8	10.2	10.0	9.1	7.9	7.0	1.7	-2.1	-0.4
<b>NL</b>	12.4	12.3	13.6	14.8	16.4	18.4	20.6	20.0	6.0	1.5	7.6
<b>AT</b>	13.4	12.8	12.7	12.8	13.5	14.0	13.4	12.2	0.6	-1.7	-1.2
<b>PL</b>	13.9	11.3	9.8	9.8	9.7	9.4	9.3	9.3	-4.5	-0.5	-4.6
<b>PT</b>	11.1	11.9	12.6	14.1	15.0	16.0	18.8	20.8	4.9	4.8	9.7
<b>SI</b>	11.0	11.1	11.6	12.4	13.5	14.7	17.5	19.3	3.7	4.6	8.3
<b>SK</b>	7.2	6.7	6.7	7.2	7.8	8.3	9.7	11.2	1.2	2.9	4.1
<b>FI</b>	10.7	11.2	12.0	12.9	13.5	14.0	13.8	13.7	3.3	-0.3	3.1
<b>SE</b>	12.9	12.4	12.8	12.9	13.3	13.9	14.5	13.9	0.9	0.0	0.9
<b>UK</b>											
<b>EU-15<sup>1</sup></b>	12.0	11.7	11.9	12.4	13.1	13.8	14.9	14.8	1.8	0.9	2.8
<b>EU-10</b>	10.9	9.8	9.3	9.6	9.9	10.1	11.4	12.6	-0.7	2.5	1.7
<b>EU-12<sup>1</sup></b>	12.0	11.7	11.9	12.3	13.0	13.8	15.0	14.8	1.9	1.0	2.8
<b>EU-25<sup>1</sup></b>	11.9	11.6	11.7	12.2	12.8	13.5	14.6	14.6	1.6	1.1	2.7

(1) Excluding countries which have not provided data.

Source: Economic Policy Committee (2006), 'Age-related public expenditure projections for the EU-25

Member States up to 2050', European Economy, Special Reports. Note: The difference with table 6.1. also refers the sequence and size of contributions to private and occupational schemes, as reflected in table 6.6.

The projections for total pension expenditure sum up the data provided for public, occupational and private statutory pensions. The sums are presented also for countries which have not provided data on complementary occupational schemes if they are not of major importance for total pension provision. Currently, such provision in many countries is less than one percentage of GDP and in some others around one percentage of GDP. In contrast, in Denmark, Ireland and the United Kingdom, occupational pension provision is of a clearly greater importance and, consequently, the data provided for public pensions only has not been considered to represent the total pension expenditure.

The projected total pension expenditure as a share of GDP in 2004 was the same as public pension expenditure for all countries except those with occupational pensions (NL and SE) because the private mandatory pensions were still at an early stage and virtually no pensions were yet paid out from those schemes. By 2050, the dispersion in pension provision across countries will somewhat lessen since many of those countries which have projected very low public spending on pensions will have major private provisions.

Concerning the change in total pension expenditure as a share of GDP between 2004 and 2050, the negative

change observed for public pensions in the case of Latvia and virtually also in the case of Estonia will disappear while the change remains negative for Poland. Another major change when compared with public pension spending is that the total pension expenditure in the Netherlands, Hungary and Slovenia will rise to the same level, to about 20% of GDP, with Portugal (20.8% of GDP) and Cyprus (19.8% of GDP).

### 6.3. Contributions to public pension schemes

In the face of financial pressures faced by public pension schemes, financing arrangements vary from country to country. In all countries, the earnings-related social security pension scheme is primarily financed by contributions levied on earned income. In Ireland, the Netherlands and the United Kingdom, also the flat-rate basic pensions are financed by contributions and only Denmark finances its public (flat-rate) pensions through taxes. Means-tested minimum guarantee pensions are, by contrast, financed by taxes in all countries. In general, statutory social insurance systems are separated from the State budget, but only in a few countries are there statutory obligations that require deficits to be covered within the social security system itself. Large transfers from the general budget to social insurance institutions are common, partly reflecting tax-financed solidarity elements in statutory pension schemes (e.g. means-tested pension supplements and contributions for periods of unemployment, childcare, etc.).

Table 6.3 below shows what part of public pensions can be financed by the contributions when assumed that the contribution rate will be kept unchanged unless there are clear policies of contribution changes in place (such as the switch of social security pension into a private scheme). The contributions include only specific contributions to pension

schemes paid by the employers and employees as well as the self-employed. Some countries (BE, ES) have only a general contribution rate for all social insurance expenditure and they were not able to provide a separated estimate of the pension contribution. Moreover, in Denmark, social security pensions are financed virtually entirely by taxes and no contributions are shown.

It can be seen that, under current contribution policies and the projected increases in pension spending, additional financing need will grow markedly in most countries. On average, in the EU, the contribution financing of public pensions would drop from about 80% to 72% of pension expenditure between 2004 and 2050. However, it should be noted that public pensions include already in the starting position pensions which are by nature solidarity pensions or aimed at preventing poverty that are financed by general tax revenues (such as minimum guarantee pensions in all countries and disability pensions in countries with defined-contribution pension schemes).

The results show that only in a few countries (the Czech Republic, Estonia, France, Latvia, Lithuania and Luxembourg) public pensions are more or less entirely financed by dedicated contributions (in Malta and Portugal, the figures include the total social security contribution, covering also benefits other than pensions), while in a number of countries a significant share of pensions is financed from general tax revenues (or other social insurance contributions); almost one third of the expenditure in Germany, Italy, Austria and Sweden and over 40% of the expenditure in Poland. Towards the end of the projection period, the additional financing need is projected to grow to about one third also in the Czech Republic and Lithuania, and even greater in Ireland, Hungary, Luxembourg, Malta, the Netherlands, Portugal, Slovenia and Slovakia while the financing situation in Poland is projected to be balanced.

Table 6.3. – Social security pension contributions relative to public pensions

Public pensions, contributions / gross pensions									Change 2004-30	Change 2030-50	Change 2004-50
Country	2004	2010	2015	2020	2025	2030	2040	2050			
<b>BE</b>	:	:	:	:	:	:	:	:	:	:	:
<b>CZ</b>	105	108	109	105	100	93	73	63	-12	-30	-42
<b>DK</b>	:	:	:	:	:	:	:	:	:	:	:
<b>DE</b>	68	69	66	67	68	68	68	68	0	0	0
<b>EE</b>	98	97	109	119	125	132	139	146	33	14	47
<b>GR</b>	:	:	:	:	:	:	:	:	:	:	:
<b>ES</b>	:	:	:	:	:	:	:	:	:	:	:
<b>FR</b>	100	99	98	94	92	90	86	87	-10	-3	-13
<b>IE<sup>2</sup></b>	76	65	57	52	46	43	36	30	-34	-12	-46
<b>IT</b>	72	74	75	74	72	68	66	72	-3	4	1
<b>CY</b>	80	80	79	73	67	59	49	36	-21	-23	-44
<b>LV</b>	104	124	125	115	104	97	91	97	-7	1	-7
<b>LT</b>	101	96	94	87	78	75	75	72	-25	-4	-29
<b>LU</b>	99	102	93	85	74	67	59	58	-32	-9	-41
<b>HU</b>	74	61	57	52	50	49	42	40	-25	-9	-35
<b>MT<sup>3</sup></b>	96	77	66	58	53	52	50	47	-43	-5	-48
<b>NL</b>	88	84	77	71	66	61	57	59	-27	-2	-29
<b>–</b>	67	71	71	69	65	62	64	70	-5	8	3
<b>PL</b>	55	71	83	83	84	87	92	99	31	13	44
<b>PT<sup>3</sup></b>	95	88	78	68	64	59	49	44	-36	-14	-50
<b>SI</b>	85	91	90	86	80	74	63	58	-10	-16	-27
<b>SK</b>	90	75	75	69	64	61	56	49	-29	-12	-41
<b>FI</b>	85	81	81	80	80	80	81	82	-6	2	-4
<b>SE</b>	72	74	72	71	70	67	63	65	-6	-2	-8
<b>UK</b>	87	90	91	90	86	80	76	73	-7	-7	-14
<b>EU-15<sup>1</sup></b>	80	82	80	79	77	74	71	72	-6	-2	-8
<b>EU-10</b>	72	78	83	80	78	77	71	67	5	-9	-4
<b>EU-12<sup>1</sup></b>	80	81	79	77	75	73	71	72	-7	-1	-7
<b>EU-25<sup>1</sup></b>	80	81	80	79	77	74	71	72	-6	-2	-8

(1) Excluding countries which have not provided data.

(2) IE: only including the contributions to the social security scheme.

(3) MT and PT: including the total social security contribution

Source: Economic Policy Committee (2006), 'Age-related public expenditure projections for the EU-25 Member States up to 2050', European Economy, Special Reports.

Member States can apply various policies to respond to the additional financing need, ranging from increased contribution rates or additional transfers from the State budget to the accumulation of reserve funds or to policies that restrict the increase in pension spending.

As regards the contribution rate policies, there are strong commitments to prevent increases in contribution rates in countries with defined-contribution pension provisions such as Sweden, Latvia and Poland. In these countries, the contribution rate is fixed and necessary adjustments will only be made on the benefit side. Italy has moved in the same direction with its reformed system, but the adjustment on the benefit side will come fully into force only after a very long transition period, being fully phased-in in 2035. Furthermore, Germany is committed to keeping the contribution rate below 22% and the government is obliged to propose appropriate measures to Parliament if this target is threatened to be breached. Also, Austria increased in the latest reforms their commitments to take adjustment measures on the benefit side if the contribution rate had to be raised. France is committed to adjustment measures due to demographic developments. The Netherlands has set an objective not to raise its contribution rate above 18.25%, while the possible deficit will be covered from transfers from the State budget.

In other countries, there appears to be no pre-determined strategy regarding contribution rates. The National Strategy Reports appear to suggest that the contribution rate is one parameter that can be adapted according to the financial need apart from other measures. Table 6 (at the end of the chapter) summarises information on the contribution rates and other financing modalities of public pension schemes.

## 6.4. Assets of pension funds

One way of meeting the additional financing need is to accumulate reserve funds for social security pension schemes. A statutory partial funding is required in the social security pension schemes in Finland, Luxembourg and Sweden. Furthermore, many more countries have established reserve funds which may be accumulated by surpluses of social security funds or central government budgets or by other commitments taken by the government as it is done in Ireland. Such reserve funds dedicated to the financing of future increased pension expenditure exist currently in Belgium, the Czech Republic, Cyprus, Germany, Estonia, France, Ireland, Latvia, Poland and Portugal. However, the magnitude of these reserve funds is essentially smaller than that of the statutory funds in Luxembourg, Finland and Sweden.

The projection of the assets is based on the projected flows of contributions coming in the fund and pensions paid out of the fund plus on the assumed annual real rate of return of 3% over the whole projection period<sup>(16)</sup>. The projections show that the reserve funds will be exhausted before the end of the projection period (except in Estonia, Ireland and Poland) as well as also the statutory fund in Luxembourg, while the statutory funds in Finland and Sweden will grow in size.

Table 6.4. below presents the projections for the assets in all pension funds, including reserve funds of social security schemes and also funds of statutory private schemes and funds of occupational pension schemes in the Netherlands and Sweden. In particular, significant funds exist in the occupational pension funds in the Netherlands. Also the funds for statutory private pension schemes (in Estonia, Latvia, Lithuania, Hungary, Poland, Slovakia) will grow to substantial sizes over coming decades.

(16) The results can be considered as indicative only, as there is a considerable degree of variation in the rate of return over time and across countries and schemes. Also, administrative charges, which appear to be very different in size in different schemes, should be taken into account (see chapter 8).

Table 6.4. – Assets in all pension schemes as a share of GDP

Country	All pensions, assets as % of GDP								Change 2004-2030	Change 2030-50	Change 2004-50
	2004	2010	2015	2020	2025	2030	2040	2050			
BE	4.4	7.3	13.4	16.4	13.6	1.9	:	-2.5	:	:	:
CZ	0.3	3.5	6.8	9.9	11.0	9.4	:	9.1	:	:	:
DK	:	:	:	:	:	:	:	:	:	:	:
DE	0.1	0.4	0.8	:	:	:	:	:	:	:	:
EE	2.8	9.4	15.9	25.3	37.6	50.5	76.9	101.0	47.7	50.5	98.2
GR	:	:	:	:	:	:	:	:	:	:	:
ES	:	:	:	:	:	:	:	:	:	:	:
FR	1.2	2.0	2.9	4.0	3.5	2.8	1.5	0.0	1.6	-2.8	-1.2
IE	7.3	11.1	14.4	18.1	22.5	26.0	28.3	21.9	18.7	-4.1	14.6
IT	:	:	:	:	:	:	:	:	:	:	:
CY	39.3	39.6	39.7	37.9	33.4	25.1	1.9	:	-14.2	:	:
LV	0.3	12.9	25.9	38.0	48.2	57.4	68.8	71.5	57.1	14.1	71.1
LT	0.3	4.3	8.6	14.0	20.7	47.9	41.5	52.7	27.6	24.8	52.4
LU	23.6	31.7	37.4	39.2	32.9	17.8	:	:	-5.8	:	:
HU	4.0	13.2	21.9	31.5	41.1	50.0	67.7	73.7	46.0	23.7	69.7
MT	:	:	:	:	:	:	:	:	:	:	:
NL	135.5	160.6	177.5	195.6	214.5	230.1	241.0	243.7	94.6	13.6	108.1
AT	:	:	:	:	:	:	:	:	:	:	:
PL	7.1	15.9	24.0	33.5	42.5	51.1	69.9	85.0	44.0	34.0	78.0
PT	4.3	4.0	:	:	:	:	:	:	:	:	:
SI	1.4	5.5	9.6	13.9	18.3	22.6	30.1	35.9	21.3	13.3	34.5
SK	:	7.0	12.8	18.9	25.1	31.5	45.7	58.0	31.5	26.5	58.0
FI	52.4	59.3	63.1	66.0	68.2	69.9	71.3	72.9	17.5	2.9	20.5
SE	38.6	53.5	60.7	66.0	69.7	72.3	68.1	60.9	33.7	-11.4	22.3
UK	:	:	:	:	:	:	:	:	:	:	:

Source: Economic Policy Committee (2006), 'Age-related public expenditure projections for the EU-25 Member States up to 2050', European Economy, Special Reports.



## 6.5. Public pension systems in the context of public finances: evolution of public deficits and projections for public debts

Former sections indicate that current policies do not always ensure sufficient resources for financing public pension schemes. The ratio between projected contributions and pension expenditure will worsen in the majority of countries and the assets to be accumulated in the reserve funds will be exhausted before the end of the projection period in most countries where such commitments have been discretionally taken. This emphasises the close relationship between the public pension systems and public finances as a whole, which in turn calls for examining the contribution of pension systems to the sustainability of public finances and, vice versa, whether government budgets can provide leeway for the financing of increasing expenditure induced by ageing.

The three-pronged strategy, endorsed by the Stockholm Council, has recommended that Member States put in place comprehensive strategies to cope with the ageing populations and, in particular, concerning the long-term sustainability of public finances. Many

Member States have committed themselves to conduct sound macroeconomic and public policies and to undertake structural reforms with the aim of delivering stable growth, higher employment and sound public finances, while avoiding high increases in taxes or social security contribution rates. In particular, many Member States have set themselves specific targets to run annual surpluses in the years to come with the aim of reducing the debt levels and thus making room for manoeuvre to cover the projected increase in expenditure induced by ageing.

However, the latest developments regarding public deficits suggest that most countries have not succeeded in achieving their targets. Overall, the EU has moved from balanced public finances in 2000 to growing deficits year after year. Only one third of the countries were in surplus or close to balance in 2004, while 11 countries exceeded the 3% of GDP threshold. This demonstrates that achieving a balanced budget situation is a major challenge for many countries and that most countries have to make determined efforts to produce surpluses with the aim of reducing debt levels or building up reserve funds. The developments reflect slow progress in implementing structural reforms in Member States and represent a setback for the pension strategies.

Table 6.5. – General government gross debts in 2004 and their projections according to the Stability and Convergence Programmes of 2004

Country	2004	Programme compliance			2004 budget position scenario		
		2010	2030	2050	2010	2030	2050
BE	97	76	25	29	73	19	18
CZ	39	41	83	306	55	141	447
DK*	25	10	-28	-23	8	-26	-16
DE	66	62	40	23	74	91	139
EE	5	2	-23	-84	-4	-52	-153
EL	111	95	120	347	111	230	629
ES*	49	35	4	56	36	6	58
FR	65	59	90	219	70	158	383
IE*	22	12	12	63	4	-1	43
IT	106	91	31	-6	99	120	218
CY*	74	50	35	83	72	126	254
LV	14	15	35	109	16	40	122

Table 6.5. – General government gross debts in 2004 and their projections according to the Stability and Convergence Programmes of 2004 (continued)

Country	Programme compliance				2004 budget position scenario		
	2004	2010	2030	2050	2010	2030	2050
LT	20	19	21	77	24	40	116
LU	5	6	32	74	11	50	104
HÚ	57	46	47	83	58	82	153
MT	73	66	64	60	90	177	286
NL	56	56	82	155	56	99	195
AT	64	54	16	-19	55	25	1
PL	46	45	-8	-69	61	57	70
PT	62	63	65	132	67	158	374
SI	30	26	38	187	28	54	229
SK	43	43	29	52	49	76	154
FI*	6	-5	-31	-14	-15	-45	-35
SE*	29	18	4	60	13	15	92
UK	41	43	52	90	46	71	129

\* Adjusted gross debt; net of public pension fund assets.  
Source: EU Commission (2005), 'Public Finances in EMU – 2005', European Economy, No 3/2005.  
Note: This table relates to national budgetary projections presented in the 2004 Stability/Convergence Programmes. Thus, the projected age-related expenditure figures are not fully consistent with the AWG 2005 projections. Nevertheless, in most countries, the magnitude of the projected increase (or decrease) does not essentially differ from the 2005 projections. It can be assumed that qualitatively the evolution of debt trends presented in this table will hold also with the revised expenditure projections.

Overall, the developments of public finances and the projected debt levels (developed in the framework of the assessment of the long-term sustainability of public finances) clearly show that many countries cannot rely only on the policy of creating room for manoeuvre in public finances. Ageing under current policies would unavoidably push expenditures to such high levels that the debt levels would surge. Reforms of the pension systems will also be needed. This is demonstrated by countries with the pension reforms that have brought their pension systems on a sound financial footing. In particular, reforms which keep the financing of the pension system in balance over time will clearly contribute to the sustainability of public finances as a whole. Such reforms have been undertaken in Sweden and Italy earlier, and more recently in Austria and Germany. As regards new Member States with similar

reforms (Latvia, Poland, Estonia, Lithuania, Hungary and Slovakia), the picture is more complicated, as other factors contribute to keeping the deficits high in the near future, while the pension reforms contribute to the overall sustainability of public finances.

## 6.6. National strategies to ensure the sustainability of public pensions

### 6.6.1. Reforms to date

Member States are aware of the financial challenge posed by ageing populations and most have already made efforts aimed at ensuring the financial sustainability of their statutory pension schemes. Reforms of pension schemes have been carried out in many

Member States during the last decade or two. In particular, major reforms involving a transformation from defined-benefit scheme into a notional defined-contribution scheme in the public pension system have been undertaken in Italy (1995), Latvia (1996), Sweden (1999) and Poland (1999). In these systems, the financial sustainability is managed, first of all, through a close link between contributions and benefits. Further, a part of the public social security pension system has been switched into a funded private defined-contribution scheme in Hungary (1997), Sweden (1999), Poland (1999), Latvia (2001), Estonia (2002), Lithuania (2004) and Slovakia (2005). These reforms contribute to the sustainability of public pension systems through taking a part of the pension liabilities into funded schemes, thereby differentiating the demographic risk between the State and the individual and also improving incentives to work for the individual.

Furthermore, the longevity risk and the issue of the balance between the numbers of contributors and pensioners have also been addressed in the latest reforms of Germany, France, Austria and Finland. The German 2004 reform introduced a so-called sustainability factor in the pension indexation formula, which requires reducing the index adjustment of pensions if the balance between the numbers of contributors (employees) and the pensioners worsens. The French 2004 reform introduced a principle that the requirement of contribution years for a full pension will be raised in line with the increase in longevity (with a weight of 2/3). The Austrian 2004 reform strengthened the link between contributions and benefits and raised the requirement of contribution years for a full pension, while actuarial adjustments are applied to early and deferred retirements. The Finnish 2003 reform introduced a longevity coefficient, which will be applied as of 2009, reducing the benefit level at the time of retirement by the increase in life expectancy at the age of 60.

Many countries have undertaken parametric reforms in their pension systems with the aim of improving their financial sustainability and improving incentives to work. Such reforms have included switches in the indexation of pensions to prices only (or close to prices), e.g. most recently in Austria and tightened access to early retirement schemes (Netherlands, Finland, Austria). Other countries, notably Belgium, Cyprus, Denmark, Ireland and the Netherlands have

operated more on the financial side with the aim of guaranteeing sound public finances and creating room for manoeuvre through the reduction of public debt and interest payments and accumulating reserve funds for increasing future pension expenditure.

### 6.6.2 Strategies and challenges ahead

Table 6.7 (at the end of this section) provides an overview of national strategies to ensure the financial sustainability of pension systems in Member States. While all Member States recognise the pension challenges in their National Strategy Reports and are preparing strategies for the future, the size of the challenge ahead varies greatly across countries, not least due to the strength and nature of reforms undertaken to date. Further reforms are also debated currently in many Member States, in particular in Belgium, the Czech Republic, Denmark, Ireland, Hungary, Malta, Portugal, Slovenia and the United Kingdom.

In sum, in comparison with the strategies assessed in the 2003 Joint Report on Adequate and Sustainable Pensions, it appears that there is a larger diversity across Member States both in the pension challenge and the strategies chosen. Firstly, the fundamental reforms of new Member States have contributed to the diversity, bringing funded private schemes more into the debate on pension strategies. Secondly, a number of Member States, identified with significant pension challenges in the 2003 Pensions Report, have undertaken major reforms with the aim of improving the financial sustainability of their pension systems, thereby highlighting the importance of pension reforms themselves for their sustainability. Thirdly, many Member States have not made significant progress as regards the reduction of public debt. This is particularly worrying for Member States that also have major pension challenges at the same time and where no major reforms of the pension system have been undertaken in recent years.

Regarding the challenge of the financial sustainability of public pension schemes ahead, Member States can be grouped in four groups.

In a number of countries, the underlying pension system design and, for instance, the indexation of pensions to prices (or close to prices), strongly contributes to explaining why the financing of the public

pension system will not face major challenges in coming decades (as in Estonia, Latvia, Sweden and the United Kingdom).

In a large number of countries the additional pressures posed by ageing on public finances have been reduced, while the level of spending will remain at a relatively high level in most of these countries. This include countries such as Denmark, Germany, France, Italy, Lithuania, the Netherlands, Austria, Slovakia and Finland. Also, Ireland can be considered as facing only moderate challenges despite a relatively high increase projected in its pension spending because the current spending level is very low. (It should also be noted that a significant reserve fund has been accumulated for the need of the ageing effect, projected to materialise mainly only after 2025.)

A number of countries appear to face important pressures on their pension expenditures despite the fact that comprehensive strategies are in place or that some – even major – reforms have already been undertaken. This is the case in Belgium, Poland and Malta. Belgium faces the challenge of increasing the effective age of exit from the labour market. Despite the fact that Poland projects a major decrease in the spending in the general social security scheme (which is based on sound financial principles and provides appropriate incentives to work), a major challenge remains as regards reforming the farmers' and the disability pension scheme. In the Maltese pension system, the level of expenditure as a share of GDP is projected to decline but, despite this, the financing of the pension system will worsen, which demonstrates the need to increase the transparency between contributions and benefits.

A number of countries face significant challenges regarding the sustainability of their pension systems in the face of ageing populations. High increases in public spending on pensions are projected in the Czech Republic, Greece, Spain, Cyprus, Luxembourg, Hungary, Portugal and Slovenia (only earlier projections available for Greece). Also the deterioration of the financing by the contributions is foreseen as well as the exhaustion of reserve funds where such funds are currently accumulated. Consequently, large increases in public debt levels are projected for most of these Member States.

## 6.7. Conclusion – financial sustainability of public pension systems and sound public finances

The financial sustainability of public pension systems is to a large extent linked to the sustainability of public finances as a whole. This is due to the fact that pensions are a major component in the total expenditure of all governments and the financing of pension systems often involves interventions from the central government budgets. The burden of projected increases in expenditure will be shared among contributions, taxes and reserve funds, or postponed for future generations through increased borrowing. The projections and analysis available indicate that despite the policies in place, a major financing gap is expected to arise in a number of Member States as the population ageing materialises.

Member States cope with the challenge of the sustainability of public pension systems to various degrees and with various strategies. While the elements recommended in the broad economic policy Guidelines for ensuring the long-term sustainability of public finances, namely reforming pension systems, increasing employment rates and reducing public debts, are recognised and integrated in the strategies of the Member States, the progress in recent years regarding these objectives has been uneven. Regarding the reduction of public debt, it has been low in most Member States, while several major reforms undertaken in recent years in countries identified earlier with significant challenges bear witness of the importance of the pension reforms themselves for their sustainability and their contribution to the sustainability of public finances as a whole.

Recent reforms undertaken have made major steps in improving incentives for working longer, developing life-cycle approaches for managing increasing longevity, strengthening the link between contributions and benefits and increasing funding while bringing private pensions as an essential part of pension provision. Looking ahead, these developments highlight the importance of broad strategies for ensuring sustainable and adequate pensions, including secure private pensions as part of total pension provision, in a constantly changing societal and economic environment, while ensuring that pension reforms contribute to employment and growth. In turn, stronger economies can deliver better pensions.

Table 6.6. – Contribution rates in public pension schemes in 2005

Contribution rate, % of wages <sup>1</sup>		Observations <sup>2</sup>
<b>BE</b>	<p>37.94% (social security)  Employer: 24.87%  Employee: 13.07%  'Wage moderation' contribution: 7.48%  Small additional social security contributions depend notably on the firm size; different measures lead to a marked reduction in the effective rates compared to the abovementioned rates.</p>	<p>The contribution rate covers all branches of social security, including healthcare, unemployment, disability, family allowances, and the general pension scheme for wage-earners and self-employed. The contributions account for approximately two-thirds of the total social security revenues; specific social security taxes and transfers from the State budget account for the rest. Means-tested minimum pensions are financed by taxes.</p> <p>In order to finance the future increase in pension expenditure, the Belgian authorities plan to accumulate budgetary resources in a public 'ageing fund' using the decrease in interest payments.</p>
<b>CZ</b>	<p>28.00%  Employer: 21.50%  Employee: 6.50%</p>	<p>The contribution rate covers both earning-related and flat-rate social security pensions. In 2004, the social security pension system was in balance for the first time since 1996.</p>
<b>DK</b>		<p>Public pensions are financed by taxes, with the exception of the voluntary early retirement scheme, to which there is a small own contribution.</p> <p>(Also the statutory supplementary schemes (ATP) are subsidised from tax revenues.)</p>
<b>DE</b>	<p>19.5% in 2004–06  Employer: 9.75%  Employee: 9.75%</p>	<p>Subsidies from the federal budget account for 27.5% of pension expenditure in 2004 (33% in 2003). In addition, social assistance pensions are financed by taxes. A target has been set that the contribution rate should not exceed 20% until 2020 and 22% until 2030.</p>
<b>EE</b>	<p>22%  Employer: 16% to the first pillar scheme  4% to the third pillar scheme  (or 20% to first pillar if the person has not joined the third pillar scheme)  Employee: 2% to the third pillar scheme, only to those who have joined</p>	<p>Pension insurance contributions covered 94% of social security pensions in 2004.</p> <p>Special pensions to some groups of government officials (policemen, parliamentarians, judges) are financed from the government budget.</p>
<b>GR</b>	<p>20% (if insured before 31.12.92)  Employer: 13.33%  Employee: 6.67%  30% (if insured between 1.1.93–31.12.2002)  Employer: 13.33%  Employee: 6.67%</p>	<p>Tax subsidies to the financing of contribution-based pensions would have to rise from the current 4.8% of GDP to 15.5% in 2050. In addition, pensions of uninsured persons over 65 and civil servants are financed by taxes.</p> <p>The current contribution rate is applied equally</p>

Table 6.6. – Contribution rates in public pension schemes in 2005 (continued)

Contribution rate,% of wages <sup>1</sup>		Observations <sup>2</sup>
<b>GR</b>	State: 10.00% After 1.1.2003 Employer: 13.33% Employee: 6.67% State: 1% of GDP in 2003–08 on average 1% of GDP in 2009–32	to all employees and covers only pension benefits.
<b>ES</b>	28.3% (social security, except healthcare and unemployment benefits) Employer: 23.6% Employee: 4.7%	The contribution rate covers contributory benefits for old-age, disability and survivors' pensions and maternity benefits. The social security sector is expected to produce a surplus until 2020, thereafter a deficit. Means-tested minimum pensions are financed by taxes.
<b>FR</b>	Basic scheme: Employer: 9.8% (below ceiling) Employer: 1.6% (above the ceiling) Employee: 6.55% (below the ceiling) Mandatory supplementary scheme: Rate varies between 7.5%–20% (including employer and employee contributions), depending on wage level and employee status	The contribution rate covers old-age and survivors' pensions; disability pensions are covered by health insurance contributions. The contribution rate will be raised by 0.2 percentage points in 2006. Further, employment measures are expected to reduce unemployment, which would allow to transfer unemployment contributions to pension financing.
<b>IE</b>	12.5–14.75%, excluding the health levy Employer: 8.5–10.75% Employee: 4%; self-employed: 3%	Social insurance (flat-rate) pensions are financed by contributions. In recent years, the Social Insurance Fund has been in surplus. Means-tested social assistance pensions are financed by taxes. In the future, due to the extension of the contributory scheme, there will be a shift from tax funding to contributions.
<b>IT</b>	32.7% Employer: 23.81% Employee: 8.89% The self-employed: Farmers: 20% Shopkeepers: 19% as of 2013 Artisans: 19% as of 2014	Contribution rate covers old age, survivors' and disability pensions of the social security scheme. Social assistance pensions and additional amounts due to social assistance purposes are financed by taxes (2.3% of GDP in 2003).

Table 6.6. – Contribution rates in public pension schemes in 2005 (continued)

	Contribution rate, % of wages <sup>1</sup>	Observations <sup>2</sup>
<b>CY</b>	12.6% of wages	<p>In addition, social (minimum flat-rate) pensions (8.5% of total pension expenditure) and civil servants' earnings-related pensions (27% of total pension expenditure) are financed from the State budget.</p> <p>The total contribution to social security for employees, covering sickness, maternity, unemployment, work injury and pensions, is 16.6%, of which employers pay 6.3%, employees 6.3% and the state budget 4.0%. The financing of pensions requires 12.6% of wages in total.</p>
<b>LV</b>	25.51% of the wage within the total social insurance contribution rate of 33.09% (of which the rate for employers is 24.09% and employees 9%) is needed to finance the old-age, survivors' and service pensions in 2004. However, the contribution for the calculation of the NDC pension is fixed at 20% (not separated between employer and employee) to those who participate also in the private scheme (and reduced by the rate to private schemes if the person participates only in the public (PAYG) NDC scheme). Up to 2006, 2 p.p. of the contribution goes to the funded scheme, increased gradually to 10% by 2010, to persons participating in the funded scheme.	<p>The total social insurance contribution covers old-age, survivors', service (during the transition period) and disability pensions, work injury, maternity, sickness and unemployment benefits and funeral benefits.</p> <p>The NDC pension contribution covers old-age pensions (including minimum pension and actuarial early retirement) and it is the basis for the calculation of survivors' pensions.</p>
<b>LT</b>	26% Employer: 23.5% Employee: 2.5%	<p>The pension contribution rate is further broken down by type of pension: (basic) old-age pension (10.5%), supplementary old-age pension (10.6%), disability and survivors' pensions (4.9%);</p> <p>In 2004, a private (second tier of the first pillar) scheme was introduced with a switch of a contribution rate at 2.5% (employee's part) to a private fund. This rate will be increased to 5.5% (2.5% by the employee plus 3.0% from the employer's total contribution) by 2007. In 2004, the State Social Insurance Fund turned to be in surplus.</p> <p>State pensions to servicemen, policemen, meritorious persons, scientists, judges, casualties as well as social assistance pensions are financed from the State budget.</p>
<b>LU</b>	24% Employer: 8% Employee: 8% State: 8%	<p>One third of the contribution rate is financed by taxes. The guaranteed minimum income for old people and public sector employees' pensions are financed by taxes. Currently, the contribu-</p>



Table 6.6. – Contribution rates in public pension schemes in 2005 (continued)

Contribution rate, % of wages <sup>1</sup>		Observations <sup>2</sup>
LU		<p>tion rate allows accumulating the pension fund over its statutory requirement. The future development of the contribution rate depends heavily on the growth rate.</p> <p>Further, public sector pensions are financed from the State budget, 2.5% of GDP in 2004.</p>
HU	26.5% Employer: 18% Employee: 8.5% (fully to the PAYG scheme, if not joined the second tier of the first pillar; 0.5% to the PAYG scheme and 8.0% to the funded scheme when joined	<p>Disability pensions and survivors' benefits (13% of all pension expenditure) are financed by health insurance contributions and transfers from the government budget.</p> <p>Social insurance fund required a subsidy of 23.6% of its total expenditure from the State budget (1.8% of GDP) in 2004. Also, supplementary means-tested allowances guaranteeing the minimum old-age income are financed by taxes (0.6% of GDP).</p>
MT	30% Employer: 10% Employee: 10% State (tax revenues): 10% (with a substantial variation according to age and wage level of the employee) (Self-employed: 15% plus State: 7.5%)	<p>Covers all social insurance, including all pensions, short-term benefits, hospital, community and elderly care.</p>
NL	17.9% (old-age pension) 1.25% (survivors' scheme) Employee: 19.15%	<p>A target has been set to ensure that the old-age pension contribution rate will not be raised above 18.25%. The contribution rate of 17.9% is expected to produce a surplus until 2010. Thereafter, the deficit is covered from the reserve fund and taxes. In addition, a contribution rate of 1.25% is paid for the survivors' scheme and a rate of between 7.09–13.93% for disability benefit schemes.</p>
AT	22.8% Employer: 12.55% Employee: 10.25%; different rates in the civil service schemes without any ceilings	<p>The contribution rate was harmonised for all groups in 2004; however, the rates paid by the self-employed (17.5%) and farmers (15%) are lower but subsidised up to 22.8% from general tax revenues. Furthermore, contributions are paid from tax revenues for periods of childcare, military/civilian service, sickness benefits, maternity allowances and long-term care.</p> <p>There is a deficit guarantee for the statutory pension insurance to be covered from the Federal budget. In 2004, the government financing of the pension system accounted for 2.6% of GDP.</p>

Table 6.6. – Contribution rates in public pension schemes in 2005 (continued)

Contribution rate, % of wages <sup>1</sup>	Observations <sup>2</sup>
<p><b>PL</b></p> <p>Total pension contribution: 32.52% of gross wage, of which:  19.52% (old-age pension)  13.00% (disability &amp; survivors pensions)  Paid by:  Employer: 16.26%, of which  9.56% (old-age)  6.50% (disability and survivors)  Employee: 16.26%, of which  9.56% (old-age)  6.50% (disability and survivors)  (In addition: 0.97–3.86% (work injury; paid by employer) and 2.45% (sickness and maternity; paid by employee))</p>	<p>The earnings-related old-age pension contribution constitutes a notional defined-contribution scheme (12.22%) and a pre-funded defined-contribution scheme (7.3%); these rates are to be kept constant in the future. The outflow of the funded contributions creates a financing gap in the PAYG Social Insurance scheme – in 2004 it was 1.2% of GDP, while the total subsidy for the financing of pensions amounted to 3.8% of GDP.</p> <p>Disability and survivors' pensions are financed from separate contribution (13.0%). Farmers' old-age and disability pensions are financed up to 90% of the pension payments from State budget subsidies (1.7% of GDP in 2004). Furthermore, minimum pension guarantee (topping-up a small pension from earnings related pension system) as well as contributions during selected career breaks (maternity and parental leave, periods out of work due to the care of a disabled child, unemployment benefit period) are financed by taxes (or other public sources).</p>
<p><b>PT</b></p> <p>34.75% (contributory cash benefits)  Employer: 23.75%  Employee: 11%</p>	<p>The contribution rate covers all contributory benefits (pensions, sickness, unemployment, maternity, professional deceases, family benefits). Means-tested universal non-contributory social pension and other benefits are financed by taxes (3.3% of GDP in 2000). The social security sector currently produces a surplus of 1.7% of GDP, projected to turn into a deficit of 1.5% of GDP by 2050.</p>
<p><b>SI</b></p> <p>24.35%  Employer: 8.85%  Employee: 15.50%</p>	<p>The contribution rate covers old-age, survivors' pensions, disability pensions and health insurance contributions for retired persons. The public pension scheme is subsidised by the State budget for the difference between contributions collected and the actual payment of the pensions concerned. It is currently in surplus (0.1% of GDP in 2005) but, without reforms, would fall into a deficit about 2010, increasing to 10% of GDP in 2050 under current policies and activity rates.</p>
<p><b>SK</b></p> <p>24% in 2005;  Employer: 17%, of which  14% to old-age scheme  3% to disability scheme</p>	<p>In addition, employers pay a contribution of 4.75% of wages into the Reserve Solidarity Fund. A mandatory funded pension scheme was introduced in 2005. For those who join the scheme, half of the old-age pension contribution (9%) is passed on to personal accounts of private funds.</p>

Table 6.6. – Contribution rates in public pension schemes in 2005 (continued)

Contribution rate, % of wages <sup>1</sup>		Observations <sup>2</sup>
<b>SK</b>	Employee: 7%; of which 4% to old-age scheme 3% to disability scheme	This introduction of the mandatory funded pension scheme is estimated to result in a deficit in the financing of the social security pensions by 1.3% of GDP as of 2006.
<b>FI</b>	Earnings-related pensions in 2005: Employer: 16.8% (private sector) 18.9% (state sector) 23.4% (municipalities) Employee: 4.8% National basic pensions: Employer 2.3% (private sector)	The earnings-related pension contribution for the private sector (21.6%) is estimated to rise by about 7 percentage points (taking account of the 2005 reforms). Means-tested (against pension income) national basic pensions and the pensions of sea-farers, self-employed persons and farmers are partially financed by taxes; the subsidy totalling to 1.7% of GDP in 2004.
<b>SE</b>	18.5% (old-age pension) Employer: 10.21% Employee: 7% Note that the contributions add up to 17.21% only because the contribution paid by the employee (7%) is deducted from the income of which contributions are defined. 1.7% (survivors' scheme)	The earnings-related pension system is a notional defined-contribution system (16%) and a pre-funded defined-contribution system (2.5%); these rates are to be kept constant in the future. Income guarantee pensions (means-tested against public pensions), disability and survivors' pensions and contributions during career breaks are financed by taxes.
<b>UK</b>	19.85% (social security except health); in 2005 Employer: 10.9% in 2005 Employee: 8.95% in 2005 (Class 1 contribution rates; for those not contracted out, earnings between the primary threshold and the upper earnings limit for employees)	The contribution rate covers the basic state pension and the additional earnings-related pension (SERPS/State Second Pension) as well as disability and widow's benefits, contributory jobseeker's allowance, maternity and guardian allowances, redundancy payments. Means-tested Minimum Income Guarantee/Pension Credit benefits and civil servants' pensions are financed by taxes. The contribution rates to private pension schemes vary considerably: in 2004, in open funds 9–17% and in closed funds 7–21% of wages.

(1) Source: National Strategy Reports 2005; European Commission, MISSOC and Ageing Working Group update in 2005. The rates apply to the general, first pillar social protection schemes. In many Member States, there are floors or ceilings for earnings which are subject to contributions. Rates may also be different for the self-employed.

(2) The observations are based on the information given in the 2005 National Strategy Reports and by the Ageing Working Group.

**Table 6.7. – Overview of the national strategies for ensuring the financial sustainability of pension systems**

	<b>Main elements of the strategy to ensure the sustainability of the public pension schemes</b>	<b>Observations</b>
<b>BE</b>	<p>The key element of the strategy is the consolidation of public finances, based on the principle that the reduction in interest payments is expected to be larger than the increase in all public age-related expenditure. Therefore, the reduction of public debt is the primary objective: from the current 97% to 60% of GDP before 2015. This requires continuous budget surpluses, which should be increased to 1.5% of GDP around 2010. Budget and social security fund surpluses will be transferred to the 'Ageing Fund', which accounts for 1.8% of GDP in 2004 and should be increased to 14–15% of GDP in 2020. This fund will be used for payments of increased ageing costs during the period of 2015–30.</p> <p>The Government has taken initiatives to tighten access to early retirement arrangements, which currently contribute significantly to one of the lowest employment rates of older workers.</p>	<p>'Global' management of the social security system may provide benefits in terms of redirecting resources between different types of benefits according to the needs, while it makes the impact of pension system less transparent. Social security contributions are enough to finance about 70% of total benefits; this share is expected to remain rather constant until 2015, thereafter additional resources from the Ageing Fund would be needed to finance the ageing-induced increase in expenditure.</p> <p>The strategy can be managed provided that large primary surpluses can be sustained to about 2020 as foreseen in the Stability Programme. Since 2000, the total budget has been balanced or slightly in surplus and the public debt has been on a declining trend.</p>
<b>CZ</b>	<p>An increase of the pension insurance contribution from 26% to 28% of wages and a tightening of eligibility rules to early and old-age pensions brought the social security pension system in balance in 2004 while it had been in deficit since 1996. These measures are expected to stabilise the pension system financing to about 2020. Further reforms are considered necessary in light of a heavy influence of demographic developments; several reform proposals are already under discussion and an experts' evaluation has been requested. Additionally, reforms in the labour market with the aim of increasing both the overall employment rate and that of older workers are envisaged.</p>	<p>Demographic developments are among the most unfavourable in the EU and a fast increase in pension expenditure is projected in the AWG projections (by 5.6 p.p. of GDP by 2050). The ratio between pensioners and contributors is expected to rise from the current 55% to 97% in 2050, indicating either a strong increase in the contribution rate or in the public debt unless the pension system is reformed.</p>
<b>DK</b>	<p>Ambitious targets have been set to run an annual surplus of between 0.5% and 1.5% (1.5–2.5% of GDP including ATP, which, however, after the EU regulation of 2005 has been excluded from the general government sector) up to 2010 with the aim of reducing public debt and to increase employment by about 60.000 persons by 2010. To the latter end, the government has initiated a new integration plan called 'A new chance for everyone' in 2005. Further,</p>	<p>Increase in public pension expenditure is expected to be moderate (3.3 p.p. of GDP by 2050) given that they are flat-rate, while occupational (labour market) pensions will grow significantly in importance over time. The strategy can be managed provided that budgetary surpluses will be achieved and the tax base strengthened (public schemes are fully tax-financed) through increasing employment. The government initiatives for further measures to this end are welcome.</p>

**Table 6.7. – Overview of the national strategies for ensuring the financial sustainability of pension systems (continued)**

	<b>Main elements of the strategy to ensure the sustainability of the public pension schemes</b>	<b>Observations</b>
<b>DK</b>	a Welfare Committee is due to present its proposals for reforming the welfare system more supportive to employment and to be financed without tax increases, possibly including proposals for measures tightening access to the labour market early retirement scheme, which is subsidised by the government for 2/3 of the total contributions.	
<b>DE</b>	The 2001 pension reform has reduced pressures for pension expenditure increases, while increasing subsidies for occupational and private pension saving, which were streamlined and further increased in 2005. Economic slow-down and new demographic projections put additional pressure to review the sustainability of the financing, which resulted in the 2004 old-age pension insurance Sustainability Act. It sets an equal weight on the goals of the contribution rate and the pension level. It introduced a sustainability factor in the pension indexation formula, i.e. requiring for adjustments if the ratio between contributors and beneficiaries worsens. Consequently, the increase in pension spending will be drastically curbed and the ratio between contribution revenues and public pension expenditure stabilised at about the current level of 68%. In addition, a ceiling has been set for the contribution rate and the government is obliged to propose to Parliament appropriate measures if the projections indicate a risk that the contribution rate had to be raised above 20% (2020) or 22% (2030). Such a review is required every four years, for the first time in 2008.	Tax subsidies to the social insurance pension scheme accounted for 27.5% of the pension expenditure in 2004, somewhat less than in the previous years. The government appears to be determined to stabilise the pension system and ensure its long-term sustainability. However, the overall sustainability of public finances seems to be more uncertain. Public finances have been in deficit over a long period, breaching the 3% threshold in 2002–05, and the consolidation will still require some years. The long-term sustainability hinges critically upon the medium-term measures and progress.
<b>EE</b>	The level of public pension expenditure is relatively low (6.7% GDP in 2004) in Estonia. The partial switch of the social security pension into funded schemes in 2002, which is mandatory for those born in 1983 or later and which already covers over 50% of the labour force, contributes to the future sustainability of the public pension system as it differentiates the demographic risk between the State and the individual and strengthens incentives to employment. Moreover, a State pension insurance reserve	Estonia appears to be well-prepared for the challenges of ageing. As the participation in the funded pillar will increase, the contribution revenues to the state pension scheme will diminish. This transition cost will be financed during a couple of coming years from the state pension insurance reserve but between 2007 and 2012 it is expected to require additional financing.

**Table 6.7. – Overview of the national strategies for ensuring the financial sustainability of pension systems (continued)**

Main elements of the strategy to ensure the sustainability of the public pension schemes		Observations
EE	has been established to accumulate the surpluses in social security contributions in 2002-03, which accounted for 1.4% of GDP in 2004 and are projected to rise to about 40% of GDP in 2050.	
GR	The 2002 pension reform laid down provisions for a fairer and more credible pension system (equalisation of replacement rates for different cohorts) as well as for a reorganisation of numerous funds into fewer, larger and financially more stable organisations. Also, provisions for occupational pension arrangements have been laid down. The implementation of these reforms is continuing, while, in general, the government pursues consolidating public finances and promoting employment.	The deficit of public finances has continued over a long period and was 6% of GDP in 2004; the public debt ratio was at 111% of GDP. The government pursues to bring the deficit below the 3% reference value in 2006.  Pension expenditure projections have not been updated since 2001 and, thus, there is little information on the impact of the 2001 reform on the sustainability of the pension system. Tax subsidies to the pension system were 4.8% of GDP in 2000 but were expected to diminish in coming years but to increase again when the ageing will take effect, about 2015 onwards. Further reforms for ensuring the financial sustainability of the pension system are necessary.
ES	Budget discipline has been enforced in all sub-sectors of the general government and public finances have been in surplus in recent years. Also the number of contributors to social security fund has increased, thanks to increased employment, and resulted in a significant surplus, which has been accumulated in the reserve fund for future pension liabilities. In 2005, the fund assets accounted for 3.2% of GDP. The social security sector is expected to run a surplus up to 2015; thereafter the impact of the population ageing will materialise, which will require payments from the reserve fund. The government aims to separate the funding of contributory social security benefits from that of non-contributory benefits, which will be financed from the State budget. The latter financing has been on an increasing trend, partly due to the increases in the levels of minimum benefits, accounting in 2005 for 28% of minimum and non-contributory pension expenditure, though less than 2% of total pension expenditure.	Due to a relatively late ageing in Spain, the pension expenditure as percentage of GDP is expected to remain broadly at the current level until 2015 and then to rise from about 9% to 15.7% of GDP by 2050 (AWG). This expected increase in public pension expenditure is one of the highest in the EU. The government considers further reforms, e.g., measures to early retirement, disability and widow's pension schemes, for ensuring the financial sustainability of the pension system from 2020 onwards.

**Table 6.7. – Overview of the national strategies for ensuring the financial sustainability of pension systems (continued)**

	<b>Main elements of the strategy to ensure the sustainability of the public pension schemes</b>	<b>Observations</b>
<b>FR</b>	<p>The Government implemented a major pension reform in 2004. It is estimated to absorb about 40% of the additional financing need of the pension system by 2020. The main measures include a prolongation of the contribution period for a full pension from 37.5 to 40 years to public sector employees and a further increase to 41 years to all employees between 2009–12; thereafter, further gains in life expectancy (at 60) will prolong the contribution period by 2/3 of the increase. Moreover, retirement has been made more flexible and bonus/malus adjustments will be applied in deferred/early retirements. Pension indexation was switched to prices only and the contribution rate will be increased by 0.2 percentage points in 2006. By 2020, three reviews of the impact of the 2003 pension reform and further reform needs are due to be carried out.</p>	<p>A reserve fund for future pension liabilities (FRR) is accumulated with the aim of contributing to the financing of the increased expenditure due to the ageing. However, asset accumulation is still very low (1% of GDP according to AWG) and the size of the reserve is projected to rise only modestly (4% of GDP in 2020); thereafter to decrease and be exhausted by 2050.</p>
<b>IE</b>	<p>The key element is the statutory requirement for the government to contribute annually to the Pension Reserve Fund by 1% of GDP; assets accounting for 9.6% of GDP in 2004. The reserves can only be used from 2026 onwards. The Pension Board is due to deliver its review at the end of 2005. Also a new actuarial review of the Social Insurance Fund is due to be carried out in 2007 (the previous review is from 2002).</p>	<p>The expenditure of the statutory pension system is projected to increase significantly (by 4.8 p.p. of GDP by 2050), mainly during the latter part of the projection period, due to the late ageing of the population. The pension system, at current benefit levels and under current indexation rules, remains stable up to 2030. The expected new actuarial review will provide further insight into how well the Pension Reserve Fund will meet the ageing challenges from 2030 onwards.</p>
<b>IT</b>	<p>The Government's strategy is based on improving conditions for economic and employment growth and on stabilising pension expenditure at about the current level relative to GDP through the 2004 reform, which increased tax incentives to continue in work for the years 2005–07 when the regulations of the old defined-benefit system remain in force for older workers. Further, the reform will increase the early retirement age as of 2008 and promote the development of funded supplementary pension provision through TFR (end-of-service allowance).</p>	<p>The 2004 reform is estimated to reduce the increase in pension expenditure by 0.6–0.7 p.p. of GDP between 2010 and 2035, which should help bring public finances in balance over the long term. However, over a shorter term, the outlook is gloomier: public finances have been in deficit over a long period, (3% in 2004 and close to it since 2001) and are at risk of rising during next years. Public debt was 106% of GDP in 2004.</p>



**Table 6.7. – Overview of the national strategies for ensuring the financial sustainability of pension systems (continued)**

	<b>Main elements of the strategy to ensure the sustainability of the public pension schemes</b>	<b>Observations</b>
<b>CY</b>	The main element in the strategy to maintain financial sustainability is the pension reserve fund, the assets of which accounted for 37% of GDP in 2004. However, at the same time, the public finances as a whole showed a deficit of 4.8% of GDP in 2004. A projected fast increase in total pension expenditure (by some 10 percentage points of GDP by 2050, for according to a national projection) is due to the ageing risks requiring significant increases in contributions as well.	The government has set a target to reduce the deficit of public finances to 1% of GDP by 2008. It appears necessary to reform both the general social security pension scheme so as to increase the transparency between the contributions and benefits and the civil servants' earnings-related scheme, which appears very generous relative to the pension provision to other groups of employees.
<b>LV</b>	The Latvian social security pension system was reformed to a notional defined-contribution system in 1996 and complemented with the introduction of a mandatory funded scheme in 2001. The latter part will be increased from the current 2 p.p. to 10 p.p. out of the total 20% contribution rate by 2010. The pension system design provides financial sustainability in the long run as it is fully defined-contribution. Moreover, the system provides appropriate incentives to work, which has already borne fruit in terms of employment rates for older workers, and is able to cope with demographic changes.	Latvia appears to be well prepared for the challenges of ageing, which will increase pension expenditure (as % of GDP) only after 2030 (old-age pensions by 3 p.p. of GDP between 2030 and 2050). As the funded pillar will grow in importance, the contribution revenues to the state pension scheme will diminish. However, this transition will be smooth due to a later and gradual introduction of the funded scheme and the anticipated surpluses in the social security scheme during the next 15–20 years can broadly finance the transition costs.
<b>LT</b>	The Lithuanian pension system was fully reformed in 1995, being based on social insurance pensions, which are defined-benefit but closely dependent on contributions. A funded tier was introduced in 2004, allowing transfer of a part of the social insurance contributions into a private fund. Currently, already 50% of the insured had opted for this. The contribution to private pension fund will increase to 5.5%, while the social insurance pension contribution will decrease to 20.5% by 2007. The introduction of the funded tier works as a balancing mechanism for the total social insurance pension system, allowing the accumulation of funds at the time when the PAYG part of the system has started to produce surpluses. In 2004, the State social insurance fund was in surplus for the first time since its establishment and it is expected to be in balance or surplus up to about 2020. Thereafter, the ageing will materialise, resulting in a long-term deficit in the fund.	While Lithuania does not anticipate major increases in public pension expenditure (by 2 p.p. of GDP by 2050) under current pension rules, due to the growing funded tier of pensions, the strengthening of the contribution base is needed in order to finance the future pensions, and even more so if the pressures to increase the level of the social insurance pension will materialise.

**Table 6.7. – Overview of the national strategies for ensuring the financial sustainability of pension systems (continued)**

Main elements of the strategy to ensure the sustainability of the public pension schemes		Observations
LT	The measures to bring the social insurance pension system in balance envisage increasing employment and increasing the statutory retirement age to 65 by 2026 (currently 60 for women and 62.5 for men).	
LU	The strategy is based on the financing method for public pensions. The contribution rate is set for a period of seven years in such a way that it allows the reserve fund to be kept at least at a level which exceeds 150% of annual pension payments. Currently, the reserve accounts for a payment of three years' pensions. However, the projections of the AWG show a rapid increase in pension expenditure from 2020 onwards (from 12 to 17.4% of GDP in 2020–50). This implies that the current contribution rate would not be sufficient to finance the pension system. The Government has indicated its preparedness to take corrective measures in the pension system if financial sustainability so requires.	The sustainability of the Luxembourg pension system is largely driven by the development of the numbers of cross-border workers and to a lesser degree by the development of the native population. Under the assumption of about 3% annual growth rate and the current contribution rate of 24%, a large financial gap would emerge and the reserve fund would be exhausted by about 2035. It appears that the transparency between the contributions and benefits has to be increased.
HU	The Hungarian pension system was reformed during the 1990s, being based on social insurance pensions, which are defined-benefit but closely dependent on contributions. A funded tier, 2 of the pension provision, was introduced in 1997, allowing transfer of a part (8%) of the social insurance contributions (26.5%) into a private fund and being mandatory for new entrants to the labour market. Currently, already 62% of the insured has joined the funded scheme. In the long run, the funded scheme should help to counterbalance the effect of ageing on pension expenditure. However, the projections of the AWG indicate a large increase in public pension spending (by 6.7 p.p. of GDP in 2004–50, resulting in a growing financing gap in the public pension system (in 2004, a subsidy of 1.8% of GDP from the Budget was required). The strategy to cope with the deficit includes parametric changes in the PAYG scheme (increasing retirement age, tightening eligibility, improving incentives to work longer) and a fight against grey economy and contribution evasion.	The transition cost in addition to the anticipated deficit in the running of the PAYG pension scheme is significant, despite the assumed improvement in employment, and risks the consolidation of public finances, which have been in deficit since 2000 (4.5% of GDP in 2004) and are expected to remain in deficit still over some years.  The measures suggested, including the fight against grey economy and contribution evasion as well as a better governance of private funds, are very much needed and may need to be strengthened in order to bring the pension system in balance, while contributing to the consolidation of public finances as a whole.

**Table 6.7. – Overview of the national strategies for ensuring the financial sustainability of pension systems (continued)**

	<b>Main elements of the strategy to ensure the sustainability of the public pension schemes</b>	<b>Observations</b>
<b>MT</b>	<p>Currently, the social security contributions are not adequate to cover all expenditure that they intend to cover. First, a split between pension and healthcare contributions is envisaged in order to provide better transparency of the financial balance of both expenditure items. Second, the deficit of the PAYG pension system is on an increasing trend, estimated to rise to 3.5% of GDP in 2015, 4.7% in 2030 and 6% in 2050 without reforms. The Government presented in 2004 a White Paper of the pension reform, which is currently under discussion. It proposes measures to increase the retirement age to 65, to index pensions to a price index, to increase the contribution period to 44 years and to introduce an occupational pension scheme in 2006 (the regulatory framework was implemented in 2002) and make it mandatory in 2010. The measures, together with labour market reforms to raise the employment rate and reduce the take-up of early retirement, are estimated to reduce the PAYG pension system deficit to 2.8% of GDP in 2050.</p>	<p>The reform of the pension system is necessary, although the suggested reform does not seem to bring the pension system fully on a sustainable basis in a long time. The introduction of an occupational pension scheme will reduce pressures on the PAYG scheme, the expenditure of which is projected to decrease about after 2015, due to the capping mechanism of the maximum pensionable income. However, this capping will also reduce contribution revenues, resulting in a worsening trend in the ratio between contributions and pensions. It appears that the parameters of the pension system need to be overhauled with the aim of increasing the transparency between the contributions and benefits.</p>
<b>NL</b>	<p>The Government's strategy for ensuring the financial sustainability of the public pension scheme is based on the elimination of public debt by 2025, which would require an annual budget surplus between 1.25 and 1.75% of GDP up to 2025. Tax revenues from second-pillar pensions increase tax revenues, notably from 2020 onwards. Incentives for the take-up of early retirement (VUT) will be significantly reduced by the reduction of favourable tax conditions as of 2006. Furthermore, an innovative life course arrangement (VPL Act) will be introduced in 2006. Regarding occupational pensions, which amount to over one third of total pension expenditure and will grow in importance in the future, the new Financial Assessment Framework has been laid down by the Pension Act in 2004, setting tighter requirements, i.e., for the size of reserves and the break-even contribution rates.</p>	<p>Economic growth has been sluggish in recent years and since 2001 government finances have been in deficit (3.2% and 2.5% of GDP in 2003 and 2004) and are expected to remain in deficit (though smaller) still for some years. This raises concerns regarding the government policy and underlines the need to boost labour market reforms with the aim of increasing employment rate.</p>

**Table 6.7. – Overview of the national strategies for ensuring the financial sustainability of pension systems (continued)**

	<b>Main elements of the strategy to ensure the sustainability of the public pension schemes</b>	<b>Observations</b>
<b>AT</b>	A substantial reform entered into force in 2004 improving the financial sustainability of the public pension system via increased transparency between contributions and benefits and applying a bonus/malus system (4.2%/year) for deferred/earlier retirement and requiring a longer contribution period (45 years) to a full pension (80% of wages) at the age of 65. A switch to a price indexation of pensions will be introduced as of 2006. This reform is projected (AWG) to result in a decrease in public pension expenditure by 1.2 p.p. of GDP in 2004–50.	The Government aims to achieve a balanced budget in 2008 (-1.2% of GDP in 2004). Currently, the pension system requires a subsidy of 2.6% of GDP from the budget. The projected trend of pension expenditure would largely stabilise the ratio between contribution revenues and pension expenditure.
<b>PL</b>	An important reform to a notional defined-contribution PAYG scheme, accompanied with a partial switch to a funded scheme, was implemented in 1999 (except for farmers). In the long run, it will help to make the pension system financially sound. However, during the long transition period (about up to 2030), the financing problems of the PAYG scheme are apparent due to the high take-up rates of pensions from the old pension system and still from the unreformed disability pension scheme. Further, the farmers' pension scheme is almost fully tax-financed. Also, a rapid introduction of a relatively large funded scheme reduced contributions to the NDC scheme.	Currently, the public pension system is largely underfinanced by the contribution revenues. The total of subsidies to pensions amounts to about 27% of the government's budget. This financing deficit is expected to continue in many years to come.  Public finances as a whole have been in deficit over a long period, exceeding the 3% of GDP threshold since 2001. Further problems arise from low employment rates and contribution evasion, which both call for further measures. Also, it would be important to align the disability and farmers' pension schemes with the general old-age pension scheme.
<b>PT</b>	A reserve fund was established in 1989 and a reform of public pension schemes was implemented in 2002. In 2005, the Government approved further measures which will tighten eligibility rules to early retirement and align public sector employees' pensions to the general social security scheme. The surpluses of the social security system, which are expected to continue up to about 2015, and a part (2–4 percentage points) of the employees' social security contributions are set aside in reserve fund. The reserves of the fund are estimated to be enough to cover increased expenditure up to about 2015. Thereafter, however, the ageing will start materialising and a rapidly widening gap in the financing of pension expenditure is projected (AWG).	Public finances have been in deficit over a decade (2.9% of GDP in 2004) and the consolidation will require still several years, thereby risking setting the government debt on an increasing trend.  The AWG projections show a very high increase in public pensions by almost 10 percentage points of GDP by 2050, mainly driven by very unfavourable population developments from 2015 onwards. This will make the current system unsustainable and calls for further measures to make the pension system cope better with demographic developments.

**Table 6.7. – Overview of the national strategies for ensuring the financial sustainability of pension systems (continued)**

	<b>Main elements of the strategy to ensure the sustainability of the public pension schemes</b>	<b>Observations</b>
<b>SI</b>	Despite the fact that the 2000 pension reform has brought the public pension scheme in balance in 2005, the deficit cannot be avoided in the future due to the rapid ageing of the population and due to a change of the indexation of pensions back to wages. Without further reforms and under current activity rates, the deficit in the pension scheme risks rising to 10% of GDP by 2050 (national projection). A relatively rapid increase in the employment rate and a rise in the effective retirement age could substantially reduce the foreseen deficit. The government agrees on the need to improve employment rates and to undertake further reforms in the pension scheme.	The current pension spending is at a relatively high level (11% of GDP in 2004) and is projected (AWG) to rise to 18.3% of GDP by 2050. Taking into account that pensions are tax-free, the level of public spending on pensions, in net terms, would be the highest in the EU in 2050. It appears that the pension system is on an unsustainable trend and major reforms will be necessary to make it financially sound.
<b>SK</b>	A mandatory funded tier was introduced in the social security pension scheme in 2005, implying that half of the old-age contributions rate (9 p.p.) will be transferred to the individual accounts in private pension funds. This reform was aimed to encourage activity and strengthen individual responsibility, while diversifying the longevity risk and making the pension system sustainable in the long run. The transition cost due to a decrease of contributions to the social security scheme will be mainly financed by the privatisation of the Slovak Natural Gas Industry. Additional financing need will depend on the employment development and on the success of increasing the effective retirement age.	Public pension expenditure is projected (AWG) to rise only modestly by 2050 (7.2% of GDP in 2004, 6.6% in 2015 and 9.0% in 2050). The 2005 reform makes a major step towards long-term sustainability of the pension system. However, the later years of the transition period may require additional parametric changes in the social security scheme if economic and employment growth would stagnate.
<b>FI</b>	The Government's strategy is based on ensuring economic and employment growth, reducing public debt and increasing pension reserve funds beyond the statutory funding requirement; the statutory pension funds amounted to 59% of GDP in 2004. The private sector earnings-related pension scheme is financially autonomous and fully financed by pension contributions. Major revisions in the pension system were implemented in 2003–05, in particular with the aim of increasing the effective retirement age by two years by 2025 and by three years by 2050 and adjusting future pension benefits to the increase in life expectancy as of 2009.	Despite recent pension reforms and an estimated increase in reserve funds, there is a need to raise the contribution rate by five percentage points of wages.

**Table 6.7. – Overview of the national strategies for ensuring the financial sustainability of pension systems (continued)**

Main elements of the strategy to ensure the sustainability of the public pension schemes		Observations
SE	The 1998 reform came fully into effect in 2003. It introduced a two-tier defined-contribution system comprising a pre-funded part and a notional defined-contribution PAYG scheme. The system is financially autonomous from the state budget and responds to economic or demographic developments. In addition, the government is committed to achieving budget surpluses over the business cycle.	It appears to be financially sustainable since benefits are automatically adjusted if required by demographic or economic developments.
UK	The Government's Green Paper in 2002 outlined pension reform measures which are built on the principle of providing a pension system based on both the public and private sector involvement. The measures undertaken have strengthened the public provision of decent minimum income in retirement and the promotion of the private pensions through simplified and streamlined regulation concerning private pension schemes, the establishment of the Pension Protection Fund and the Pensions Regulator in 2005, and through increased and streamlined tax provisions for pension saving. Moreover, the Government is committed to promoting a stable macroeconomic framework and sound public finances. Due to a great reliance on private pensions, public pension expenditure as a share of GDP is expected to increase only modestly (6.6% and 8.6% of GDP in 2004 and 2050).	The public pension system currently plays a relatively modest role and appears to be financially sustainable. In contrast, a major concern is whether there should be a stronger public sector involvement in the pension provision. Late 2005, the Pensions Commission laid down its proposal for reforms.



## Objective 7 – Adjust benefits and contributions in a balanced way

Ensure that pension provisions and reforms maintain a fair balance between the active and the retired by not overburdening the former and by maintaining adequate pensions for the latter.

In the light of increasing life expectancy additional pressure is put on the sustainability of pension systems. One way of seeing the financing of the pension burden is as a triangle, the corners of which are the three generations: future tax-payers, current tax-payers and current retirees. All of them should make a contribution to the pension system by giving up part of their rights or by contributing more, either in the form of increased contributions or working longer in order to insure the sustainability of the system and availability of adequate pensions throughout the years.

As a result of establishing pay-as-you-go pension systems, where benefits are based on promises made to individuals during their active life, the main burden in ageing societies is laid on current workers. To ensure continued sustainability one of three things can occur: contribution rates may go up, stronger measures may be implemented on tax and insurance collection, and retirement ages may be increased. Establishing funded tiers in recent years has also increased the burden on the current active labour force, as in addition to providing pension for present retirees they are also contributing for their own retirement income.

Current retirees are mostly enjoying pension benefits, promised to them when demographic processes were not cause for concern. In addition since the 1970s–80s early retirement schemes were available which have since proved problematic to close. During the same time, many countries have changed the rules of their pension systems more fundamentally. The young active of today and future tax-payers are the ones to whom new established rules regarding working life and regulations will fully apply at the time of retirement. They are also the ones who will have to bear the burden resulting from the inbuilt debt required to pay out present pensions and, or, pay for the transition of pension provision to a mixed (pay-as-you-go and funded) system.

In order to share the consequences of the changing demographic situation the necessary adaptations of pension system reforms seem to follow some common features. Many Member States wish to lower pressures on the generations in work by keeping contributions to the public system constant and increasing employment rates, notably, motivating the elderly to continue participation in the labour market. Other measures include introducing funded pension schemes and reserve funds, decreasing the level of benefits (through taxation or indexation) and introducing automatic balancing mechanisms.

### 7.1. Maintaining or adjusting contribution rates

Many Member States have stated in their National Strategy Reports that they intend to keep the contribution rate to the pension system stable, but expect contribution rates to private and occupational schemes to increase. Poland has said that further increases of contribution rates are not possible in the light of the low levels of employment, high unemployment and the already high costs on labour in form of taxes and contributions. Latvia also intends to maintain the contribution rates to the public system at the present level. This issue is of special importance for Germany: 'Achieving an improvement in fairness between the generations has been the primary goal of the pension reforms of recent years. Whilst an estimate made in 1987 for 2030 forecast a contribution rate of roughly 36% to 42%, the current estimates for the same year reach a contribution rate of only roughly 22%. The additional demographic burden on the future generations will hence be considerably reduced.' The Netherlands has set a cap on contributions for the public pension system, stating that in order to make sure that it is not only people below 65 who pay for the costs of ageing the contribution level is capped at 18.25%.

The situation is different in Cyprus though, but they have had historically low contribution rates (16.6% of wages) which are also partially funded by the state (by 4 p.p.). Ireland (without any form of compulsory income-related pension provision for a majority of workers) has identified a similar problem, saying that



if benefits are to remain indexed by earnings, contribution rates would need to increase significantly to provide the promised benefits. In Finland, contributions in the private sector are projected to rise by about 6 p.p. from today's 21.6% by the 2030s and then remain stable (and that is only about half of what was projected before the pension reform, which will significantly reduce the pressure to raise pension contributions in the private sector).

Portugal is increasing its VAT rate from 19% to 21% to contribute to funding future pensions. As that tax is being paid by both the active and the retired, it shares the increased costs of demographic change between generations. Similarly in the United Kingdom the rapid increase of the minimum pension has seen an increase in the incomes of the poorest pensioners, without an increase in contribution rates (this has been funded from general revenues). The last reform in France envisages a rise of 0.2 p.p. of the old age contributions as from 2006 and also the use of unemployment contributions towards pensions in the event of unemployment falling sufficiently.

## 7.2. The contribution of employment rates

A key condition for stabilising the finances of social insurance is an improvement in the situation of the labour market and an increase in employment rates (see chapters 4 and 5). Poland indicates that the social security system and the labour market are closely linked, and therefore adaptations are necessary in the mandatory social insurance system. One of the key objectives for them is to increase the number of employees and limit undeclared work. Slovenia stresses that changed requirements for old-age pension eligibility and its calculation, and a stricter definition of disability, have resulted in a gradual increase in statutory as well as the actual retirement age and a more selective approach to establishing incapacity to work, which has slowed down increases in the number of recipients of such pensions. Latvia has observed that its new pension system, including the notional defined contribution PAYG pillar, has already increased the incentives to extend working lives and as a result the burden on those in

work has decreased. Spain has introduced flexible retirement provisions that continue to have positive effects on labour market trends.

## 7.3. Influence of taxation mechanisms

Balancing the burden can also be realised through taxation systems. In Finland, statutory pensions are included in the progressive income while special deductions apply to smaller pensions. The German Parliament has also taken a decision to gradually reform pension taxation. This will translate into tax exemptions of the pension insurance contribution of the employed, while pensioners' income will be fully taxed in the long run. The United Kingdom Government offers generous tax incentives to support people in saving for their pensions. However, the extended evolution of the system means that it can be complex. It is for this reason that, from April 2006, the taxation of pensions will be radically simplified.

## 7.4. Indexation of pensions

Many Member States have reformed their indexation systems in recent years in order to either improve the financial sustainability of the pension system or the adequacy of benefits. In Hungary their NSR presents the introduction of the 'Swiss' indexation formula on pensions (50% consumer price increases and 50% increases in net average earnings) as an important component of the reform. The indexation is expected to lead to a drop of 8–10 p.p. of average pensions to average wages by 2050. Also Austria has changed its indexation formula towards price indexation. This change is expected to lead to long-term savings and thus change the balance between the active and the retired. Price indexation in Poland is seen as combining the protection of pensioners against inflation, with a reduction of the burden on those who work. In Sweden, the earnings-related pension from the pay-as-you-go system is indexed to average earnings. In the Netherlands, social security pensions are linked to minimum wages and indexed on wage growth, while the indexation of occupational pension schemes varies from prices to wages. The adjustment of pensions in payment can be suspended or allowed to lag behind inflation or earnings if this is required by the financial situation of the scheme.

## 7.5. Funded pension schemes and creation of buffer funds

With regard to ensuring the adequacy of pension provision, partial funding of pension obligations has been mentioned by some Member States. Ireland predicts that the partial funding of future state pension liabilities will ease the impact of the burden on future taxpayers and increase future Governments' capacity to respond to other financing needs which may arise. The Slovak Republic, Latvia and Estonia have also mentioned that the introduction of funded components has increased personal involvement and responsibility of the individual for their future entitlements and thus increased motivation to contribute to the pension system. While the introduction of voluntary funded pillars does not increase pressures to the State budget (unless it is supported by tax credits), the introduction of mandatory funded tiers usually results in transition costs of varying severity, that need to be financed from other resources.

One solution to overcome transition costs or to lower pressures on public finances due to an ageing population is the introduction of a reserve fund. It is used in Sweden, where pensions from the pay-as-you-go system are also financed with money from the buffer funds and its income from interest. The original buffer fund was established as early as 1960 but a new regulatory framework was applied in 2001, allowing greater diversification and thus a higher rate of return for the same risk level. In Belgium, as from 2007, the budgetary surpluses of the federal government and of the social security system will be used to finance the Ageing Fund which will in turn finance increases of public pension expenditure. In Finland, reserve funds have been established since the late 1980s for local government and State pensions with the aim of increasing funding to the same level as that for the private sector pension schemes (where reserve funds were established in the 1960s). Altogether, the reserves of all mandatory schemes amounted to 59% of GDP in 2004 and are projected to rise to almost 80% of GDP by 2020. Spain has pointed out that with regard to the objective of maintaining adequate pension levels in

the context of an ageing population, the social security Reserve Fund helps to cushion the effect of economic cycles and to guarantee the financial stability of the pensions system.

## 7.6. Combining different measures and the importance of automatic balancing mechanisms

Some Member States describe a common set of measures that should keep future expenditure under control and thus also reduce the efforts required by tax-payers to maintain the balance of the pension system. The Hungarians have taken measures aimed to reduce imbalances between generations. These include raising the retirement age, changing the indexation formula and implementing fully-funded schemes. The Austrian NSR has stated that new methods used for pension calculation and pension adjustment are tools to maintain a fair balance between active and retired persons because of strengthening actuarial principles in statutory pension insurance. The calculation base for pensions was changed with the 2004 reform and deductions for early retirement increased. Also, Portugal reports a set of measures to ensure a balanced spread of resources between working people and pensioners (such as implementing a new pension calculation formula and reviewing special retirement schemes)

The sustainability factor, introduced in Germany, reflects not only demographic processes, but also labour market trends. It is expected to work both ways – reducing the need to increase contribution rates for the currently active as well as safeguarding pension levels and preventing the average level of pensions falling below a certain limit in relation to workers' income. Sweden uses an automatic balancing mechanism that works in a similar way if the financial sustainability of the system is at risk. Latvia has established a pension calculation method in their notional defined contribution scheme based on disbursing capital equally over the years of retirement, taking into account increases in life expectancy.

## 7.7. Conclusion-risk-sharing between the active and the retired

The National Strategy Reports indicate that most Member States are committed to preventing excessive burdens on future generations. They have taken measures to share the burden between generations, keeping the future growth of pension expenditure under control but also insuring that adequate pensions are available for future retirees. There is reluctance in many countries to increase contribution rates but it is seen in some as part of a comprehensive package to ensure an accept-

able balance between adequacy of incomes of those retired and the burden on those in work. Increasing employment rates notably of older people is a key component everywhere. Pension reserve funds have been set up and automatic balancing mechanisms have been introduced in a number of Member States. Changes in the taxation of contributions and benefits and of the indexation formula are also seen as means to achieve a fair balance between contributions benefits. Where public pension benefits are expected to decline in relation to earnings, the development of private supplementary provision has been promoted.

## Objective 8 – Ensure adequate and financially sound private pensions

Ensure through appropriate regulatory frameworks and through sound management, that private and public pension schemes can provide pensions with the required efficiency, affordability, portability and security

One reason for a more extensive development of private pensions in some countries can be the limited scope of income replacement of the public scheme (in some Member States first-pillar benefits are flat rate, while in others they may be earnings-related but subject to a fairly low ceiling or offer only a low replacement rate for covered earnings, see chapter 2). In these cases, private schemes have an important role in ensuring adequate replacement rates for pensioners.

Many Member States are currently promoting the development of privately-managed pensions, in order to contribute to the overall adequacy of pensions in a context of declining replacement rates from public pay-as-you-go schemes. In a number of Member States, replacement rates provided by first-pillar schemes are indeed projected to decline in the coming decades for people retiring at a given age (again see chapter 2). As a result, the importance of privately-managed pensions (statutory, occupational or individual) is generally expected to increase in the coming decades, though the public pay-as-you-go pensions will remain the principal source of income of pensioners in all but a few Member States.

In this context, as underlined in the SPC special study on privately-managed pension provision, it is essential to ensure that the development of private pensions will meet the corresponding demand and expectations. This requires, in particular, both sufficient coverage of the active population and adequate contribution rates. Moreover, the tendency towards a broader use of privately-managed pension provision should not assume that public policy retreats from the area. Monitoring and regulating private pension provision is becoming an important and complex task for government. This highlights the importance of public policy intervention, notably through the provision of appropriate frameworks including

regulatory, tax and information provisions, in order to ensure secure and efficient management of assets.

### 8.1. Current and expected role for private pension provision

The importance of privately-managed schemes varies greatly among Member States: Their importance reflects to a large extent the size of public first-pillar schemes, which represent by far the main source of income for most retired people. Private provision can be gauged in different ways; firstly through the level of coverage of the active population and its likely evolution, but also through the current and expected contribution of these schemes to the income of retired people in the future.

Levels of assets also reflect the maturation of these schemes as they result from the level and length of past contributions. The total amount of assets held by private pension schemes (and reserves from public schemes) represents a very useful indication of the importance of private provision and its capacity to contribute to older people's incomes. It also gives a good indication of the future importance of these schemes in the overall pension system. Present levels of assets vary significantly across Member States and are currently modest as regards pension financing needs in most Member States, although it should be noted that private funded schemes have been introduced only recently in several Member States, and asset levels may well be growing fast (see chapter 6). When examining the projected evolution of assets, it should also be kept in mind that the value of pension fund assets can change widely over a short period of time due to fluctuations in financial markets, as was the case at the beginning of this decade due to the slump of stock markets. The vulnerability to such fluctuations also depends on the composition of assets and investment diversification, which can be influenced by the design of the regulatory framework.

#### 8.1.1. Coverage and access of private pensions

Coverage levels vary greatly among Member States<sup>(17)</sup>. Four main groups of Member States are

(17) They are generally less important for individual schemes, except in a few Member States, where occupational (funded) schemes are relatively less developed like the Czech Republic, Spain, France or Finland.

distinguishable<sup>(18)</sup> (see table 2.4, chapter 2): a group with near comprehensive coverage (higher than 90% of the workforce, including Denmark, the Netherlands and Sweden), a group with high coverage rates (coverage of around 50% or slightly higher, including Belgium, Germany, Estonia, Hungary, Ireland, Poland, Slovenia, the United Kingdom), a medium coverage group (between 10% and 50% of the workforce, including the Czech Republic, France, Spain, Cyprus, Latvia, Lithuania, Luxembourg, Austria and Slovakia) and a low coverage group (less than or near to 10% of the working population, including Greece, Italy, Finland and Portugal). As a result of the maturation of these schemes, notably for those that are progressively extending over the whole active population (e.g. Estonia, Latvia, Hungary, Poland and Slovakia) coverage is projected to increase within the coming decades.

A number of Member States use mandatory membership in private pension schemes, built as a funded tier of the statutory scheme (Sweden, Poland, Hungary, Estonia, Latvia, Slovakia) or as a separate scheme (Denmark<sup>(19)</sup>, Austria<sup>(20)</sup>). Some type of mandatory membership can also be implemented through collective agreements (generally under certain conditions or mandatory for the employer, or available at the request of the employee) between social partners, especially for occupational schemes (for instance Belgium, Denmark, Germany, Spain, France, the Netherlands, Italy, Portugal or Sweden). Some Member States rely on some type of hybrid between mandatory and a pure voluntary approach for membership, which may be implemented through a general scheme (for instance, Lithuania's funded tier of the statutory scheme, Italy with a silent assent of the TFR), or be contractual or unilateral with the employer (Austria's BPG, Germany's deferred compensation, Greece's occupational pension funds, Ireland's voluntary occupational funds, Finland's occupational schemes, United Kingdom's occupational schemes) or also rely on the opportunity given to people to subscribe to pension schemes through one's employer or individually (such

as the Czech Republic's *Supplementary Pension Insurance*, France's *PERP*, Spain's *Personal plans*, Ireland RACs and PRSAs, Slovakia's *Supplementary voluntary plans* and the United Kingdom's *Stakeholder and Personal pensions*)

It should be noted that the nature of membership of private pensions can translate into lower coverage of some categories of workers, as a result of myopia, lower earning levels and incomplete careers of many people in working age, who face difficulties in taking long-term decisions on making provisions for their retirement. For instance, voluntary pensions are used more frequently by higher income groups and according to OECD recent analysis of the use of private pensions, there are strong indications that the shift to private pensions in some countries has strongly benefited higher income groups in particular.<sup>(21)</sup>

Furthermore, voluntary pensions are generally less often used by the younger active age cohorts, as underlined in the Czech Republic NSR. Partly as a result of this, the length of contribution period is generally shorter. For instance, Finland indicates that the average length of contribution for individual pension policies is 23 years, which is significantly below average length of contributions to mandatory pension schemes.

Such features could exacerbate the impact of reductions to the level of replacement rates in statutory pension systems especially for older pensioners. If private pensions are to provide retirement incomes for people with lower incomes it is therefore essential that Member States invest in good governance structures. Some Member States provide relatively favourable incentives for low-income people (Germany, Czech Republic) to participate in privately-managed pension provision, but this may not be sufficient.

This also explains the debate in some Member States about the nature of membership for private pension provision and the extent to which it should be made

(18) Coverage levels can refer to the population in employment or to the working age population. The use of a percentage of the population aged 20–64 is preferred as in some countries unemployed and inactive people can also be covered. However, it should be noted that figures for different types of coverage should generally not be added together, as these estimates generally arise from different sources (this can thus lead to double counting as people can combine different types of pensions). Only comprehensive surveys could give a clearer picture on different coverage levels.

(19) ATP, SP and SAP schemes.

(20) BMVG, the new severance pay scheme, *Betriebliches Mitarbeitervorsorgegesetz*.

(21) See Förster M. and Mira d'Ercole M. (2005), *Income Distribution and Poverty in OECD Countries in the Second Half of the 1990s*, OECD Social, Employment and Migration Working Papers No 22.

mandatory, in particular in Member States where a major part of pension provision is projected to be based on private saving (as is the case in many new Member States). However, it can be noted that a move to mandatory membership will not necessarily increase total savings, as it may result in reduced voluntary savings or increased household debt.

A few Member States also have plans to increase coverage in the coming years, through collective agreements (Netherlands) or are in the process of defining measures in order to reach higher levels of coverage. In Ireland a target of 70% was set, while in the United Kingdom an independent Commission, the Turner Commission, has reported on the system of supplementary pensions and long-term savings. One of the main recommendations of its November 2005 report was the establishment of a very low cost, national funded pension savings scheme into which individuals will be automatically enrolled, with a compulsory matching employer contribution. The United Kingdom Government is currently assessing the Commission's proposals with the intention of publishing a white paper on pension reform in spring 2006.

### 8.1.2. Contribution of private pensions to pensioners income

Currently a significant part of retirement income (more than 20%) is derived from private pensions in only a few Member States (Denmark, Ireland, Netherlands and United Kingdom).<sup>(22)</sup> In some other Member States (Belgium, Germany, Portugal and Sweden) the average share of income coming from private pensions is notable (from 5% to 20%), while the contribution of private schemes is modest or almost negligible in other Member States (Spain, France, Cyprus, Malta, Finland and Luxembourg). This low level can also be due to the fact that such schemes have only recently been introduced, as is the case in the Czech Republic, Estonia, Greece, Hungary, Italy, Latvia, Lithuania, Poland, Austria, Slovenia and Slovakia.

As a result of the maturation of privately-managed pension schemes, the contribution of private pensions to pensioners' income is expected to increase in a number of Member States. However, in all but a few Mem-

ber States, the contribution of public pay-as-you-go schemes is expected to remain predominant. In most member States, a significant share of income is expected to come from private pensions (the Czech Republic, Germany, Ireland, Italy, and Hungary) either now or in the future. In some Member States, the share of pensions' income coming from private pensions is projected to increase by between one third and one half and in a few cases will become as , or even more important than the share of public pensions (Denmark, Estonia, Latvia, Lithuania, Netherlands, Poland and United Kingdom) over several decades. In a few Member States the projected role of private pensions is to remain modest (Spain, Luxembourg) and in some countries no information is currently available (Greece, France, Portugal, Sweden, Finland).

## 8.2. The importance of public intervention as regards private pension design and risk-sharing

As underlined in the Swedish NSR, both pay-as-you-go schemes and funded schemes are sensitive to increases in life expectancy: any type of pension arrangement will have to adapt to increases in life expectancy by either reducing the amount of benefits, raising the effective age of retirement or raising the level of resources dedicated to pension purposes (through increases in general government resources, social contributions or private savings). Both pay-as-you-go and funded schemes are also exposed to economic risks: adverse developments in growth, employment and earnings would reduce revenues in pay-as-you-go systems and hence the ability to pay current pensions;<sup>(23)</sup> while in funded systems, benefits could be adversely affected by lower returns resulting from such trends and a possible imbalance between the supply of, and demand for, financial assets.

Some economic and financial risks arise from demographic change itself which may not only change the balance between contributors and beneficiaries, but also between the number of people who save and people drawing down on their savings.

The development of privately-managed schemes represents an important transformation of pension sys-

(22) Estimates in this section are not directly comparable; they come from the NSRs and the Special SPC study on privately-managed pension provision.

(23) Even though some Member States plan to be in a position of increasing budgetary transfers to public pension schemes thanks to a decrease in public debt.



tems with numerous implications for the role of public policies in achieving adequacy and sustainability. Governments are directly responsible for providing first-pillar pensions and guaranteeing them, in the event of unfavourable economic or demographic developments. Privately-managed pension provision, by contrast, is shaped indirectly by governments which set framework conditions, ensure the supervision of schemes and provide incentives.

### 8.2.1. The design of risk-sharing

The design of risk-sharing between the individual, and the organisation offering supplementary provision relates in particular to the type of benefit they provide (defined benefit, or defined contributions schemes or a mix of both elements) and to how the benefits are paid out (lump sums or annuities).

A shift from defined benefit to defined contributions schemes modifies risk-sharing: it reduces the risk for the scheme or the scheme sponsor (for instance the state or employer) and increases it for beneficiaries (employees and their dependants). Defined contributions schemes generally provide individuals greater freedom of choice in the trade off between higher savings, later retirement and lower retirement income (they also tend to be far more portable, and can be more attractive to those who change jobs frequently), although flexibility is also built into some defined benefit schemes. The prevalence of defined contribution schemes appears to be rising as a result of recent reforms and trends in benefit design.<sup>(24)</sup> Pension provision in the new Member States is often of the defined contribution mode (e.g. Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Slovenia, Slovakia), while in the old Member States there has been a tendency for the share of defined contribution schemes to increase in response to changes in the economy, rising life expectancy or reforms (Italy, Austria, Sweden, United Kingdom). However, it should be noted that in some Member States, a significant proportion of schemes remain defined benefit (for instance in

Netherlands or in United Kingdom where defined benefit schemes remain common particularly in the public sector). There are also, in some Member States, hybrid schemes where (for instance) a minimum rate of return is guaranteed (for instance in Denmark or Belgium) in a defined contribution scheme.

An important other distinction as regards risk-sharing is how the benefits provided are realised as income (lump sums or annuities)<sup>(25)</sup>. Annuities insure against the longevity risk, whereas with lump sums there is a risk that the beneficiary will outlive the money that is available; on the other hand, any remaining money can be bequeathed (lump sums can also be converted into annuities, but this remains at the initiative of the individual beneficiary).<sup>(26)</sup>

The extent to which private voluntary schemes are used for retirement savings depends notably on the regulatory framework, e.g. tax incentives conditional on the bulk of savings being used for a regular income (annuity) rather than for paying out a lump sum or a minimum age at which a person can access such savings.

Individual schemes mostly provide either annuities or lump sums, even if in some Member States the part devoted to a lump sum is restricted either by direct legislation or by tax rules (like Germany, Ireland, Luxembourg, Hungary, Portugal or United Kingdom). Lump-sum payments represent the largest share of pay-outs in Belgium, the Czech Republic and Spain, but are not common in the Netherlands, Portugal, Slovenia and Finland. In Cyprus provident funds provide mostly lump sums that are paid at the termination of each period of employment, which translate into relatively low levels of relative income for pensioners. Some Member States have introduced restrictions on the amount of retirement savings that may be taken as a lump-sum payment (e.g. Ireland, Italy, Lithuania or the United Kingdom) and in other Member States, only annuities are available (like in Latvia and in Poland where the governments are preparing legislation stipulating that the entire value of pension fund savings will have to be converted into an

(24) This also applies to pay-as-you-go schemes with the introduction of notional defined contribution schemes in some Member States.

(25) Annuities provide periodical payments to retired people (with insurance against biometric risks such as longevity and survivors' protection in the event of death, based on the use of life expectancy tables), while lump sums provide a single payment to the retired person in the form of a capital, leaving it to the beneficiary to ensure that this provides sufficient income during retirement. In some cases, pension funds can provide 'phasing out' lump-sum payments: in that case, periodical payments are provided, but without any insurance against the longevity risk, that is progressively diminishing the available capital.

(26) This also relates to the difficulty to distinguish among different types of savings those that are clearly for retirement purposes: part of the savings that are not specifically labelled as pension savings may be used for retirement purposes, whereas part of the savings collected by retirement schemes may – depending on the rules of the Member State – in fact be used for other purposes than providing periodic retirement income (lump sum benefits, early withdrawal options).



annuity). In the United Kingdom (apart from a proportion which may be taken as a lump sum) any tax privileged pension saving has to be converted into an annuity by the age of 75.

The possibility to choose between lump-sum and annuity payments currently varies greatly among the Member States. A greater role of private pensions in securing adequate incomes in old age would call for more benefits being taken as annuities rather than lump sums and in some Member States an increased use of annuities is expected (Belgium and the Czech Republic plan to limit the use of lump sums). In Spain, the Government intends to change pension fund legislation, in order to encourage the use of annuities, rather than lump sums.

With the rising significance of funded defined contribution schemes for future retirement incomes, the development of financial institutions offering annuities has become an important issue. In many Member States markets for annuities are weak and, overall, the capacity of the financial sector to provide annuities on a large scale seems to be insufficient. This question is particularly burning in a number of Member States that have introduced funded tiers of their statutory schemes and will soon need to define the conditions of the pay out phase of these individual accounts, as in some cases first payments are expected to occur at the end of the decade.

### 8.2.2. The importance of public support and efficient regulatory framework

The role of public policy intervention in the development of privately-managed schemes is essential. Such intervention can take different forms, providing tax or other financial incentives notably for pension schemes that are mandatory; defining prudential requirements and information frameworks; and establishing the legal framework for collective or individual bargaining on pension entitlements.

- *Tax incentives and level of public support*

In most Member States, savings in individual pension plans benefit from some form of tax exemptions. The

widespread practice of EET<sup>(27)</sup> taxation represents a form of deferred taxation, allowing people to spread their income over their whole life. Under progressive income tax regimes this will typically have the net effect of lowering average taxation over the lifetime (as people usually pay a lower marginal rate of taxation in retirement than in work, reflecting lower retirement income than previous earnings). In a number of Member States there are additional advantages for individuals saving for a pension such as exempting income used for pension savings from social insurance contributions or direct state support.

Recent studies highlight that the immediate budgetary costs in the form of foregone revenues generally exceed the future revenues resulting from the taxation of benefits (estimates indicate that revenue losses for OECD countries represent around 20% of contributions).<sup>(28)</sup> However, harmonised measures for the 25 Member States of the total cost of public support through tax exemptions or subsidies are not available. Estimates provided by Member States for the SPC special study on privately-managed pension provision indicate that gross annual costs currently range from 0.5% to 1.5% of GDP (taxes levied on pension incomes should be deducted to obtain the net cost).

- *Ensure an efficient regulatory framework*

The development of privately-managed schemes calls for the implementation of prudential requirements for which there is also a framework in European legislation. In most Member States the financial protection of members is based on several tools: the presence of supervision and control authorities and a legal basis, including requirements of prudential and administrative rules of management, and rules concerning insolvency and fraud. Several European directives are particularly relevant in this regard: the insolvency directive of 1980, the life insurance directives and the directive on institutions for occupational retirement provision (see box 8.1).

(27) Contributions and investment income of the scheme are exempt from taxes; benefits are taxed.

(28) P. Antolin, A. de Serres and C. de la Maisonnette (2004), 'Long term budgetary implications of tax favoured plans', OECD Economic Department Working Paper No 393.

### Box 8.1. – European directives and prudential requirements

The insolvency directive (80/897EEC) guarantees the payment of outstanding claims to employees in the event of insolvency of their employer. This directive applies to employees' claims arising from contracts of employment or work relations and existing against employers who are in a state of insolvency within the meaning of the directive. Article 8 of this directive requires Member States to "ensure that the necessary measures are taken to protect the interests of employees and of persons having already left the employer's undertaking or business at the date of the onset of the employer's insolvency in respect of rights conferring on them immediate or prospective entitlement to old-age benefits, including survivors' benefits under supplementary company or inter-company pension schemes outside the national statutory social security schemes."

Several insurance directives cover the field of life insurance (directive 2002/83). They include the principle of a single passport allowing them to operate in all Member States. This implies notably the mutual recognition of prudential rules between Member States. The Member State in which the company has its registered office is responsible for providing the operating license and ensuring the surveillance of its financial soundness (solvency, provisions, and investments). Concerning provisions, it stipulates that Member States shall make sure that sufficient technical and mathematical provisions are constituted and that their calculation is sufficiently prudent. The directives also include some rules on the diversification of investments. Moreover, some special rules are issued on solvency margins and on a guarantee fund in the event of insolvency of an insurance business.

The directive on institutions for occupational retirement provision (IORP, directive 2003/41) applies to institutions operating on a funded basis (the transposition period expired on 23 September, 2005).<sup>(29)</sup> Concerning provisions, it stipulates that Member States shall ensure that institutions establish an adequate amount of funds corresponding to their financial commitments and that the calculation of provisions shall be executed and certified by an actuary, with sufficiently prudent rules (for instance for the rates of return used). Concerning investments, the qualitative 'prudent person principle' applies to all assets with one quantitative restriction concerning investments in the sponsoring undertaking (no more than 5%, or 10% when the sponsoring undertaking belongs to a group). Member States may lay down some quantitative restrictions, but within limits.

In most Member States, the prudential framework has recently evolved, notably as a result of the implementation of the IORP directive. Member States have generally created one or several independent supervision and control agencies. Supervision agencies are in charge of the monitoring of the financial situation of schemes through periodical reporting including actuarial assessment of the coverage of liabilities and adequate funding (schemes have to assess periodically the extent to which their assets effectively cover their liabilities). Supervision agencies generally can ask underfunded schemes, for the introduction of a recovery plan to restore financial sustainability. In Denmark, according to a system of traffic lights, if following losses, the capital base of a company falls below the solvency margin required, the Danish Financial Supervisory Authority will intensify its supervision and require

more frequent reporting of data, or it will initiate discussions with the company and possibly order it not to increase its risk exposure.

Moreover, Member States define rules of management, requiring the independence of pension funds from the sponsor or the re-insurance of pension commitments and also define special rules to deal with cases of insolvency and fraud in order to protect pension rights. They also impose prudential requirements on privately-managed schemes, but the strength of these requirements varies significantly. Some Member States have chosen not to impose quantitative rules on the investment of assets, but to rely mainly on qualitative rules (for instance 'prudent person principle' as used in United Kingdom, Ireland or the Netherlands). A majority of Member States apply some quantitative

(29) Institutions managing social security schemes covered by Regulation 1408/71 and 574/72, but also life insurance institutions covered by directive No 2002/83, and companies using book reserve schemes are excluded from the scope of this directive.

limits or qualitative restrictions on the use of different types of investments (for instance on liquidity, debt and equity securities, issuer's country of residence, currency denomination, share of investments guaranteed by the same entity or use of derivative instruments).

In some Member States, the prudential framework has acknowledged significant adaptations in recent years, such as in the Netherlands and the United Kingdom. In the Netherlands, the principles for a new Financial Assessment Framework for supplementary pensions were established in 2004. It sets tighter requirements in particular for the size of reserves for collective private pension arrangements. It also sets requirements for the break-even contribution rate and consistency between commitments regarding indexation, financing and related communications. In the United Kingdom, the provision of private pensions has been promoted by a streamlined and simplified regulatory regime (overseen by the Pensions Regulator and the Financial Services Authority), a simplified tax regime for pension funds and greater protection for final salary schemes (by the establishment of the Pension Protection Fund).

However, higher security has some costs and in particular, tight regulations aimed at short-term financial stability can eventually become counterproductive, if for instance, large and rapid increases in the levels of contributions are required to restore financial reserves after a financial market downturn. This may have a pro-cyclical effect on the economy by increasing the cost of labour and reducing consumption during an economic downturn. Achieving the right balance between short-term security of pension schemes and the overall long-term robustness of the pension system thus remains a challenging task for policy-makers and regulators.

# • *Information and monitoring*

Information plays a key role for the provision of pensions and in particular for private pensions where a greater readiness of individuals to participate in private schemes requires a clear understanding of how they operate (see chapter 11) while for the public policy debate and the decision-making process tools are required to monitor the development of privately-managed schemes.

In most Member States pension schemes have to provide periodical reports to supervision authorities. Some Member States plan to reinforce the monitoring capacity of the supervision authority in the coming years, leading to improved information collection (Luxembourg) or more up-to-date information (the Netherlands). Monitoring of privately-managed pension schemes can also be achieved through specific representative surveys or collected through income tax declarations, as contributions to individual schemes can often be deducted from taxable income (this will be the case from 2005 in Ireland).

Information to members of private pension plans will also be crucial with regards to the amount of benefits individuals are likely to receive. While these crucially depend on expected return rates and administrative expenses (see below) it is also crucial that regulators determine tight and uniform standards for the simulation of benefits, allowing individuals to be confident on the information they receive and to assess their options. To this end the United Kingdom has put in place the 'Informed Choice' programme through which it is trying to increase awareness amongst workers of their access to pensions.

## **Box 8.2. – International data on privately-managed pensions**

Solid information on private pension schemes is essential for the decision-making process for both the private sector and the government. The present situation is unsatisfactory at national level but even more so at the European level. National information is sometimes highly aggregated and it is very difficult to avoid double counting for coverage. Improvements are being introduced at national level and this is supported by international data collection programmes (EUROSTAT and OECD) in order to allow for a more detailed analysis of privately-managed pension schemes. Data to be produced include, for instance, coverage levels, contributions, levels and structure of investments, rates of return and of administrative charges. A shortcoming of such data has been that it focuses too much on particular types of institutions rather than the overall role of privately-managed pension systems in social protection systems: some types of schemes are better covered (in particular occupational pension schemes using external funds), whereas information on others is very patchy (e.g. third-pillar individual provision) or almost non-existent in institution-based statistics

### Box 8.2. – International data on privately-managed pensions (continued)

(e.g. book reserve schemes). Moreover, most of the data sources do not cover all the 25 Member States (this is however the case for ESSPROS).

EUROSTAT data on pension funds cover occupational pension funds (excluding all insurance schemes, but covering individual schemes for some countries). The ESSPROS database covers occupational pension funds (generally excluding individual schemes) and first-pillar schemes. Following the SPC special study on privately-managed pension provision the feasibility of a new breakdown of schemes is currently being considered, in order to distinguish between publicly- and privately-managed pension schemes. OECD data covers autonomous pension funds (occupational or individual; in theory, insurance companies can also be included), while non-autonomous funds (that are not legally distinct from the sponsors of the fund) are not covered (for instance book reserves).

#### 8.2.3. Real rates of return, guarantees provided and administrative charges

Future benefits will depend on the level of effective real rates of returns, which determine future assets. The future level of pensions will depend on long-term real rates of returns disposable for pensions (that is net of administrative charges), though short-term fluctuations in rates of returns can also affect future pensions (in particular for people that are about to retire).

As a response to the uncertainty pertaining long-term rates of returns, a few Member States provide future pensioners with some type of guarantee regarding future rates of returns, while some Member States have introduced a framework aiming at regulating administrative charges.

Recent experience indicates that there is an important heterogeneity in the level of rates of return both between Member States and within Member States for different types of schemes (see for instance SPC special study). A few Member States provide a protection against the risk of negative rates of return. In Belgium the guaranteed return for occupational pensions has recently been extended from employees contributions to employers contributions. In the Czech Republic the state-subsidised supplementary pension provides a year-to-year guarantee of non-negative return. (This provision may be removed for new entrants, but remains operational for existing members.) It can also be noted that the general development of tax incentives indirectly provides a mutualisation of the risk of years of low or negative returns, though this is generally not quantified.

In mandatory private pension schemes (Sweden, Poland, Estonia, Lithuania, Slovakia, Hungary), individuals generally have a choice among a limited number of funds with different investment strategies and risk exposure, although they are not covered against the risk of adverse developments of rates of return. In Poland's funded tier of statutory pensions, the system of monitoring pension funds' (OPFs) investment efficiency is based on the three-year rate of return of the funds (determined twice a year): rankings of all OPFs are made and two measures used (three-year average asset-weighted rate of return and the minimal required rate of return). So far, one of the funds achieved lower investment results than the minimal rate of return three times and the managing private societies made additional payments to the accounts of that fund's customers.

Short- or medium-term evolution of rates of return can affect pensioners as a sharp drop in the value of investments held by a scheme would be particularly dramatic in the case of defined-contribution schemes for people who have to convert their accumulated capital into an annuity. Some Member States highlight that people might shift funds into less volatile asset classes as they approach to retirement.

However, it should be emphasised that rates of returns should not only be observed over short periods of time. It is essential to have a good understanding of what level of returns is realistic over the long term (several decades) as this determines the level of contributions that is required for adequate pensions. A number of elements, both from a theoretical and an empirical perspective tend to indicate that the level of real rates of return is unlikely to be very high in the future and in

particular that it would be prudent not to rely on an extrapolation of the trends observed over recent decades (see box 8.3.). The technical rates of interest used for actuarial purposes should thus be based on a

reasonable and prudent estimation of future rates of return. These are of course difficult to predict, but safe assumptions should be preferred in order to avoid creating inappropriate expectations.

### Box 8.3. – Real rates of return

It is generally assumed that real interest rates cannot differ significantly in the long run from long-term growth. This suggests that population ageing will have a negative effect on the real interest rate through the slowing down of the labour force growth. It is thus probably misleading to build assumptions of future rates of returns only on past trends, as growth prospects for the future decades are typically lower than observed average rates for past decades, especially from the past half century.

Over the last forty years, the average real interest rates were ranging around 2% or 3% in EU countries, US and Japan for the period 1961-2000. While former average growth rates for the last four decades were of about 3-3.5% and past long-term interest rates of 2-3%, if one expects a slow down in growth rates, this suggests levels of future long-term rates of returns not exceeding 2-3%.

Moreover, real long-term interest rates have not been stable over the last decades: they were lower in the 1960s and 1970s, higher during the period of disinflation of the 1980s and the first half of the 1990s and lower since the launch of the third stage of EMU. Indeed, during the 1990s, the levels of real long-term interest rates decreased in both the EU-15 and the US: they currently stand at around 2%.

This also raises the question of the right balance between return and risk for pension scheme investments. While it may be possible to achieve higher average rates of return on pension fund investments, this may come at the price of increased risks of negative returns. In that respect, it should be taken into account that as the purpose of pension schemes is to secure an adequate and safe income for a long period of one's life cycle, this also requires protection against the risk of negative returns. In practice, this calls for an appropriate composition of assets (notably the proportion of stocks and bonds) and the adaptation of this mix to the circumstances of members (young vs. close to retirement). An example of this can be found in the United Kingdom where from April 2005 'lifestyling' has been introduced into stakeholder pensions. As a member approaches retirement, their savings can be moved gradually from equities to fixed income investments.

- *Administrative costs and policies to keep charges low*

Administrative charges can be defined as any type of cost that decreases the real rate of return available for future pensioners (including charges for managing the

funds, but also marketing costs). The level of administrative charges as a percentage of total assets provides the most direct indication of the impact of charges on real returns: this percentage has to be deducted from the real return on assets. Administrative charges generally vary greatly among different types of pension provision and are in particular reduced by the full use of potential economies of scale associated with large coverage (for instance mandatory schemes have the lowest charges, while charges for pay-as-you-go schemes are generally lowest due to both economies of scale and to the absence of marketing costs and expenses for managing assets).

Charges can be a major problem especially for people with low incomes and hence low savings capacity as they are likely to represent a higher proportion of contributions or pension assets of people with small amounts of pension savings. Estimates provided by Member States<sup>(30)</sup> indicate that administrative costs generally range between 0.5% and 2.5% of assets per year; an average value of 1% per year appearing as most representative (costs tend to be lower for large collective schemes due to economies

(30) In their NSRs and in replies to the SPC questionnaire on privately-managed pension provision.

of scale), which implies a reduction in the real rate of return by one percentage point leading to a considerable reduction in the pension level.<sup>(31)</sup>

This underlines the importance of policies aimed at keeping charges low. This can take the form of obligations of information and transparency imposed on pension providers with the aim of inducing a downwards pressure on charges levied, or be eased by a strong involvement of all stakeholders, notably through large-scale schemes and the association of social partners in the definition of the design of pension funds.

A number of Member States have introduced direct regulations on the levels of administrative charges, for instance in the form of ceilings expressed as a percentage of contributions or of assets. For instance, in Belgium, there is a legal ceiling of 0.5% of administrative charges as a share of contributions for so called social plans, in Spain commissions may not be higher than 2% of the yearly balance of an account and in Latvia (for the second tier of the first pillar) charges are capped at 2.5% of contributions (there is no limit to the fund management fee). In Lithuania there is a legal ceiling (for the voluntary second tier of the first pillar) limiting maximum administration charges to 1% of assets and 10% of contributions, in Austria charges on contributions may not exceed 3.5% (in the new severance pay scheme), in Poland (for the second tier of the first pillar) there are direct limits on the value of charges and fees and in Slovenia (for occupational schemes) there is a legal maximum amount of administrative charges. In Slovakia, there is a legal ceiling for charges (in the funded second tier of the first pillar). Finally, in the United Kingdom, administrative charges must not exceed 1.5% of assets for stakeholder pension schemes for the ten first years and 1% of assets afterwards.<sup>(32)</sup> It is interesting to note that charges on other personal pension products have fallen by around a third since 1999 to around stakeholder pension charge levels.

### 8.3. Conclusion

Following recent reforms and the maturation of private schemes, the importance of privately-managed pensions (statutory, occupational and individual) is expected to increase in the coming decades, though the public pay-as-you-go pensions will remain the principal source of income of pensioners in all but a few Member States. While privately-managed pension provision can contribute to overall adequacy of income replacement in old age, notably by partly compensating adequacy gaps left by cuts in public pensions, it should not be seen as a panacea for the challenge of population ageing. Indeed, both pay-as-you-go schemes and funded schemes are sensitive to economic and biometric risks (in particular increases in life expectancy). There is strong evidence that lower-income groups are less able to rely on private schemes and this poses an important challenge if countries pursue a strategy of ensuring adequate retirement income with a strong emphasis on the promotion of private voluntary pension schemes.

The state of pay-as-you-go schemes is highly dependent on the ratio between the level of active population (contributors) and retired people (beneficiaries), crucially influenced by the general rate of employment (chapter 4) and the rate of employment of older workers (chapter 5). The viability of funded schemes not only depends on the ability to constitute sufficient reserves (which also depends on employment levels but also on levels of coverage and contributions), but also on their ability to transfer adequately these resources over time: other key elements need to be taken into account, such as the design of risk-sharing over the period of accumulation of funds, but also public support and regulation, and the level of real effective rates of returns (net of administrative costs).

Defining an efficient and adequate regulatory framework for the development of private pensions is an essential aspect of a number of recent reforms among Member States and this is an area where Member States could certainly mutually benefit from further exchange of experience and of good practices.

(31) To illustrate this, let us assume that a person saves 100 currency units per year for 40 years. This means that after 40 years this person has contributed 4000 currency units (assuming for simplification that there is no inflation and that the real rate of return is zero). If administrative charges amount to 1% assets per year the accumulated charges after 40 years amount to about 720 currency units. This means that the level of charges as a percentage of total contributions made would amount to about 18%.

(32) This requirement is set out in regulations and enforced by the Pensions Regulator. Apart from a small number of exceptions specified in the regulations, for example concerning the costs of buying and selling investments, all other administrative charges must come within the cap.



## MODERNISATION

### Objective 9 – Adapt to more flexible employment and career patterns

Ensure that pension systems are compatible with the requirements of flexibility and security on the labour market; that, without prejudice to the coherence of Member States' tax systems, labour-market mobility within Member States and across borders and non-standard employment forms do not penalise people's pension entitlements and that self-employment is not discouraged by pension systems.

The pre-reform design of many statutory pension schemes in Europe were well-adapted to standard employment patterns such as full-time work and life-long careers, but these systems are less suitable for people with non standard careers or employment patterns. Because of changes in European labour markets, notably increased labour market participation of women combined with an increase of temporary jobs, part-time work, longer career breaks and a shift to more self-employment, both statutory and supplementary pension systems need to be adapted to allow these new working practices to be fully integrated into modern pension systems. This is especially important in supporting greater labour mobility, reflecting 'the Europeanisation' of labour markets. The following chapter reviews the content of the National Strategy Reports on the issues covered under objective 9: different career patterns, extending coverage to those potentially outside of pension systems, non-standard employment, self-employed and mobility and portability.

#### 9.1. Different patterns of employment careers and career breaks

Final salary pension schemes (statutory, occupational and voluntary) were often based on the assumption of rising wages over a career. Often making reference to a limited number of years at the end of career, when calculating final benefits – this had the effect of diluting the link between contributions and benefits. As reported in previous chapters, reforms have strengthened the link between contributions and benefits, either through moving to defined contribution systems or through taking account of earnings over a whole career. In this way recent pension reforms tend to

favour more equal treatment concerning pension entitlements of people with different patterns of career development as compared to the classic final salary schemes. On the other hand, periods of part-time work or lower wages would have been totally disregarded in schemes considering only a final salary or a limited number of best years. This may also affect benefits of workers with either long or frequent periods of unemployment depending on how periods of unemployment are assessed by Member States. This is partly reflected in declines of theoretical replacement rates for broken careers (of 30 years instead of 40) provided by some Member States in their National Strategy Reports.

Several Member States compensate for unemployment, education or non-paid care work through the State budget or acknowledgment of 'non-contributory' periods without additional contributions (see chapter 10). Providing minimum pensions for all as a basic pension underpin in addition to the earnings-related pension is also a method to ensure adequate pensions for people with non-traditional work patterns. Further measures to provide better coverage for periods of career breaks or part-time employment may be the ability to make voluntary contributions during these periods.

#### 9.2. Extending coverage

In several Member States adaptations since the first wave of NSRs have broadened the access for individuals to statutory and supplementary pension schemes. Luxembourg introduced pension contribution payments by the National Solidarity Fund for recipients of social assistance with a contribution record of at least 25 years. Germany transferred more than one million recipients of social insurance with earning capacity into the reformed system of unemployment insurance in 2005 and pays pension contribution on behalf of these individuals. In Finland, developments of the pension provision for recipients of art or research grants are currently being investigated as these individuals are not, as a rule, covered by any statutory earnings-related pension scheme.

Since July 2005 spouses of self-employed persons in Belgium (who help with their partners business) are



obliged to register as if they were self-employed, and subsequently have the same status, the so-called 'maxi status', as any other self-employed individual. In the past these people were inadequately insured and did not receive sufficient pension rights. Belgium also reported identical rights for part-time, temporary and seasonable workers with regards to access to supplementary pension provisions. In addition, new legislation from 2003 aims to extend second-pillar pensions via sector-wide collective agreements on occupational pensions, which will be implementable in small and medium-sized enterprises. Sector-wide collective agreements still appear to be a good tool for ensuring comprehensive coverage.

Several new Member States as well as Greece and Italy reported serious problems with undeclared work, undermining the contributory principle and weakening the social security protection for these 'envelope-economy' employees. The efforts to transfer undeclared work into declared and insured work should be continued.

### 9.3. Atypical working contracts

Member States have only started to propose measures in order to cover individuals with atypical working contracts. In 2003 France introduced the possibility of buying pension entitlements of up to four years for an incomplete contributory record due to marginal employment (low earnings) or professional training. To tackle the high rate (of around 30%) of all workers having temporary employment contracts in Spain, further labour market reforms will be giving priority to this situation.

Developing access to occupational pension schemes for part-time employees and especially for women is a major challenge for governments and social partners. The United Kingdom, for instance, reported that only 30% of part-time women employees are covered by occupational pensions, compared with half of full-time men employees. Since the last round of National Strategy Reports, where Member States with a long history of occupational pension provision reported legislation making it illegal to exclude part-time workers from supplementary pension schemes, several other Member

States introduced new regulations in favour of non-traditional work patterns. In 2002 Spain, for instance, created a part-time retirement scheme. Minimum contribution periods entitling a worker to a pension are calculated as in several other countries by multiplying the time worked by 1.5 in order to guarantee equal treatment between part-time and full-time workers. Greece has a regulation concerning equal treatment of part-time (at least four hours per day) and full-time workers in IKA-ETAM. The insurance coverage for working four hours a day gives part-time workers the right to voluntary insurance for full-day employment. Austria and Germany entitled every employee to remuneration conversion.

### 9.4. Social security of self-employed

Several Member States (Spain, Denmark, Finland, Belgium, France and the Czech Republic) reported improvements of the pension system for the self-employed. These improvements are responding to an increasing trend of this type of work, especially of so-called "single self-employed" - working alone and earning an average comparable or even less than employees.<sup>(33)</sup> In that respect, Member States which are excluding the self-employed from their obligatory pension schemes due to no historical need for protection, might start to discuss the necessity of addressing this area.

Most of the Member States which include the self-employed in their statutory pension system have different contribution bases for the employed and self-employed. Normally self-employed (obligatory insured or on voluntary base) are obliged to pay a certain flat-rate minimum contribution and may contribute more. As a result, the contribution of the self-employed in the statutory pension scheme is much lower than that of employees. The Czech Republic reported, for instance, that the average assessment base of the self-employed in 2004 was only 30% in comparison with employees. To address this issue, the Czech Republic government decided to increase the minimum contribution base from 2006 onwards. Poland pointed out that the differences in the size of the contribution burden to social insurance between employed and self-employed leads to an increasing number of self-employed and transfor-

(33) See Karin Schulze Buschoff: 'Neue Selbständigkeit und wachsender Grenzbereich zwischen selbständiger und abhängiger Erwerbstätigkeit – Europäische Trends vor dem Hintergrund sozialpolitischer und arbeitsrechtlicher Entwicklungen' Wissenschaftszentrum Berlin für Sozialforschung, Discussion Paper, July 2004.

mation of employment into self-employment. As long as adequate social protection of all types of self-employed is not guaranteed, social politics might focus on such developments. Austria, Germany and Italy for example integrated new types of self-employed work (such as the self-employed working for only one client) into their statutory pension scheme.

## 9.5. Portability of pension rights

The decision to change job depends on a variety of factors, including the impact on future pension entitlement, as often a significant share of an individual's remuneration is in the form of pension rights. While geographical mobility between EU Member States was only (between 2001 and 2002) 0.2% of the population, job-to-job mobility was much higher (about 9% of employees change employer each year in the EU-25). Job tenure gives another indication on professional mobility, as about 25% of people in employment have less than 2 years of job tenure in the EU-25 and only about 55% of employees have more than 5 years. There is empirical evidence that mobile workers risk finishing their career with lower supplementary pension rights as compared to those employees remained with the same employer.<sup>(34)</sup> There is little doubt that the old pattern of one or two large employers in a life career is losing relevance while new patterns are emerging characterised by frequent changes of often smaller employers, notably in the new service industries. In order to encourage activity and ensure adequate pension entitlements for the mobile work-force, Member States should put emphasis on minimising obstacles to mobility.

### 9.5.1. First-pillar pension schemes

Transferability of pension rights for first-pillar benefits is not a problem in Member States with universal statutory pension schemes like Denmark, Sweden, Finland or the Czech Republic, that insure all kinds of employments in the same pension scheme. Fairly fragmented pension systems (France, Germany, Lithuania and Greece) have to take action on pension rights of peo-

ple moving between different types of dependent employment or self-employment. Normally, on retirement an individual will receive pensions from two or more different pension schemes, provided that she or he has fulfilled each schemes requirements (for instance certain waiting periods). In that respect Member States might continue to avoid disadvantages for the insured due to the fragmentation of their social security systems by, for example, reducing waiting periods or minimum ages, or allow for transferability.

Concerning cross border mobility, Regulation 1408/71 on the coordination of social security schemes protects social security rights under statutory schemes in cross-border situations. This Regulation will eventually be replaced by Regulation 883/2004 of 29 April 2004 which contains a fundamental reform and simplification of the existing rules. It will be applicable once the necessary implementing provisions are adopted, which will probably not be before 2007/2008.

### 9.5.2. Supplementary pension schemes<sup>(35)</sup>

With the prospect of increasing the number of employees covered by supplementary pension provision the current problem of reduced portability<sup>(36)</sup> of supplementary pension rights is likely to increase for mobile workers within and across Member States. Member States where occupational pension provision is already well-developed seek to ensure this by legislation or through agreements with social partners. This includes low minimum ages and short maximum vesting periods (the time after which a guaranteed pension entitlement is acquired). Nevertheless some obstacles remain. In the United Kingdom, for instance, some personal and occupational pension schemes (other than stakeholder pensions) are able to refuse to accept the transfer of vested rights into their system. Denmark indicated in their NSR that while reduced transfer fees have improved the possibilities for transfer, the bonus potential is not transferable between pension providers, which make the consequences of a transfer less transparent.

In other Member States portability remains a major

(35) *Supplementary pension scheme means here "any occupational pension scheme established in conformity with national legislation and practice such as a group insurance contract or pay-as-you-go scheme agreed by one or more branches or sectors, funded scheme or pension promise backed by book reserves, or any collective or other comparable arrangement intended to provide a supplementary pension for employed or self-employed persons"* (definition taken from directive 98/49/EC).

(36) *In this context 'portability' is the possibility of acquiring and keeping pension entitlements in the event of professional mobility. 'Transferability' refers to one specific way of achieving portability, namely by transferring a capital representing the acquired pension entitlements from one scheme to another.*

problem. Most of the new Member States did not mention the topic at all in their NSR, partly due to the absence of occupational pension provision in these countries. Cyprus reported that transferability of pension rights amongst Provident Funds is not possible and for most funds full vesting of rights does not occur before seven or even ten years membership. Finland pointed out that supplementary pensions are considered as part of corporate personnel policies rather than essential elements of pension provisions. While Spain, Italy and Portugal had announced in the first round of National Strategy Reports that they are planning to tackle the issue of portability, only Portugal referred to it but stated that there is still no effective portability established. Germany has improved portability by introducing a right for employees (under certain conditions) to take occupational pension entitlements with them to their new employer. This right applies to new agreements concluded since 1 January 2005 and implemented through direct insurance, 'Pensionskasse' or pension fund.

As the analysis of the recent pension reforms show, evidently there is a trend for a greater role for supplementary pension provision to ensure future adequacy. It is important therefore that the Regulation 1408/71 on the coordination of social security systems for people who move within the Union in view of statutory social security systems is complemented by regulations to ensure that mobile workers are not limited in their mobility because of restrictions to their supplementary pension rights. In order to improve the overall conditions of portability and accompany the initiatives already taken by some Member States, the European Commission has recently adopted a proposal for a

directive improving the portability of supplementary pension rights. This proposal aims at reducing the main obstacles to portability (besides taxation) both within Member States as across borders related to acquisition conditions (waiting, vesting periods, minimum ages), preservation of dormant rights and transferability of acquired rights.

## 9.6. Conclusion

Statutory pension systems manage to guarantee pension rights of mobile and atypical workers better than supplementary pension schemes, where compensation for career breaks or part-time work are almost non-existent. Shifting pension provision to create a stronger link between contributions and benefits are overall ambiguous but can have favourable impacts on people with careers different from the standard pattern of rising salaries over the life cycle. Member States improved access to statutory and supplementary pension schemes for persons with atypical contracts and the self-employed and further action in this respect may be desirable. Also a broader compulsory coverage of the self-employed might be a possible measure in order to increase social protection of those workers.

In the field of supplementary pension provision, a further improvement in portability both within Member States and across borders is needed in order not to penalise mobile workers in terms of their pension entitlements. Some Member States have already undertaken steps to this effect and the proposed directive of the European Commission accompanies and supports these efforts.

## Objective 10 – Meet the aspirations for greater equality between women and men

Review pension provisions with a view to ensuring the principle of equal treatment between women and men, taking into account obligations under EU law.

### 10.1. Gaps in the pension situation of men and women

The gender difference in the relative income of people aged 65 and older (relative to the age group 0-64) varies from around 2 to 15 p.p. within the Member States.<sup>(37)</sup> But the current gap in pension entitlements of men and women is on average even larger. All Member States except Denmark and Estonia reported in their National Strategy Reports substantial gender gaps in the pension entitlements of current pensioners. In Estonia the average old age pension of women in the state pension scheme amounts to 97% of the average old age pension of men. Estonia pointed out that this 'relic from former times' will not last, as the 1999 pension reforms introduced equivalence between contributions and pensions while at the same time the evaluation of periods for raising children was reduced. In Denmark, the overall net pension entitlements of women are only 5-15% lower than the pension entitlements of men from the public pension system and supplementary labour market pensions. This is unique within Europe, in that there is nearly equal prevalence of (mostly mandatory) labour market pension schemes for men and women. Even in part-time jobs, women's participation rate is only marginally lower than that of full-time employees.

One reason for the significant gender gap in pension entitlements is the pay gap between men and women, which Eurostat estimates to be 15% on average for gross hourly earnings. This gap reflects a number of structural inequalities in the labour market, such as the over-representation of women in less-valued and less-well remunerated occupations and sectors and their disadvantages in career advancement. Other factors include the impact of temporary work and in some countries the prevalence of part-time work for women,

long career breaks notably because of care obligations and the tensions arising when trying to reconcile work and private life as well as gender stereotypes in education. These differences in the employment histories of men and women contribute to the lower employment rate of women and are reflected in today's pension entitlements as well as in higher poverty risks of women also in older age groups (see objective 1).

Part-time work also impacts the gap in pension entitlements notably in systems which establish a close relationship between contributions and benefits. In the EU-25, around 19% of the total employment is part-time employment, but 33% for women compared to 7% for men.<sup>(38)</sup> The Netherlands are currently the country with the highest total part-time rate of about 42% in total (75% of female employees and 16% of male employees) and Belgium, Germany, Austria, Luxembourg and the United Kingdom stay significantly above the EU-25 average of female part-time employment.

The general structure of Member States' earnings-related pension schemes mirrors the earnings and employment gaps, resulting in unsatisfactory pension outcomes for women. Most Member States' first-pillar pension schemes are comprised of an earnings-related scheme for the working population, which often includes entitlements to minimum pensions. In some Member States the basic systems are of a citizenship insurance type, providing flat-rate minimum pensions, which diminish the gender gap in pension entitlements. While in earnings-related pension schemes career breaks and lower income heavily influence the amount of pension entitlements, minimum pension provisions are often independent of the individual career. It must, however, be noted that minimum pension provisions may not be sufficient to prevent pensioners who are receiving only this benefit from being exposed to the risk of poverty.

Remaining differences in national ages for which State pensions can be received for men and women also lead to lower pension entitlements for women. In Poland the retirement age is 60 for women compared to 65 for men. Italy and Slovenia have not yet

(37) Source: see box 1.1 in objective 1.

(38) Source: Eurostat, 2<sup>nd</sup> quarter 2005

decided whether to equalise the age in which men and women are entitled to State pensions. In Austria the equalisation of the retirement ages of women and men starts only in 2024 and will reach 65 years as for men in 2033. Greece harmonised the legal retirement age for persons insured since 1993. A lower retirement age may not oblige women to use the opportunity to retire earlier but employers may see this as acceptable practice. Even if this were not the case, societal expectations may make it difficult for them to remain in the workforce beyond their pensionable age.

## 10.2. Gender differences in pension legislation

Community legislation requires the equal treatment of women and men in statutory social security, but

allows for certain exceptions regarding legal retirement age, survivors' benefits and pension rights related to bringing up children (directive 79/7). These derogations have been interpreted restrictively by the European Court of Justice. The directive clearly considers these exceptions as transitional and requires Member States to examine periodically, in the light of social developments, whether such derogations from the principle of equal treatment are still justified in some Member States. While legislation for survivors and childcare pension provisions tend not to be exclusively linked to women but have changed into gender neutral regulations, legal retirement ages of men and women still differ in several Member States as shown above. In addition, Slovenia, the Slovak Republic, the Czech Republic and Italy still provide opportunities for early retirement for women who brought up children.

### Box 10.1. – European pension legislation

Pensions paid in the context of occupational social security are considered as pay and must respect the principle of equal pay for women and men guaranteed by Article 141 of the EC Treaty. The principle of equal pay in occupational social security has been further implemented in more detail in directives 86/378 and 96/97. Currently, community law does not prohibit, however, the use of actuarial factors which differ according to sex. This means that where the employer makes the commitment to pay a defined benefit this benefit has to be the same for men and women. So the employer may have to pay higher contributions for women in order to bring about the same benefit. In a defined-contribution scheme, by contrast, the individual pension benefit is determined according to the amount of the accumulated savings. Due to the use of sex-based actuarial factors for calculating the monthly pension provision, this may result in lower benefits for women. In this case the employer's commitment, which has to be equal for men and women, is his contribution to the scheme.

Community legislation on equal treatment of women and men has been in general extended by directive 2004/113 to financial services such as private annuities and pensions. By this directive, the use of sex-based actuarial factors in insurance and related financial services is banned in principle, but Member States may decide not to apply the ban in cases where 'sex is a determining factor in the assessment of risk based on relevant and accurate actuarial and statistical data'.

## 10.3. Measures to promote greater gender equality in pension systems

All Member States try to correct the insufficient pension coverage of women through promoting higher labour market participation of women in the context of the European Employment Strategy and by applying specific measures within the pension systems. Statutory

pay-as-you-go systems take better account of periods of non-paid work such as care for children (and more recently for the elderly) than funded occupational and private pension schemes. The overall trend to declining pension provisions out of the first pillar schemes may lead to an increase in the gender gap in pension entitlement unless corrective solidarity measures are introduced in supplementary pension schemes.

### 10.3.1. Measures within pay-as-you-go systems

Against the overall trend to reduce future pension benefits in the pay-as-you-go schemes, several Member States implemented or improved the crediting of family care periods in the last two decades, though the coverage differs widely among Member States.

In terms of gender equality on the labour market it might be more efficient to reallocate some resources from generous full-time leave allowances to a combination of benefits for care periods and work and to develop child-care services, as some Member States are already doing. Concerning part-time work beyond the child credit period, Germany has introduced a system of more generous accruals for contribution periods between a child's fourth and tenth birthdays. Belgium works with a more general system of 'minimum pension entitlement per career year'. This measure mainly results in increasing the retirement pension of future pensioners that had been poorly paid and for short or part-time careers. By doing so it particularly favours women.

Elderly care has started to be credited within pension systems too. Half of all Member States (Austria, the Czech Republic, Germany, Estonia, Hungary, Lithuania, Poland, Slovakia, Slovenia, Sweden, Luxembourg, Ireland and the United Kingdom provide additional contributions or pen-

sion credits for periods of dependent and elderly care.

It should also be mentioned that minimum guarantee pension schemes, such as those offered by the Netherlands, the United Kingdom, Ireland, and Denmark, do not require such measures in their first-pillar provisions. The Netherlands minimum pension already guarantees 70% of the net minimum wage so that the risk of poverty among people aged 65 or more is 7% (6% for men and 7% for women), significantly lower than for the general population (12% for people aged less than 65).

Survivors' benefits remain an important tool for ensuring adequate living standards for older women. Several countries (Austria, Germany, the Netherlands, Sweden, the United Kingdom) reduced these benefits mainly because of a better employment situation, resulting in better contribution records of current working cohorts. Another reason was the introduction of policy measures that enable women to accrue pension rights (for instance through care credits or the splitting of entitlements) instead of deferred pension entitlements. In the case of divorce, some countries follow a procedure to share pension entitlements gained during the period of marriage between the wife and the husband. This is done in the United Kingdom, France, Germany, Poland, Ireland and (statutory) in the Netherlands and

#### Box 10.2. – Child credits

A period of childcare lasting four years is covered by Austria (on the basis of three quarters of the average national earnings), Sweden, the Czech Republic and Slovenia. Three years of child credits are given in Belgium, Germany (based on the average national earning) for each child born in 1992 and later, and the same is applied in France for births in 2004 and later, and in Lithuania (based on the minimum monthly salary), Estonia (on the basis of a certain part of the minimum wage) and Finland (based on calculated earnings of about EUR 538 during childcare leave, but only if the parents do not use institutional childcare provisions). In Luxembourg, contributions on behalf of the parents are paid into the pension system for a period of up to three years, while six months from that period are lost if the father does not take the unpaid parental leave. Poland gives child credits on the basis of so-called 'nursing benefits' for two or three years, depending on the family status and the number of children. Latvia covers the period until the child reaches one and a half years of age. Spain gives one year for each child and Italy gives six months. Hungary also has provisions for rewarding care within the pension system. It seems that the new Member States in particular tend to connect these childcare credits to the right to certain means-tested social benefits for parents, which means that not all parents receive these pension credits. The Slovak Republic is the only country where raising children leads to a reduced contribution rate for one parent (0.5% in respect of each dependent child).



in Greece. Central and eastern European Member States have not indicated their intention to introduce special provisions in the case of divorce while Malta, Denmark and Luxembourg stated that it would be necessary to introduce this measure in order to protect divorced women from falling into poverty. Germany and Austria (only for child-caring periods) have introduced the possibility of splitting pension rights for spouses who continue to live together as a way of individualising pension rights.

### 10.3.2. Measures within funded pension schemes

Several Member States introduced unisex-tariffs in second-pillar provisions, or like in Sweden and the Slovak Republic (Poland is planning to do so), in the mandatory funded part of the first-pillar provisions, in order not to worsen the pension situation of women due to a shift to funded pension provisions. Sex-related life tables single out one factor among many which may determine life expectancy of an individual person. Other important factors are, for example, genetics, social environment, working and living conditions and healthcare during one's lifetime. To quantify only one criteria out of this portfolio tends to discriminate against women purely on a basis of quantifiable ease. For that reason the following countries prevent the use of gender life-tables in order to calculate pension entitlements in occupational pension schemes: the Netherlands, Denmark, Ireland, Sweden, Hungary, Slovenia, the Slovak Republic, Greece, and Luxembourg. In Germany, using unisex life-tables can be agreed between the social partners only on a voluntary basis. However, for State supported private saving 'Riester' contracts unisex tariffs will be mandatory beginning in 2006. Luxembourg and Slovenia have also put in place legislation in order to prevent private insurance companies using gender life-tables in private pension contracts.

Some countries provide State- or employer-financed contributions into second-pillar schemes for periods of maternity or parental leaves. In Sweden and Poland a contribution out of the State budget is paid into the funded tier of statutory pension schemes for a certain period of childcare. In Austria the Family Equalisation Fund pays contributions to the second-pillar 'severance pay' funds. Also in Denmark the social partners in the central, local and regional government area agreed in association with the collective bargaining in 2005 that maternity leave periods will be covered by contributions.

Luxembourg plans to implement allowances for career interruptions in the occupational pension scheme. Other measures in order to aid parents to contribute to supplementary pension schemes were undertaken by Ireland, the United Kingdom and Germany – the PRSA in Ireland and the State Second Pension in the United Kingdom. Labour market participation is not a requirement for contributions to be made. In Germany, state support of private 'Riester' contracts is provided at a higher level for low income groups and for those bringing up children.

## 10.4. Conclusion

At least six features should be taken into account when addressing gender imbalances, in particular, the disadvantages faced by women, in the earnings-related pension systems of the Member States:

- Career breaks because of maternity and parental leaves or care for disabled and elderly persons;
- Part-time work notably because of care obligations;
- Gender differences in earnings and career patterns;
- Differences in the statutory retirement age;
- Dependency on the breadwinner's income in periods of no full-time employment because of family care obligations;
- Gender-separated life-tables for the projection of life-expectancy.

Pensions systems may not be the appropriate place to compensate for the gender differences in earnings and career patterns, rather pension systems tend to mirror social circumstances, which highlights the importance of efforts to reduce gender gaps in employment, earnings and career patterns. Pension systems can, however, give credits for breaks in paid employment or for part-time work because of care obligations. Provisions within the public and private pension systems which contribute to gender gaps in pension outcomes need to be addressed. While public schemes seem increasingly to cover unpaid care work, solidarity features (e.g. pension credits for parental or elderly care leave) are seldom present in second- and third-pillar schemes



except in a few Member States. The broader use of second- and third-pillar provisions may increase gender differences in pension entitlements as the employment gap continues to be substantial and women are more often in jobs which do not give access to occupational pensions.

## Objective 11 – Demonstrate the ability of pension systems to meet the challenges

Make pension systems more transparent and adaptable to changing circumstances, so that citizens can continue to have confidence in them. Develop reliable and easy-to-understand information on the long-term perspectives of pension systems, notably with regard to the likely evolution of benefit levels and contribution rates. Promote the broadest possible consensus regarding pension policies and reforms. Improve the methodological basis for efficient monitoring of pension reforms and policies.

This objective can be divided into two distinct areas of policy. Firstly, how Member States engender confidence in the sustainability and security of statutory schemes and any proposed reforms; and, secondly, how Member States oversee the provision of information and education in order for individuals to make informed choices about their retirement incomes. Providing sustainable and adequate pension provision today and in the future is clearly the priority for all Member States. The communication of pension strategies to individuals is also essential to achieve confidence in pension reform strategies, so that individuals are assured of the sustainability and adequacy of their future pension rights.

Information needs to be provided on two levels: firstly, those responsible for pension reform need accurate information detailing long-term projections on demographics and public expenditure in order to determine parameters for the design of long-term strategies for reform. Monitoring mechanisms play an important role as the complexity of the issues coupled with the slow impact of changes mean that reforms are generally not achieved within electoral cycles but over several legislative periods. For pension reforms to be successful and sustainable they need to be built on as broad a political consensus as possible.

In addition, individuals need information about their own pension entitlement in order to plan and provide for their retirement. It is the responsibility of policy-makers to give citizens a clear idea of what they can expect from their pension systems – and what they

have to do themselves to prepare for retirement, especially as there appears to be a trend towards a greater reliance on supplementary pension provision in many Member States.

### 11.1. The development of monitoring tools and models

Mechanisms for monitoring the aggregate financial situation of pension systems have been significantly improved in some Member States. Some countries have introduced statutory obligations to report on the development of public pension schemes. Often these statutory obligations were established in order to monitor results from reform measures already in force or to activate adjustment mechanisms, in order to preserve stability.

In Austria, an Expert Committee will begin triennially monitoring the development of pension provisions from several perspectives in 2007, including financial developments and the evolution of life expectancy. Any deviation from life expectancy projections are to lead to proposals for changes in contributions of the federal government, adjustments to pension benefits, adjustments to accrual rates or adjustments to retirement ages in order to balance the system. Changes in the projection of other assumptions will lead to the government having to recommend reform measures to the legislator. Due to the introduction of the 'sustainability factor', the German government is committed to report to the legislative bodies every four years from 2008 onwards. In the event of a risk of not achieving the set replacement rates in 2020 and beyond, the government will have to propose reform measures whilst leaving contribution rates unchanged. In Sweden annual reporting will trigger whether to activate the system's automatic balancing mechanism (which adjusts the indexation of benefits and of notional pension capital if pension liabilities exceed pension assets – including payments by the reserve buffer funds).

The growing prevalence of supplementary pension provision within many Member States has necessitated the development of greater monitoring in this sphere. In Germany, the Government is committed to report on

the development of the new additional old-age pensions (introduced in 2001). A legal basis for setting up and maintaining a pension database will be established in the Netherlands in order to respond to the need for information about the development of supplementary pensions. In Ireland, the quarterly national household survey has been adapted to track improvements in occupational pension coverage.

Other monitoring tools are not linked to specific political decisions but shall lead to a better understanding of the features of pension systems and may help to find political consensus within the Member State. The Ministry of Social Security and Labour in Lithuania provides comprehensive information to the public and institutions about any reform, in its annual Social Report. Cyprus presents regular triennial actuarial studies of long-term perspectives to social partners in order to inform them of the level of benefits and contributions that should be expected. In Ireland, actuarial reviews of the Social Insurance Fund are statutorily required every five years.

One important feature of effective long-term strategies is the ability to model and test them over different assumptions and scenarios. The United Kingdom government is currently investing in the development of a dynamic micro-simulation model, Pensim2, for long-term analysis of pension policy. That type of model enables analysis of any proposed change to policy and identifies possible gainers and losers, estimating in particular the effect of measures on adequacy and sustainability. France, Poland, Estonia, Portugal and Latvia have also developed various statistical tools and long-term projection models.

## 11.2. Political consensus building

Creating a high degree of political and social consensus greatly facilitates the likelihood of creating sustainable long-term pension reforms. Throughout the reform process, from policy development to implementation, the role of social partners is an important one. In order to achieve political consensus general consultations of well-informed social and economic players are needed. In Spain for example, the conclusions of the renewed Toledo Pact underlined the importance of this dialogue when it comes to monitoring both present and future reform measures. In order to study options for pension reform, the United Kingdom government

set up an independent Pension Commission, which submitted two reports. Following the second report, the United Kingdom government is engaged in a national pension debate to listen to stakeholders views on how the reform process should proceed.

Member States like Denmark, Ireland, Finland, Germany, Austria, Portugal, Greece, the Czech Republic and Malta have counted on the input of experts from social partners, ministries, involved institutions and scientists for the development of their pension reforms. Most of these expert committees, such as in Denmark, also fulfil the task of informing politicians and the public about latest trends in social systems and stimulate debate in order to foster a broad social consensus.

## 11.3. Information tools for individuals

All Member States allow access to general pension information via interactive Internet sites or the websites of their ministries and pension providers. A special public awareness-raising campaign was implemented in Lithuania and the Slovak Republic when preparing for the establishment of the statutory funded pension scheme.

Providing the insured with information regarding acquired pension rights is essential for informed planning of retirement. In particular, this should enable individuals to assess the need to contribute to voluntary supplementary old-age provision. As Sweden pointed out, a wide dissemination of basic knowledge about the principles of the pension systems is also a precondition for the effectiveness of the incentives for increased work that reformed pension systems generate. Hungary stated the urgent need to develop a database on individual entitlements and provide regular information from certain ages onward, as this would also help in legalising the black and grey economies and would encourage people to make individual savings for their old age.

The trend towards a decline in replacement rates at a given age from statutory schemes and the development of defined-contribution-funded schemes will make pension benefits more difficult to foresee at an individual level. Indeed, individual pension benefits depend on the individual's life course and labour participation, but also on some uncertainties concerning the future economic and demographic development and

resulting uncertainties in indexation and the rate of return.

### 11.3.1. Information on individual pension entitlements

Member States reported considerable improvements in the information provided to the insured on their statutory pension rights as well as on supplementary pensions since the last Joint Report. The traditional approach in statutory pension schemes has been to give information only on request and mainly to people who are close to retirement age. This approach is still prevalent in most of the new Member States. The trend in the old Member States is to provide regular statements of pension rights accrual to all scheme members. Sweden pioneered this approach with the 'orange pensions envelope' that is sent yearly (since 1999) to all those covered by the public pension scheme and a number of Member States have followed a similar route. New legislation introduced in 2000 in Portugal establishes an obligation to provide regular information to insured persons and in Poland the same target was set for information about pension account balances in the reformed pension system. In Germany (from 2004 onwards) statutory pension insurance institutions must send annual 'pension information' to all insured individuals who have made at least 5 years of contributions and are aged 27 and over. Austria (from 2007) onwards will do the same for those under 50 and Finland will send out information on pension entitlements annually from 2008. In the Netherlands pension providers strive to provide an improved and harmonised annual pension overview and also France will generally implement individual pension information beginning in 2007. Hungary, Cyprus and Malta pointed out the necessity of developing a database on individual entitlements.

Several National Strategy Reports discussed the creation of Internet sites to provide information for both State and private pension provision. By December 2002 Finland had established a joint Internet site for the entire earnings-related pension sector, to provide general and individual pension information. In Denmark a common database has been established in cooperation with pension funds, life-insurance companies, banks and public authorities. In Sweden, since December 2004, an Internet portal of the government and pension institutions has been available and it is planned to deliver information at the individual level for national, occupational and private pension savings in the future. In the United Kingdom a web-based retirement planner is to be launched in spring 2006.

These joint information platforms raise questions regarding data protection and should be monitored in order to determine which social groups take advantage of them and which do not. However, as Finland mentioned in its report, it should be noted that despite the large amount of information provided for the public, increasing the insured persons' knowledge of the operation of the pensions systems remains a challenge. As for instance a recent Dutch survey among the Dutch working population shows, a majority of respondents were unable to determine, on the basis of the pension information they receive, whether they should make further long-term savings. Recent research in Sweden found that almost everyone in Sweden knows that they have received the 'orange envelope' but only two-thirds had opened and read at least some of the materials (2003). In addition, older participants were more likely to read the information compared to their younger counterparts and low-income individuals were less likely to look at it than higher-income groups.

#### Box 11.1. – European legislation and its implementation in occupational pension schemes

Improved access to information not only applies to statutory schemes. Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provisions (Article 11) requires information to be given to the members and beneficiaries<sup>(39)</sup>. Several Member States, such as the Netherlands or France, pointed out that expanded information obligations to private providers of pensions are necessary. The Netherlands wants to improve the information furnished by pension providers about, for instance, indexation, investment policy, capital position and setting of contributions. The German government already expanded the obligations to inform prior to conclusion of contract. Providers must give information on possible investments, the structure of the portfolio and the risk potential. Furthermore, standard calculations by

(39) Official Journal of the European Union, 23 September 2003, L 235/10 – 21.

### Box 11.1. – European legislation and its implementation in occupational pension schemes (continued)

the providers should enable consumers to compare products better. Concerning pension fund management, Ireland established an ombudsman procedure that investigated and determined complaints made by beneficiaries who suffered losses as result of maladministration.

Also in case of leaving the company, information is required regarding the ways in which employees can benefit from their accrued pension rights. As Ireland mentioned, quality information needs to be furnished to the members in order to project their rights and allow them to make informed decisions especially in the upcoming defined-contribution arrangements as the full investment risk is placed on the employee. The proposal of a directive of the European Parliament and of the Council on improving the portability of supplementary pension rights<sup>(40)</sup> contains, in Article 7, corresponding information obligations.

#### 11.3.2. Financial literacy

Better individual information should raise awareness about pension matters. But it does not necessarily enable individuals to take appropriate action if they feel that they should do more to provide for their retirement. While individual choice gains more importance in the preparation of adequate pensions, the State has to provide its citizens with a suitable financial education.

The United Kingdom government, including the Financial Services Authority, is developing a combined national strategy for improving financial capability, mainly in schools and through the workplace. This strategy aims to ensure that people in the United Kingdom are better informed to allow them to take greater responsibility for their financial affairs. Poland has included banking, service and capital markets as mandatory curriculum subjects in secondary schools since 2003. In Germany the federal government, old-age pension insurers, social partners and the Federation of German Consumer Organisations have launched a 'Well-informed about pensions' information campaign in cooperation with the Association of German Adult Education Institutions. This series of courses, to be held at about 500 evening schools, is open to all and shall enable participants to estimate their financial requirements in old age and to structure their pension provision in line with their individual priorities. Experts from German old-age pension insurance

organisations make available information which is provider-neutral and product-independent.

#### 11.4. Conclusion

A more informed policy debate in the Member States is essential to strengthen the consensus on the required policy measures in order to prepare adequate and sustainable pensions. The National Strategy Reports made clear that a new trend towards a greater reliance on the work of expert committees is occurring. Moreover, periodic reviews of pension systems and regular reporting on key indicators should help to build the momentum for further reforms. Close monitoring of the actual impact of measures described within this chapter will be paramount, both to assess levels of understanding, but also to measure subsequent behavioural changes at both the individual and societal level.

Finally, it should be noted that providing better information and improving financial education are important ingredients to achieving greater consensus for the provision of adequate and sustainable pension systems, which are supported by general populations. However, on their own they should not be seen as a panacea. Better informed and educated populations may not necessarily lead to sufficient longer working or saving habits, which are essential to long-term pensions' sustainability.

(40) COM (2005) 507 final, 2005/0214 (COD).

## Index of boxes and tables

### Tables

1.	Sources .....	49
1.1.	Risk of poverty amongst older people .....	54
1.2.	Poverty risk of older people .....	55
1.3.	Minimum income guarantees .....	57
2.1.	Income of people aged 65 or more (in percentage points) .....	66
2.2.	Median pension relative to median earnings .....	69
2.3.	Evolution of theoretical replacement rates from 2005 to 2050 .....	71
2.4.	Percentage of employees contributing to a private pension scheme .....	74
4.1.	Progress towards the Lisbon and Stockholm targets .....	80
5.1.	Evolution of older workers' situation in the labour market .....	85
6.1.	Gross public pension expenditure as a share of GDP between 2004 and 2050 according to the 2005 projections .....	92
6.2.	Total pension expenditure as a share of GDP between 2004 and 2050 .....	97
6.3.	Social security pension contributions relative to public pensions .....	99
6.4.	Assets in all pension schemes as a share of GDP .....	101
6.5.	General government gross debts in 2004 and their projections according to the Stability and Convergence Programmes of 2004 .....	102
6.6.	Contribution rates in public pension schemes in 2005 .....	106
6.7.	Overview of the national strategies for ensuring the financial sustainability of pension systems .....	112

### Boxes

1.1.	Poverty measure and income and living conditions data .....	54
2.1.	Current and prospective replacement rates, empirical and theoretical measures .....	68
5.1.	Directive 2000/78/EC .....	88
6.1.	Pension expenditure projections .....	93
8.1.	European directives and prudential requirements .....	131
8.2.	International data on privately-managed pensions .....	132
8.3.	Real rates of return .....	134
10.1.	European pension legislation .....	141
10.2.	Child credits .....	142
11.1.	European legislation and its implementation in occupational pension schemes .....	147





## Part III – Country summaries

### Belgium

#### 1. Main characteristics of the pension system

The Belgian **statutory pension systems** (pay-as-you-go) cover old-age, invalidity and survivors and comprise three schemes: a scheme for salaried workers in the private sector, a scheme for self-employed persons and a scheme for civil servants. Pensioners who have paid contributions to more than one of these three schemes receive a pension of the 'mixed career' type. The retirement pension is determined on the basis of three elements: career, wages and family situation<sup>(41)</sup>. For both self-employed and private schemes, every worked year counts for 1/45th in the calculation of the pension.

Men reach a full career after 45 years, women (employees in the private sector and self-employed) after 43 years at present. As a result of the 1997 pension reform, the legal retirement age of woman and their calculation fraction will be equalised with those of men as from 2009 in the scheme for salaried workers and the self-employed. Early retirement is possible from the age of 60, on the condition that the beneficiary has cumulated 35 years of contributions for workers and self-employed and 5 years for civil servants. The effective average age of exit from the labour market is 59.4 (2004). This is below the legal early retirement age (60 years) and the legal normal retirement age (65 for men and currently 63 for women employees in the private sector and self-employed) due to the existence of specific schemes embedded in the unemployment insurance.

Pensions for workers and the self-employed are calculated on the basis of the full contributory career and provide 60% (for a single person) or 75% (for a head of family) of the revenues earned in the whole contributory career up to a certain wage ceiling. The provision of a minimum pension relies on different mechanisms. For civil servants, however, pension rights are

calculated on the basis of the incomes of the last five years before retirement (multiplied by the number of worked years and divided by 60), while the family situation has no influence on the pension amount. A guaranteed minimum pension is provided for the civil servants with at least 20 years of service.

A new scheme of '**sectoral pensions**' was introduced in 2003, in order to extend the second-pillar pension provisions besides existing complementary pension commitments. Membership can be mandatory at sector level, depending on collective agreements, and access is provided independently based on the size of enterprises. A guaranteed minimum return is provided on the contributions paid in occupational pension schemes by the employees and the employers.

Further, voluntary **individual pension schemes** are promoted with tax deductions for contributions up to a maximum ceiling (of EUR 780 per year in 2005).

The coverage of occupational pensions for the working population is estimated to be around 40–45% (20% of current pensioners are covered by these schemes). On average, around 25% of their net pension is contributed out of occupational pensions. Information on contribution rates for occupational schemes is limited. Rates are very diverse. The modal value appears to be in the range from 1% to 5%, while employers typically pay 90% of contributions.

A person who has worked full-time during at least 30 years of employment can benefit from a guaranteed income in the pension schemes for salaried workers and self-employed persons. This minimum pension can be combined with other sources of income. For persons with a mixed career, a new scheme for minimum pensions has been introduced. The minimum pension for a salaried worker amounts to EUR 10 396 in 2005 while for a person with a mixed career the amount is around EUR 8 200. The minimum pension with a full

(41) Pensioners (except civil servants) receive a supplementary family amount if they have to support a partner with no pension entitlements. In the future this pension will be more and more frequently replaced by two pensions for single persons because of higher participation of women in the labour market.

career is higher than the poverty threshold for salaried workers (60% of the national equivalised median disposable income), but lower for the self-employed. Self-employed individuals receive a minimum pension of around EUR 8 200. This minimum level for the self-employed is planned to increase gradually until December 2007.

Individuals who are 65 or older (for women from the age of 64 during the period 2006–08) and have insufficient income are protected by a social assistance scheme, GRAPA (*Garantie de Ressources aux Personnes Agées* – GRAPA – guaranteed income for the elderly). This guaranteed income is means-tested and amounts to around EUR 8 235 for a single person. Other supplementary benefits for pensioners like reimbursement of healthcare and various offers of healthcare services are available.

## 2. Situation and perspectives in light of the common objectives

### 2.1. Current situation

**Adequacy:** Based on provisional EU-SILC 2004 figures, poverty risk among older people (21%) is estimated to be significantly higher than for the Belgian population below the age of 65 (14%). The Belgian government addressed the issue of poverty risks by improving the minimum pension for salaried workers and for the self-employed.

Pensions arising from the first pillar represent about three quarters of the total income of current pensioners. The theoretical total net replacement rate of the first pillar in the base case scenario of the Indicators Sub-Group (ISG) for a worker retiring in 2004 at 65 after 40 years at the average wage is currently 67% if the second pillar is included (total gross 43%), and falling to 64% after 10 years of retirement (gross 38%). Indeed, pension benefits are automatically adapted to the so-called health index (in line with inflation) but are only partially and discretionally adapted to the development of the general living standard. Beginning from 2007, social partners and the government will examine the adaptation of benefits (including the minima) for the salaried workers and the self-employed every two years.

**Financial sustainability:** Pension expenditures have decreased during the period 1995 to 2002 (starting from 12.1% to 11.2% of GDP), notably due to the reforms of 1990 and 1996. The total employment rate increased in the recent years but at 59.6% in 2003 and 60.3% in 2004, still well below the Lisbon targets. The situation is especially bad regarding older workers (aged 55–64) where in 2004 the employment rate of 30.0% contrasts with the Lisbon target of 50%. The gap in the total employment rate in 2004 between the age groups 25–54 (77.3%) and 55–64 (30.0%) is one of the largest in EU. The Belgian government pointed out that, in fact, most of the pensioners are no longer active during the years preceding retirement, but are entitled to early retirement embedded in unemployment schemes (*pré-pensions*) or invalidity benefits.

The overall contribution to social security as a percentage of individual gross earnings for private employees amounts to 46.26% (employer 33.19%, employee 13.07%). This contribution is distributed to the different social branches, strictly according to needs (so-called 'global management of social security').

**Modernisation:** The scheme with which a person is affiliated depends on his activity status (salaried worker, self-employed person or civil servant). Between self-employed and salaried workers (and vice versa), no qualifying periods in order to build up rights in the new scheme are required when the activity status of a person changes. For persons with a mixed career, a new scheme for minimum pensions was developed in 2003. A minimum pension is awarded, even when the condition of two thirds of a career as a salaried worker has not been fulfilled, but pension rights have also been built up in the scheme for self-employed persons. Since mid-2005, the helping spouses of self-employed persons are obliged to affiliate with the social status of the self-employed persons: the so-called 'maxi status'. This regulation will enable them to build up proper pension rights.

Participation rates of women in the second pillar is half of that of men and the average amount of pension accrued in both pillars is also on average half of men's accruals. This is mainly due to the fact that women's wages remain below those of men. With regard to the average wage of the active salaried workers and because of the longer working career of today's women, Belgium expects that new female pensioners will have higher average pensions.

## 2.2. Outlook, reform measures and policy debates

Belgium is projected to face similar demographic trends to most EU-15 Member States in coming decades. The fertility rate is expected to rise from 1.62 in 2004 to 1.70 by 2050 which is in line with the EU-15 average. According to 2005 Eurostat demographic projections used in the new OMC round of pension projections, the number of elderly persons (aged 65 or more) will increase by some 67% until 2050, albeit less than the average for the EU-15 (77%). This implies that the old-age dependency ratio will steadily increase from 26% in 2003 to 47% by 2050 (below the EU-25 average of 52%).

Belgium is facing substantial budgetary pressures due to ageing populations. According to the budgetary projections made by the AWG in 2005, public pension expenditures will rise from 10.4% to 15.5% of GDP between 2004 and 2050, an increase of 5.1 p.p. of GDP. Respectively, overall age-related expenditures are projected to increase by 5.1 p.p. of GDP between 2004 and 2050. Thanks to the determined policy to reduce the current general government debt, with the aim of creating room for manoeuvre for future increased expenditure due to the ageing of the population, the debt is projected to decline as a share of GDP from 97% in 2004 to 76% in 2010 and 29% in 2050, according to the latest available national budgetary projections included in the 2004 stability programme in the context of the assessment of the long-term budgetary projections of public finances.

Reducing the public debt as quickly as possible is regarded as the best way to safeguard the statutory pension benefits against the consequences of ageing. As the Belgian government stated in their NSR, further measures are necessary in order to remain close to the budgetary balance in 2005 and 2006 and to attain the surpluses programmed after 2007. The surpluses should be increased to 1.5% of GDP around 2010 in order to meet the target reduction in public debt. Belgium has been building up an 'Ageing fund' since 2001. In 2004, it amounted to 1.8% of GDP and should be increased to 14–15% of GDP by 2020. This fund aims to build up a demographic reserve that should allow the financing of extra costs of ageing in the period between 2015 and 2030. Until 2006, the fund is mainly provided for by budgetary receipts. As from 2007, on top of this, yearly budgetary surpluses will also have to be deposited into the Ageing fund.

In order to make work pay, the Belgian government has taken measures to eliminate certain financial traps. In this context, the system of local employment agencies, which caused important financial traps in practice, was abolished and replaced by the system of the 'service cheques'. The tax credit was also replaced by the so-called 'working bonus', so that financial incentives no longer appear at the moment of the final tax settlement, but much sooner. Nevertheless, a number of financial traps remain and need to be overcome.

According to projections of theoretical replacement rates, based on the ISG-methodology, for a worker retiring at 65 after 40 years of employment at the average wage, the gross replacement rate in the statutory scheme is expected to decrease slightly from 63% to 61% in 2050 (corresponding to a decrease from 39% to 37% in gross terms). The overall net replacement rate for both pillars is expected to rise about 7 p.p. from 67% to 74% (corresponding to an increase from 43% to 47% in gross terms), thanks to contributions of 4.25% of gross wages to the second pillar (currently about 40–45% of the employed population is covered by occupational schemes). The government introduced sectoral pensions in order to extend the second-pillar pension provisions starting in 2004. A guaranteed minimum return is provided on the contributions paid by the employees and the employer in all complementary pensions, in order to protect the employees from the volatility of the financial market.

A reform of the pension scheme for self-employed persons will also be introduced by mid-2006, that will reduce the differences between the general pension of the salaried workers and that of the self-employed worker.

At the end of 2005, the *Contrat de Solidarité entre les Générations* was agreed on, which is part of a number of measures aiming at increasing incentives to work longer and reducing paths of early exit from the labour market. As regards pensions, a bonus will be introduced for people retiring at the legal retirement age, who will also be given the opportunity to combine wages and a pension. Other measures aim at revalorising pensions of atypical workers (mainly careers with a large degree of partial employment), notably by facilitating access to minimum pensions.

### 3. Conclusion

Reducing the public debt to about 60% of GDP by 2015 is a primary objective. This would reduce interest payments and aims to create room for manoeuvre for future increased expenditure due to the ageing of the population, while the global management of social security enables the reallocation of social security contributions to changing needs. Moreover, Belgium has been building up an 'Ageing fund' since 2001, which aims to develop up a demographic reserve that should help finance the extra costs of ageing in the period between 2015 and 2030.

Since the first strategy report on pensions, the design of minimum retirement income has been strengthened (through indexation of guaranteed minimum assistance

to the general increase of net national income and the introduction of new minimum pension rules for mixed careers and the self-employed). Moreover, the promotion of occupational pension schemes could raise replacement rates in the long run and hence the relative living standards of pensioners. Further efforts to ensure a high coverage of the working population (especially women) by occupational pension schemes might be needed.

Encouraging an overall higher labour-force participation of people in their 50s and 60s, which is currently one of the lowest in the EU, appears to be necessary. In that respect, the recent *Contrat de solidarité entre les Générations* could make a key contribution to adequacy and financial sustainability.

## 4. Background statistics

	BE			EU-25				
Adequacy								
Current situation								
	Total	Men	Women	Total	Men	Women		
At-risk-of-poverty rate <sup>(1)</sup>	15	14	16	16	15	17		
0–64	14	13	15	16	16	17		
65+	21	20	21	18	15	20		
75+	21	20	21	Nd	Nd	Nd		
Income inequality <sup>(1)</sup>								
0–64	4.1							
65+	3.4							
Income of people aged 65+ as a ratio of income of people aged 0–64 <sup>(1)</sup>	0.76	0.76	0.76					
Median pensions relative to median earnings <sup>(2)</sup>	0.61	0.60	0.61					
Long-term projections								
Theoretical replacement rates <sup>(3)</sup>	2004	2030	2050					
Total net replacement rate	67	76	74					
Total gross replacement rate	43	48	47					
Gross replacement rate 1st pillar	39	38	37					
Gross replacement rate 2nd/3rd pillar	4	10	10					
Financial sustainability								
Current situation								
Esspros Pension expenditure <sup>(4)</sup> , % of GDP	1995 12.1	2000 11.1	2003 11.5	1995	2000 12.5	2003 12.6		
Employment (2004) <sup>(5)</sup>	Total	Men	Women	Total	Men	Women		
Employment rate (25–54)	77.3	85.8	68.5	76.8	85.2	68.5		
Employment rate (55–64)	30.0	39.1	21.1	41.0	50.7	31.7		
Effective labour market exit age (2004) <sup>(6)</sup>	59.4			60.7p				
Public finances (2003) <sup>(7)</sup>								
Public debt, % of GDP	100.7			63.3				
Budget balance, % of GDP	0.4			-2.8				
Long-term projections (EPC 2006)								
	2004	Level 2030	2050	Increase 2004–50	2004	Level 2030	2050	Increase 2004–50
Old-age dependency ratio <sup>(8)</sup>	26	41	47	+81 %	25	40	52	+108 %
Public pensions expenditure, % of GDP <sup>(9)</sup>	10.4	14.7	15.5	+5.1	10.6	11.9	12.8	+2.2
Factors determining the evolution of public pensions expenditure (2000–50) <sup>(10)</sup>	Contribution to change in percentage points of GDP			Contribution to change in percentage points of GDP				
Demographic dependency	7.7			8.6				
Employment	-1.5			-1.1				
Eligibility	-0.4			-2.1				
Level of benefits	-0.6			-2.7				
Total (including residual)	5.1			2.2				
Notes								
<sup>(1)</sup> Source: Eurostat data collection 2005. Poverty line: 60 % of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).								
<sup>(2)</sup> Source: Eurostat. Median individual pension income of retirees aged 65–74 in relation to median earnings of employed persons aged 50–59 excluding social benefits other than pensions.								
<sup>(3)</sup> Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first- and second- pillar pension schemes, retiring at the age of 65 years in 2005.								
<sup>(4)</sup> Source: Esspros, Eurostat. Includes expenditure by certain private social protection schemes.								
<sup>(5)</sup> Source: European Labour Force Survey, 2004. 6. Source: European Labour Force Survey, 2004.								
<sup>(7)</sup> Source: European Commission, DG ECFIN.								
<sup>(8)</sup> Source: Eurostat (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15–64.								
<sup>(9)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.								
<sup>(10)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.								
(*) Negligible proportion								

## Czech Republic

### 1. Main characteristics of the pension system

**Statutory old-age pensions** are composed of two parts: a flat-rate basic pension and an earnings-related pension based on the personal assessment base (PAB) and the number of eligible years.

The 1995 pension insurance act launched an ongoing process of increasing the retirement age and lengthening the insurance period for pension assessment to 30 years, until 2016<sup>(42)</sup>. The reform also provided tighter definitions for those qualifying for disability and survivors' benefits, introduced widower pensions and set down rules for the indexation of pensions. In 1997, the government reduced indexation, cut eligible periods for non-contributory pensions and tightened conditions for early retirement. In 2001, legal amendments further decreased the advantages of early retirement and increased the rewards for deferral. In 2002, the indexation of the minimum pension was changed to a combination of 100% of prices and one third of real wage growth. The 2003 reform will see a further raising of the retirement age for the old-age pension to 63 for men and women without children (these ages will be effectively reached in 2016 and 2019, respectively).

The contribution rate was increased from 26% to 28% in 2004. Pensions are financed by both employers (21.5% of payroll) and employees (6.5% of earnings), the self-employed pay the whole 28% of declared earnings.

Non-contributory periods account for about a quarter of all insurance periods included in the calculation of pension entitlements. This refers to the period of care for a child up to the age of 4 (or 18 years, if this involves a child with a severe long-term disability), compulsory military service or the community service (as alternative to military service), those engaged in personal care for a dependent person, those receiving full disability pension (until reaching retirement age) and those registered as unemployed (the insured are also eligible for unemployment benefits, while those

not in receipt of unemployment benefits are also covered for a period of 3 years.).

Early retirement is possible up to three years before the statutory retirement age. When taking it, all employment must cease. There are temporary and permanently reduced early pension plans. *Temporarily reduced early pension* (that will be abolished from 2007) is available up to two years prior to the statutory retirement age, provided that the insured person has a minimum of 25 years of insurance, has received disability pension for at least five years and entitlement to a disability pension has expired within five years of reaching the statutory retirement age. The pension is reduced by 1.3% of the PAB for every period of 90 days prior to the retirement age, but the pension is fully restored upon reaching the retirement age. *Permanently reduced early pension* is available up to 3 years prior to the statutory retirement age. The insured must have at least 25 years of contribution period. The pension is reduced by 0.9% of PAB for every 90-day period preceding the statutory retirement age. This reduction is permanent and continues after the recipient reaches the statutory retirement age.

In case of deferred pension, an increase of 1.5% of the PAB is provided for every 90 days of economic activity during which the claim for an old-age pension is postponed.

**State-subsidised supplementary pension insurance scheme** was implemented in 1994. The State supports participation in the supplementary pension insurance schemes through the provision of a state subsidy and by an income tax allowance for participants. Contributions may be paid on behalf of the participant by his/her employer subject to the participant's prior consent. The employer's contribution may be agreed also in any collective agreement. With effect from 1 January 2000, tax allowances have been introduced for both participants and employers. Currently, there are 11 pension funds in the state-subsidised supplementary pension insurance market. The voluntary supplementary pension funds do not as yet play an important role for income security in old age.

(42) The assessment base of the earnings-related pension is currently based on average gross earnings over the last 18 years preceding retirement. Originally based on 10 years preceding retirement, this period is being extended by one year every year until it reaches a total of 30 calendar years (in 2016).



Although almost three million people had joined them by the end of 2004, the capital build-up in individual accounts is not significant, the assets held by pension funds are 3.7% of GDP. The average amount of the participant's contribution is low and since 1999 has been stagnating at 2% of the average wage. The level of coverage of the supplementary pension insurance scheme (as a percentage of the population aged 15–64) runs at 35%.

Pension funds are obliged by law to guarantee non-negative rate of return for participants leading to low levels of revenue (yield), compensated by higher security of investments. From 1995 to 2004, the average credited real rate of return was 0.8%.

Apart from the State-subsidised supplementary pension insurance scheme, **private life insurance** is also available. Tax allowances were introduced for insurance products under private life insurance schemes for both the insured and their employers.

Pensions from the basic pension insurance scheme are neither income-tested nor means-tested (the income test for the early old-age pension and partial disability pension has been abolished since 2006). The **minimum** amount of pension currently amounts to about 17% of the average net wage. An additional instrument, as regards the social security of the elderly (but not only them) is the subsistence level which complements the basic pension insurance scheme. Subsistence level currently amounts to CZK 4 300 for an individual which is some 34% of the average net wage. Benefits from the social care system are income-tested and means-tested.

## 2. Situation and perspectives in light of common objectives

### 2.1. Current situation

Concerning **adequacy**, the living standard of those aged 65 or more is 83% of those aged 0–64 (equivalised household income) and 75% of those aged 45–54.

For income security in old-age most people depend on the statutory pension insurance scheme. In spite of periodic indexation, the real value of pensions dropped in the last decade (though in 2004 the real

value is approximately the same as in 1989). The proportion of average old-age pension to average net wage gradually decreased from 61% in 1998 to 57% in 2004 (the proportion of the average gross wage decreased from 47% in 1998 to 44% in 2004). The gross replacement rates for a worker at the average wage retiring at 65, after 40 years of contributions is 61% with net replacement rate at 79%.

However, a broad scope of coverage through non-contributory periods may have an adverse impact on the willingness to pay pension insurance contributions into the basic pension scheme, since the structure of the system requires a relatively high contribution rate over a long period of time.

The earnings related part of the statutory pension follows a progressive formula, which translates into significant redistributive effects. Old-age pensions are not taxed up to an amount four times larger than normal tax-free allowance that workers have, which contributes to higher net replacement rate of wages by pension benefits.

The basic pension insurance scheme contributes to a considerable extent to the reduction of poverty of the older generation. The relative poverty rate (at the 60% threshold) among people aged 65 or more stands at the low level of 4% in 2003, below EU average and significantly below the level of poverty among people aged 0–64 (which was at 9% in 2003).

Of 3.2 million pensions paid out, 60% represent old-age pensions, 17% full disability and partial disability pensions and 23% widower's, widow's and orphan's pensions. The employment rate of 55–64 (42.7% in 2004) is slightly higher than the EU-25 average (41%) and increased significantly in recent years. Possibilities for increases remain. In 2001 and 2004 access to **early retirement** was further restricted and better rewards for deferred retirement were offered. The penalties introduced in 2001 could however be too low to discourage people from applying for early retirement pensions.

The legislation allows pensioners to receive (apart from any pension) income from gainful activity regardless of the level of their income. Since 2001, for each 90 calendar days of gainful activity pursued beyond eligibility for the old-age pension (without taking the pension), the level of the percentage assessment is



increased by 1.5% of PAB (6% annually), in comparison with the former increase of 1% (4% annually).

Currently, some 15% of persons aged between 50 and 64 years receive a disability pension. Persons who are eligible for the full disability pension are not prevented from working. A full disability pension is in general higher than the early old-age pension.

Concerning **sustainability**, the pension system has been in debt for several years (1997 – 2003) due to demographic and economic changes. Pension expenditure was 8.8% of GDP in 2003. Of the total pension expenditure, old-age pension expenditure accounts for 72%, disability pension expenditure for 18% and the survivors' pension expenditure for 10%. Controlling public expenditure on pensions has been a major concern over the recent decades, which has led to several reforms of the earnings-related public pension scheme since 1993. The measures included raising the retirement age, lengthening the period of service required for a pension and lowering the assessment basis. The index-linking was made less favourable and conditions for non-contributory pensions and early retirement were tightened.

So far, the state-subsidised supplementary pension insurance scheme has been used for the purpose of mid-term savings rather than as the supplementary income for the elderly. Since the launching of the system, lump-sum settlements account for 72% of all benefits granted to date.

Concerning **modernisation**, since 1996, the retirement age has been gradually increased and harmonised and is due to reach 63 in 2016 for men. For women the retirement age will vary from 59 to 63 by 2019 – differences are dependent on the number of children raised.

## 2.2. Outlook, reform measures and policy debates

The Czech Republic is projected to face rapid ageing in the coming decades, due in particular to a low fertility rate. The old-age dependency ratio is projected to rise from a currently low level of 20% (EU average of 24%) to 55% in 2050 (above the EU average of 52%), one of the highest increases among the EU-25.

Replacement rates are projected to decline by about 10 p.p. by 2050 (both gross and net) for persons retir-

ing at 65 after 40 years of contributions, reaching 70% net (53% gross) in 2050 for someone on the average wage, but would remain higher for modest pensioners (79% for someone at two thirds of average wages) and lower for higher wage earners. Encouraging people to join the supplementary funded scheme and increase personal savings for old age may increase replacement rates.

According to national figures, in parallel with the long-term increase of expenditure, the relative level of average pensions to average wage should be decreasing from the current level of 44% to reach some 37% of average gross wage (49% of average net wage) by around 2026, with subsequent moderate growth until the end of the projection in 2050.

Incentives for later retirement resulting from measures taken in 2001 and 2004 could probably be increased, in particular through further preferential treatment of deferred retirement.

In order to obtain the appropriate level of benefits from private pension schemes citizens' confidence in these schemes will need to be further strengthened. Within the State-subsidised supplementary pension insurance schemes the National Strategy Report underlines that further steps will be necessary to separate shareholders' assets from the participants' assets and to enable pension funds to offer pension plans with diversified investment foci, whilst increasing the coverage rate (especially with respect to younger age brackets) and motivating members and employers to greater involvement and higher contributions. Limiting the drawing of the lump-sum settlement and elimination of the guarantee of the year-on-year non-negative revenue (yield) should also be considered.

The current reforms, in particular the higher retirement age, should ensure sustainability up to 2020. Beyond this, if PAYG is to remain the main source for old-age income provision, the system would need to be further reformed.

The Czech Republic is facing rapidly growing budgetary pressures of a significantly higher magnitude than most Member States due to their ageing population. According to the AWG projections of 2005, the Czech Republic is expected to increase its spending on public pensions from 8.5% of GDP in 2004 to 14.0% of GDP in 2050, a rise of 5.6 p.p., while all

age-related expenditure is projected to rise by 6.9 p.p. Thus, pensions are by far the fastest growing item among the age-related expenditures. Hence, assuming no policy change, public debt is expected to climb from 38.6% of GDP in 2004 to over 300% in 2050.

Through the implementation of the reforms, the basic pension insurance scheme has been stabilised for a period of approximately 20 years but spending is set to rise rapidly after 2025. However, the measures so far taken will not sufficiently guarantee the sustainability of pensions and demographic developments need to be accompanied by the adoption of further reform steps. It is estimated in the National Strategy Report that in order to maintain the balance in the pension system in 2050, the retirement age should be raised to about 68 years for men and or 67 years for women between 2020 and 2050

While political parties submitted their options for pension reform in 2004, the future shape of the Czech pension system was considered by an Expert Team, the final report of which will be used for further political negotiations. Social partners have been informed about the progress of pension reform. Political parties, the Prime Minister, the Minister of Labour and Social Affairs and the Minister of Finance are represented in the Expert Team which was established in 2004. The authority in charge of the pension insurance system is also preparing for changes to the system.

The following issues will probably be considered: further strengthening of incentives to work longer through additional gradual extension of the eligible age for the old-age pension (plus consideration of equalisation of men and women's statutory pension ages) and further extension of the period from which income for the pension calculation is derived. The possible introduction of gradual retirement (with the option of converting pensions paid out in addition to income from gainful activ-

ity) is also being looked at. A limiting of the inclusion of non-contributory periods in the calculation of pension entitlements, changes in the indexation of the income actually earned for the purposes of pensions and changes in indexation of current pensions as well as updating of criteria for determining disability are also being considered.

### 3. Conclusion

New pension reforms are expected to follow from further negotiations based on the final report of the Expert Team. It would be an important step if the principles of pension reform are agreed in 2006. Measures suggested include further reforms of the statutory pension (notably increases to retirement age), the creation of a reserve fund and also further development of voluntary private pensions.

The Czech Republic has managed to ensure adequacy of pensions over the last decade and achieved a low rate of poverty amongst older people. Although replacement rates are projected to decline, future adequacy should be preserved. The employment rate of 55–64 year olds has also increased significantly in the recent years. However, the creation and the take-up of jobs for older workers should be encouraged so as to facilitate the balancing of financial sustainability and pension adequacy, while incentives to work longer need to be strengthened.

The Czech Republic is facing growing budgetary pressures due to an ageing population, which is projected to grow faster than most other EU countries. According to the National Strategy Report, the pension system is projected to run growing deficits from 2020 onwards under current policies. It will have to be seen to what extent further reform efforts will strengthen the sustainability of the pension system, while securing adequacy.

## 4. Background statistics

	CZ			EU-25				
Adequacy								
Current situation								
	Total	Men	Women	Total	Men	Women		
At-risk-of-poverty rate <sup>(1)</sup>	8	7	9	16	15	17		
0–64	9	8	9	16	16	17		
65+	4	1	6	18	15	20		
75+	7	2	9	Nd	Nd	Nd		
Income inequality <sup>(1)</sup>								
0–64	3.5							
65+	2.1							
Income of people aged 65+ as a ratio of income of people aged 0–64 <sup>(1)</sup>	0.83	0.85	0.82					
Median pensions relative to median earnings <sup>(2)</sup>	Nd	Nd	Nd					
Long-term projections								
Theoretical replacement rates <sup>(3)</sup>	2005	2030	2050					
Total net replacement rate	79	70	70					
Total gross replacement rate	43	48	53					
Gross replacement rate 1st pillar	39	38	53					
Gross replacement rate 2nd/3rd pillar	(*)	(*)	(*)					
Financial sustainability								
Current situation								
Esspros Pension expenditure <sup>(4)</sup> , % of GDP	1995	2000	2003	1995	2000	2003		
	7.3	8.7	8.8		12.5	12.6		
Employment (2004) <sup>(5)</sup>	Total	Men	Women	Total	Men	Women		
Employment rate (25–54)	81.4	89.2	73.4	76.8	85.2	68.5		
Employment rate (55–64)	42.7	57.2	29.4	41.0	50.7	31.7		
Effective labour market exit age (2004) <sup>(6)</sup>	60.0			60.7p				
Public finances (2003) <sup>(7)</sup>								
Public debt, % of GDP	37.8			63.3				
Budget balance, % of GDP	-12.6			-2.8				
Long-term projections (EPC 2006)								
	2004	Level 2030	2050	Increase 2004–50	2004	Level 2030	2050	Increase 2004–50
Old-age dependency ratio <sup>(8)</sup>	20	37	55	+175%	25	40	52	+108%
Public pensions expenditure, % of GDP <sup>(9)</sup>	8.5	9.6	14	+5.6	10.6	11.9	12.8	+2.2
Factors determining the evolution of public pensions expenditure (2000–50) <sup>(10)</sup>	Contribution to change in percentage points of GDP				Contribution to change in percentage points of GDP			
Demographic dependency	10.5				8.6			
Employment	-0.3				-1.1			
Eligibility	-3.5				-2.1			
Level of benefits	-0.6				-2.7			
Total (including residual)	5.6				2.2			

### Notes

<sup>(1)</sup> Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).

<sup>(2)</sup> Source: Eurostat. Median individual pension income of retirees aged 65–74 in relation to median earnings of employed persons aged 50–59 excluding social benefits other than pensions.

<sup>(3)</sup> Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first- and second-pillar pension schemes, retiring at the age of 65 years in 2005.

<sup>(4)</sup> Source: Esspros, Eurostat. Includes expenditure by certain private social protection schemes.

<sup>(5)</sup> Source: European Labour Force Survey, 2004.

<sup>(6)</sup> Source: European Labour Force Survey, 2004.

<sup>(7)</sup> Source: European Commission, DG ECFIN.

<sup>(8)</sup> Source: Eurostat (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15–64.

<sup>(9)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.

<sup>(10)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.

(\*) Negligible proportion

## Denmark

### 1. Main characteristics of the pension system

**The public old-age pension** is a universal, residence-based and non-contributory statutory old-age pension scheme financed from general taxation. A full public old-age pension is conditional on 40 years' residence in Denmark after the age of 15. It consists of a basic amount and an income-tested pension supplement. The pension depends on the pensioner's present income and marital status, but assets have no effect on the amount. The benefits are adjusted once a year based on the wage development in the private sector, and are taxable. Since 2003, in addition a supplementary pension benefit of a flat-rate amount is paid once a year to the most disadvantaged pensioners (means-tested). For the 70% of older people with the lowest incomes, social pension accounts for 50% or more of the gross income for both single pensioners and couples. The statutory retirement age for both men and women is 65 years, having been lowered from 67 years in July 2004.

Reforms were undertaken during the 1990s, aiming in particular at increasing labour force participation of older workers so as to offset the impact of an ageing workforce. In addition, people who postpone the take-up of a voluntary early retirement benefit beyond the age of 62 are paid a tax-free bonus at the age of 65 (which increases with time worked beyond the age of 62). Rules on deferred pension were introduced with effect from 1 July 2004. Persons who have reached public old-age pension age and who participate actively in the labour market (at least 1 500 hours annually) may choose to defer their public old-age pension and are rewarded with a higher amount.

Denmark has a supplementary mandatory funded **ATP** scheme, which can be considered as part of the first pillar due to the fact that it is mandatory. But it also has the characteristics of an occupational pension scheme being employment-related and organised in private funds, thus not burdening public finances. On average ATP offers about 10% of public old-age pensions to current pensioners. In collective agreements of 2004

covering the private labour market, the social partners agreed to raise the contribution rate to ATP in 2006.

Payments from the Special Savings Scheme (**SP**, launched in 1999), are suspended from 2004 until 2007 (all employees and self-employed persons contribute 1% of their income in order to receive benefits that are paid out over a 10-year period after the retirement age is reached).

Statutory pensions are supplemented by occupational pension schemes, such as **labour market pensions**, labour market supplement pensions (SAP) and individual pension saving. Labour market pension schemes in particular expanded in their coverage of employees during the last 25 years from 30% to around 90%. The bulk of labour market pensions are defined-contribution. In 2004, contributions to the agreement-based labour market pension schemes were typically 7–10% of the wage in the private sector and 12–16% of the wage in the public sector. In connection with the collective bargaining in 2005, a number of increases of these contributions were agreed. The employer contributes two thirds, while the employee contributes one third.

Access to a number of needs and income-tested cash supplements (e.g. housing, heating and medicine allowances), as well as free health and long-term care and to recreational activities contribute to guaranteeing a decent minimum standard for all.

### 2. Situation and perspectives in light of the common objectives

#### 2.1. Current situation

**Adequacy** The income of all people aged 65 or more relative to the 0–64 age group stands at 70%, which is lower than in most other Member States<sup>(43)</sup>. In spite of the projected significant rise of funded schemes, the first pillar will continue to play an important but decreasing role in pension provision.

(43) Accumulated wealth, which is higher for older people, should also be considered when comparing living standards across generations. Due to data limitations, unfortunately, this is not possible for all countries.

The statutory pension schemes keeps the risk of poverty for the elderly population at a moderate level (17% at the 60% threshold) higher than that of the 0–64 years (10%)<sup>(44)</sup>. The gender gap between men and women is one of the lowest in Europe. This is linked to the high labour market participation of women and also to the prevalence of supplementary labour market pension being as high for women as that of men. In addition, pension rights in ATP and labour market pensions (since 1998) are calculated on the basis of a unisex principle (labour market pension schemes are based on a unisex principle and are open to everybody in the labour market, irrespective of the person's health conditions). The unisex principle implies that a person's gender must not be taken into account when the pension is calculated in regard to the remaining projected life expectancy.

Theoretical pension replacement rates of today (2005) are relatively low compared to almost all other Member States. The current total gross replacement rate is 49%, resulting in net replacement rate of 71%. Since most Danish funded schemes are not yet fully mature (a majority of new pensioners have not yet contributed during a full working life) the level of measured income of pensioners relative to the working-age population will improve gradually, in particular for people on low and average incomes. The counterpart is, however, that the build-up of the mandatory savings-based schemes to some degree will supersede other savings. The replacement rate ensured by the pension system must be seen in relation to the supplementary benefits targeted at pensioners and the public financed health and elderly care.

The Danish government wishes to put **self-employed** persons on an equal footing with employees when it comes to the possibility for saving for retirement. Self-employed persons are now entitled to full deductions for pension contributions of up to 30% of any profits they earn that year and can thus decide on an ongoing basis how much they wish to contribute.

**Financial sustainability:** Public debt has been reduced since 1998 and is below the average in the EU, being 45.9% of GDP in 2003 and the State budget had a small surplus in 2002 (0.7% of GDP) and 2003 (0.3%

of GDP). The Government has set the operational fiscal target of upholding a structural budget surplus of 0.5–1.5% of GDP (1.5–2.5% of GDP including ATP) on average through 2010. This reduction of debt improves fiscal sustainability. To support the long-term sustainability of public finances and the pension system, tight expenditure control and a permanent rise in employment generated from new structural policy initiatives are pursued. In relation to this, the government has launched the integration plan that a majority of the political parties signed up to in June 2005.

The total employment rate (75.7%) and the total female employment rate (71.6%) are currently the highest in the EU (2004), while for older workers (60.3%) it is the second highest and far exceeds the Lisbon targets. As from 1 July 2004, the age at which a person becomes eligible for a public old-age pension is 65 years (reduced from 67). The formal pensionable age was lowered as part of a reform of the voluntary early-retirement scheme in 1999. The lowering of the formal pensionable age is not thought to have any significant effect on the average retirement age.

**Modernisation:** Reduced transfer fees for individual pensions in the third pillar have improved transfer possibilities, and this is expected to result in intensified competition between insurance companies and thus greater efficiency. New employees are often subject to a waiting period before becoming a member of the pension scheme (waiting periods can generally be transferred within the private and public sectors and generally range between one and three quarter years in the private sector and from no waiting period to four years in the public sector).

The complex structure of the Danish system (means-tested elements, ATP, defined-contribution schemes) can make it difficult to have a clear idea of a person's income situation after retirement. This issue is addressed by an obligation on pension schemes to disclose their administrative costs and performance records. In addition, a common database, *PensionsInfo*, has been established in cooperation between pension funds, life-insurance companies, banks and public authorities. *PensionsInfo* gives the individual pension

(44) This figure does not include as income negative capital income and imputed rent from private housing, which gives an incomplete picture of income situation, in particular for older people. When taking into account this more comprehensive definition of income, the risk of poverty in Denmark for elderly people is roughly the same as in the rest of the population (8.7% for people aged more than 65 and 10.6% for people aged more than 75, compared to 9.8% for 0–64 aged people).

saver access to information from almost all pension suppliers, thus enabling the individual to get a total overview of their pension savings.

## 2.2. Outlook, reform measures and policy debates

Denmark is projected to face similar demographic trends to most EU-15 Member States until 2030 when it will then experience more favourable trends. According to the latest projections of Eurostat, ageing will be slower than the EU average. Indeed, the elderly dependency ratio will increase from the present 23% (2004) to 38% in 2030 and 42% in 2050, staying significantly below the EU-25 average of 52% in 2050.

Since individuals are now entitled to higher pensions compared to the previous system, supplements for deferred public old-age pensions for those wishing to work beyond the retirement age of 65 will not necessarily improve fiscal sustainability. Nevertheless, the aim is to increase the average retirement age by six months to 61.5.

The expansion of occupational pension schemes (SP and labour market schemes) is expected to raise replacement rates significantly and therefore reduce the current difference. Theoretical total gross replacement rates for a worker retiring at 65 after 40 years at the average wage is expected to increase from 49% in 2005 to 64% in 2050 because of an expected increase of the gross replacement rate in the second pillar from today's 4% to 25% in 2050 and despite a slight decrease of the gross replacement rate for the first pillar (including ATP) from 45% today to 39% in 2050. Because of taxation, the increase in total net replacement rate is significantly lower (71% in 2005 to 76% in 2050).

Denmark's national strategy report highlights that the budgetary pressure from ageing is not only related to public old-age pension, but also to health and elderly care expenditures, and that the sustainability of the public pension system cannot be assessed independently of other public expenditures and the overall assessment of the long-term sustainability of public finances because public pensions are financed by general tax revenues. The AWG 2005 projections indicate that public pension spending will grow from 9.5% to 12.8% of GDP, by 3.3 p.p. of GDP, between 2004 and 2050, while total age-related expenditure would increase by 3.6 p.p. However, it should be borne in mind that a major increase in pension expenditures is

expected in occupational pensions as these schemes will mature in the coming decades.

In ATP and SAP savings-based schemes, pension rights are earned on the basis of a unisex principle. SP is a purely saving-based scheme without redistribution. The unisex principle, which implies that a person's gender must not be taken into account when pension is calculated, became statutory for labour market pensions in 1998. The principle will only take full effect for pensions paid out from 2040. As regards maternity leave without wage, the social partners in the central, local and regional government area agreed in connection with the collective bargaining in 2005 that pension contributions will be paid in the maternity leave periods in which no wage is paid.

The system is based on a broad consensus between the major parties about the overall structure and the relative role of its various elements. In addition, a large majority in Parliament agreed in 2000 on the principle that the public old-age pension should form a sound income basis for present and future pensioners. The government has set up a Welfare Commission charged with submitting specific proposals before the end of 2005 for reforming the Danish welfare model, including social pensions. In light of the analyses from the Welfare Commission and with a view to maintaining the long-term targets of economic policies, the Government will, in spring 2006, present a new economic multi-year plan for Denmark, covering at least the period up to 2015.

## 3. Conclusion

The strategy for ensuring adequacy and financial sustainability of public pension provision seems appropriate. A budget policy leading to quick debt reduction has already been sustained for some years and all major parties support the continuation of this policy until 2010, when the public debt is expected to be substantially reduced.

In sum, the pension system seems to be financially sustainable in the long term under present policies with a fairly equitable sharing of the burden between generations. Denmark reports not only one of the lowest gender gaps between men and women in the risk of poverty in Europe but also a very small gender gap in the pension entitlements of the current pensioners. While rel-



ative living standards of older people are moderate, building up private pensions is expected to increase replacement rates in the future and thereby alleviate potential pressure for increases in public pension rates. Nevertheless, the future contribution of private pensions to adequate pensions would benefit from periodic reviewing.

Yet the sustainability calculations hinge critically on maintaining large surpluses in public finances. Furthermore, ambitious targets have been set to increase employment by 60 000 persons by 2010. Given Den-

mark's proven record in employment, further rises in employment rates will be difficult to achieve and will require further measures, especially to slow the outflow of older workers through early retirement schemes.

In light of the proposals for welfare system reforms from the Welfare Commission and with a view to maintaining the long-term targets of economic policies, the government will, in spring 2006, present a new economic multi-year plan for Denmark, covering at least the period up to 2015.



## 4. Background statistics

	DK			EU-25				
Adequacy								
Current situation								
	Total	Men	Women	Total	Men	Women		
At-risk-of-poverty rate <sup>(1)</sup>	11	11	11	16	15	17		
0–64	10	10	10	16	16	17		
65+	17	16	18	18	15	20		
75+	23	25	22	Nd	Nd	Nd		
Income inequality <sup>(1)</sup>								
0–64	3.5							
65+	2.8							
Income of people aged 65+ as a ratio of income of people aged 0–64 <sup>(1)</sup>	0.71	0.74	0.71					
Median pensions relative to median earnings <sup>(2)</sup>	0.38	0.38	0.39					
Long-term projections								
Theoretical replacement rates <sup>(3)</sup>	2005	2030	2050					
Total net replacement rate	71	77	76					
Total gross replacement rate	49	63	64					
Gross replacement rate 1st pillar	45	42	39					
Gross replacement rate 2nd/3rd pillar	4	20	25					
Financial sustainability								
Current situation								
Esspros Pension expenditure <sup>(4)</sup> , % of GDP	1995	2000	2003	1995	2000	2003		
	11.3	10.5	11.1		12.5	12.6		
Employment (2004) <sup>(5)</sup>	Total	Men	Women	Total	Men	Women		
Employment rate (25–54)	83.7	87.6	79.8	76.8	85.2	68.5		
Employment rate (55–64)	60.3	67.3	53.3	41.0	50.7	31.7		
Effective labour market exit age (2004) <sup>(6)</sup>	62.1			60.7p				
Public finances (2003) <sup>(7)</sup>								
Public debt, % of GDP	45.6			63.3				
Budget balance, % of GDP	0.3			-2.8				
Long-term projections (EPC 2006)								
	2004	Level 2030	2050	Increase 2004–50	2004	Level 2030	2050	Increase 2004–50
Old-age dependency ratio <sup>(8)</sup>	22.5	37.7	41.9	+86%	25	40	52	+108%
Public pensions expenditure, % of GDP <sup>(9)</sup>	9.5	12.8	12.8	+3.3	10.6	11.9	12.8	+2.2%
Factors determining the evolution of public pensions expenditure (2000–50) <sup>(10)</sup>	Contribution to change in percentage points of GDP				Contribution to change in percentage points of GDP			
Demographic dependency	7.2				8.6			
Employment	-0.4				-1.1			
Eligibility	-2.8				-2.1			
Level of benefits	-0.5				-2.7			
Total (including residual)	3.2				2.2			

### Notes

<sup>(1)</sup> Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. These figures do not include as income negative capital income and imputed rent from private housing, which gives an incomplete picture of income situation, in particular for older people. 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).

<sup>(2)</sup> Source: Eurostat. Median individual pension income of retirees aged 65–74 in relation to median earnings of employed persons aged 50–59 excluding social benefits other than pensions.

<sup>(3)</sup> Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first- and second-pillar pension schemes, retiring at the age of 65 years in 2005.

<sup>(4)</sup> Source: Esspros, Eurostat. Includes expenditure by certain private social protection schemes.

<sup>(5)</sup> Source: European Labour Force Survey, 2004.

<sup>(6)</sup> Source: European Labour Force Survey, 2004.

<sup>(7)</sup> Source: European Commission, DG ECFIN.

<sup>(8)</sup> Source: Eurostat (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15–64.

<sup>(9)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.

<sup>(10)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.

(\*) Negligible proportion

## Germany

### 1. Main characteristics of the pension system

The general pay-as-you-go, earnings-related first-pillar statutory pension scheme covers around 80% of the employed population in Germany (33 million people). Since 2003 the contribution rate stands at 19.5%, paid in equal shares by employers and employees. Civil servants' pensions are paid directly from public budgets and special schemes exist notably for farmers and the liberal professions (e.g. for doctors, lawyers, architects).

For each year of contributions, an insured person in the statutory pension scheme receives 'earnings points' depending on the individual income position in relation to the average earned income. Someone who earns exactly the average therefore receives one 'earnings point' for his contributions of that year. The sum of one's individual earnings points is multiplied by the value of one earnings point. The earnings point value is adjusted annually by an index which is based on gross earnings development but curbed by the sustainability factor and the increase in the contribution rate. All pensions are adjusted in line with the change of the earnings point value, irrespective of when the pensioner retired.

The main reforms in the statutory pension scheme in order to ensure sustainability began in 1992 with the Pensions Reform Act, which modified the pensions adjustment formula, began a gradual increase of retirement ages and introduced actuarial reductions for early retirement. The 2001 reforms of old-age pensions led to a gradual reduction of first-pillar pension levels through the modification of pensions adjustments, new widow's/widower's pension (with a child component) and the creation of State-supported capital-covered (voluntary) second- and third-pillar old-age pension provision. In 2003 short-term measures were put into force in order to avoid an increase in the contribution rate anticipated for 2004. Finally, in 2004 the Old-age Pensions Insurance Sustainability Act modified the pension adjustment formula and introduced a 'sustainability factor' which is geared to changes in the ratio between contribution payers and pension recipients.

In 2003, benefits from the statutory pension insurance (without pensions to civil servants, farmers and the liberal professions) contributed 66% of the total income of people over 65. The systems of retirement income beside the statutory old-age pensions insurance amount to 21% of the total old-age income (of which 7% is occupational pensions in private industry and supplementary pensions for employed persons in the public service). It should be noted, however, that the share of statutory old-age pension insurance in the new Länder (former East Germany) is 91% and the share of supplementary retirement schemes is still small, since these systems were only introduced to the new Länder fairly recently. The various forms of private old-age provision making up the third pillar contribute an estimated 7% to pensioners' total income. The remaining 6% come from other sources such as income from working or social assistance.

The 2001-04 reforms promoted the development of supplementary pension schemes. As to the second pillar, legislation provides for five options for occupational provision: '*Direktzusage*' (book reserves), '*Unterstützungskasse*' (support fund), '*Direktversicherung*' (direct insurance), '*Pensionskasse*', and '*Pensionsfonds*' (pension fund). Since 2001, the coverage rate of occupational pension schemes has increased in the private sector from 38% to 46%. Currently, about 10.3 million workers in the private sector and 5.4 million public employees contribute to an occupational pension plan (roughly 60% of all employees in accordance to TNS Infratest Sozialforschung, 2001–04). Furthermore, since the 2001 pension reform, employees are entitled to convert remuneration into contributions to employee-funded occupational pension schemes. Remuneration conversion was used by roughly 1.7 million employees at mid-2004. The average amount converted was EUR 1 100 per year.

With '*Riester pension*', introduced in 2002, reductions in the pension level of the statutory pension scheme shall be compensated by private savings in specially regulated contracts where up to 4% of an individual's income (within set limits – the contribution base), gradually increasing until 2008. It is promoted by bonuses (independent of wages) or by contributions being tax deductible. The system is also progressive, where the

greatest support is provided to low-income groups and for those who have children. 4.7 million 'Riester contracts' have been concluded until September 2005. Besides the 'Riester pension' there are other forms of private pension provision. Since 2002, for instance, some 8 million private annuity contracts were concluded in addition to the 'Riester contracts'.

There is no minimum pension, but disabled and older people without sufficient incomes are entitled to means-tested benefits.

## 2. Situation and perspectives in light of the common objectives

### 2.1. Current situation

Concerning **adequacy**, people aged 65 and more have a living standard (disposable income) close to that of the 0–64 population (with a relative equivalised income of 94% taking into account the number of persons in the household), while the gross median pensions account for about 60% of median earnings. According to the second Federal Government Report on Poverty and Wealth, 'Living Conditions in Germany' from March 2005, older people have a favourable income development in comparison to the rest of the population; the risk of poverty of senior citizens declined by about 2 percentage points since 1998. The risk of poverty among people aged 65 and more (at 16%) is comparable to the level of poverty (at the 60% threshold of median equivalised income) of the total population (15%)<sup>(45)</sup>.

According to ISG calculations of replacement rates (of 2005), the gross replacement rate for a worker working 40 years at the average wage and retiring at 65 is currently at 43% (63% net). As several recent pension reforms will translate into a reduction of first-pillar benefits, the German government committed itself to make adjustments, should the pension benefits fall below a minimum level. The minimum projected pre-

tax replacement rate should not be less than 46% until the year 2020 and 43% until the year 2030<sup>(46)</sup>. Based on a legally defined 'standard pensioner' with 45 years of contributions at average earnings, the current level of the pre-tax replacement rate is at 53%, the corresponding net replacement rate is at about 71% (2004). The Old-age Pensions Insurance Sustainability Act of 2004 foresees that the federal government will report to the legislative bodies every four years from 2008 onwards regarding compliance with a target level of provision before tax of 46% beyond 2020, and in the event of it being at risk, will submit proposals to attain this objective, while maintaining a contribution rate of up to 20% until the year 2020 and of up to 22% until the year 2030.

Concerning **financial sustainability**, the core element of the Pension Insurance Sustainability Act of 2004 is the introduction of a sustainability factor in the pension adjustment formula: changes in the ratio of pensioners and contribution payers are taken into account when calculating the pension adjustment. For instance, whenever the number of contributors declines due to cyclical fluctuations, the next pension adjustment is lowered, or an increase in the number of pensioners will also lead to a lower pension adjustment. In order to avoid pension reductions, it is stipulated by law that the sustainability factor can lower the adjustment down to zero but can not go beyond this point. The new government has already envisaged curbing future indexation by introducing a new adjustment factor in order to make up for lost indexation cuts because of this restriction. According to Esspros figures, pension expenditure was 13.0% of GDP in 2000 and 13.4% in 2003, slightly above the EU average in 2003 (12.6% of GDP in 2003).

The employment rate for the total population has been stable over the recent years. At 65% in 2004 it remained below the Lisbon target. For older people, it has been on a steady growth path since 2000, and from 2003 to 2004 it increased from 39.5% to 41.8%. Still the gap to the 50% Lisbon target remains substantial.

(45) Effects of imputed rents of owner-occupied housing are not taken into account in the calculation of this figure. According to more recent figures, referring to income year 2003, the poverty rate of people aged 65 and more is at 15%, while the poverty rate of the general population is 16%.

(46) To calculate this level, the standard pension (gross), reduced by the pensioner's social insurance contributions, e.g. the contributions to health and long-term care insurance paid by pensioners, is put into ratio with the average wage, reduced by the social insurance contributions paid by employees, e.g. their contribution to pension, health and long-term care insurance and Federal Employment Office as well as the payments made into additional private provision for old-age. The calculation of these pension replacement rates relates to the pension of a legally defined 'standard pensioner' with 45 years of contributions at average earnings.

Concerning **modernisation**, despite the fundamentally gender-neutral wording of the pension law, there are major differences between the pension entitlements of women and men which reflect above all women's shorter average working lives and lower incomes, mainly due to part-time occupations. In order to balance this, policies to increase labour market participation for women and pension credits for child and elderly care were significantly improved.

By virtue of the new regulation applied in 2005, beneficiaries of social assistance considered able to work are covered by the unemployment benefits II and so have access to the State pension system.

Portability of occupational retirement provision has been improved with effect from 2005. A right (under certain conditions) has been introduced for employees to take occupational pension entitlements with them to their new employer. This right applies to new agreements concluded since 1 January 2005 and implemented through direct insurance, '*Pensionskasse*' or pension fund.

Since 1 January 2004, the statutory old-age pension insurance institutions inform all insured people (from the age of 27) on an annual basis about their individual pension entitlements and the amount of their expected pension. Insured people can then check their insurance careers or their pension information online. As for private insurance, the information obligations have been expanded as from 2005, and further information must be provided prior to conclusion of contract (possible investments, the structure of the portfolio and the risk potential).

## 2.2. Outlook, reform measures and policy debates

It is expected that for people taking advantage of the opportunities of supplementary provision, the replacement rate can roughly be maintained at a constant level at a given age and that the increase of older workers' employment will enable them to accrue higher pensions. Due to the most recent enacted reforms, the gross replacement rate of the statutory pension scheme for a worker working 40 years at the average wage and retiring at 65 will decrease from 43% in 2005 to 34% in 2050 (according to ISG projections of 2005). The overall gross replacement rate would

increase from 43% to 48% until 2050 (total net 63% to 67%), mainly due to a projected increase in the second- and third-pillar replacement rate up to 15 p.p. in 2050, which is assumed to compensate the decline of 9 p.p. in the statutory scheme<sup>(47)</sup>.

Recent reforms of the statutory pension scheme and Civil Servants Pension Scheme (since 2002), and in particular the introduction of the sustainability factor in 2004 will significantly improve the long-term sustainability of the pension system. The AWG 2005 projections indicate that the expected increase of public spending on pensions from 2004 to 2050 would be 1.7 p.p. of GDP, in contrast to the level of 5.5 p.p. increase projected in the 2001 AWG projections. A similar rise (1.6 p.p. of GDP) is projected for all age-related expenditure over the period 2004–50.

Measures to increase older people's employment have been introduced. The minimum age to receive a State pension because of unemployment or on account of old-age part-time work will be increased from 60 to 63 years from 2006 to 2008 for those born after 1945. For insured persons born after 1951, the possibility of drawing a pension earlier because of unemployment or after part-time working in old age or old-age pension for women has already been completely eliminated. So, in future, statutory old-age pension insurance only offers the possibility to draw an old-age pension before the age of 65 for persons with disabilities and people insured for a long period (35 years of insurance) – but with reductions (0.3% per month of early retirement). People who postpone their retirement beyond the age of 65 receive a bonus of 0.5% per month. Due to these reforms the average retirement age for old-age pension increased by one year to 63.1 years since 1998 to 2004. Furthermore, the new government has planned to gradually raise the statutory retirement age from 65 to 67 (from 2012 to 2029, with an intermediary stage of 66 in 2023), while keeping open the possibility of retirement at 65 without reductions for people who already have 45 years of contributions. Regarding all types of pension schemes, the German Parliament has also decided to gradually reform pension taxation. This will translate into tax deductibility of the pension insurance contribution of the employed, while pensioners' income will be fully taxed in the long run.

(47) Contributions of 4% of wages to the second or the third pillar are assumed. These schemes currently cover around 70% of the employed.

To have a balanced mix between statutory, occupational and private pensions, the awareness of the necessity of self-managed provision could be developed. At the beginning of 2006 the third pension provision report has to be submitted to the Parliament. For the first time there will be a part illustrating to what extent the new support for supplementary pensions (occupational and private) is being taken advantage of and how far the supplementary pension system is being established. The government expects that the high relative support level provided for low-income groups and for those raising children will trigger a sufficient participation and coverage in supplementary pension schemes especially for the economically weakest groups. Besides, the new government has announced plans to raise the support level for '*Riester contracts*' for persons who bring up children, in order to raise the support to more than 50% for parents having one child born in 2008 or later. With the introduction of unisex tariffs as a new condition for support for the funded private pensions, from 2006 on, men and women will receive equal benefits for equal contributions in '*Riester contracts*'.

### 3. Conclusion

The last pension reform made progress in terms of financial sustainability. From 2005 on, the introduction

of the sustainability factor in the pension adjustment formula will automatically slow down annual pension adjustments, including for new pensioners. Due to recent pension reforms and the gradual change in taxation, the replacement rates of public pensions will be significantly reduced.

Germany is terminating early retirement paths within a fairly short transition period. Progress in raising the employment rates, particularly of older workers, is a major condition for future adequacy and sustainability. There is, therefore, also a priority for further labour market measures. The federal government will report in 2008 on trends in adequacy and sustainability of the pension system as well as the employment of elderly employees. The new government has planned to gradually raise the statutory retirement age from 65 to 67, from 2012 to 2029.

In order to meet Germany's expectation to compensate the pension cuts in the statutory pension scheme by better occupational and personal provision, further improvements in the coverage rate might be necessary. Social partners have a key role in developing extensive occupational pension schemes so that the largest possible number of workers can benefit from this provision. They should also ensure that such schemes do not hinder mobility.

## 4. Background statistics

	DE			EU-25				
Adequacy								
Current situation								
	Total	Men	Women	Total	Men	Women		
At-risk-of-poverty rate <sup>(1)</sup>	15	13	17	16	15	17		
0–64	15	13	15	16	16	17		
65+	16	20	21	18	15	20		
75+	17	9	20	Nd	Nd	Nd		
Income inequality <sup>(1)</sup>								
0–64	4.4							
65+	3.9							
Income of people aged 65+ as a ratio of income of people aged 0–64 <sup>(1)</sup>	0.88	Nd	Nd					
Median pensions relative to median earnings <sup>(2)</sup>	Nd	Nd	Nd					
Long-term projections								
Theoretical replacement rates <sup>(3)</sup>	2005	2030	2050					
Total net replacement rate	63	65	67					
Total gross replacement rate	43	46	48					
Gross replacement rate 1st pillar	43	37	34					
Gross replacement rate 2nd/3rd pillar	0	9	15					
Financial sustainability								
Current situation								
Esspros Pension expenditure <sup>(4)</sup> , % of GDP	1995	2000	2003	1995	2000	2003		
	12.5	13.0	13.4		12.5	12.6		
Employment (2004) <sup>(5)</sup>	Total	Men	Women	Total	Men	Women		
Employment rate (25–54)	78.1	83.9	72.1	76.8	85.2	68.5		
Employment rate (55–64)	41.8	50.7	33.0	41.0	50.7	31.7		
Effective labour market exit age (2004) <sup>(6)</sup>	61.3			60.7p				
Public finances (2003) <sup>(7)</sup>								
Public debt, % of GDP	64.2			63.3				
Budget balance, % of GDP	-3.8			-2.8				
Long-term projections (EPC 2006)								
	2004	Level 2030	2050	Increase 2004–50	2004	Level 2030	2050	Increase 2004–50
Old-age dependency ratio <sup>(8)</sup>	26.8	44	51.7	+93%	25	40	52	+108 %
Public pensions expenditure, % of GDP <sup>(9)</sup>	11.4	12.3	13.1	+1.7	10.6	11.9	12.8	+2.2
Factors determining the evolution of public pensions expenditure (2000–50) <sup>(10)</sup>	Contribution to change in percentage points of GDP				Contribution to change in percentage points of GDP			
Demographic dependency	7.5				8.6			
Employment	-1.1				-1.1			
Eligibility	-0.6				-2.1			
Level of benefits	-3.5				-2.7			
Total (including residual)	1.7				2.2			

### Notes

<sup>(1)</sup> Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, Income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).

<sup>(2)</sup> Source: Eurostat. Median individual pension income of retirees aged 65–74 in relation to median earnings of employed persons aged 50–59 excluding social benefits other than pensions.

<sup>(3)</sup> Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first- and second- pillar pension schemes, retiring at the age of 65 years in 2005.

<sup>(4)</sup> Source: Esspros, Eurostat. Includes expenditure by certain private social protection schemes.

<sup>(5)</sup> Source: European Labour Force Survey, 2004.

<sup>(6)</sup> Source: European Labour Force Survey, 2004.

<sup>(7)</sup> Source: European Commission, DG ECFIN.

<sup>(8)</sup> Source: Eurostat (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15–64.

<sup>(9)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.

<sup>(10)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.

<sup>(11)</sup> Negligible proportion



## Estonia

### 1. Main characteristics of the pension system

**Statutory schemes:** There are two kinds of statutory schemes: the State PAYG defined-benefit (DB) pensions and mandatory funded defined-contribution (DC) pensions. Pension benefits of PAYG scheme can be divided into two groups: employment-related and national pensions. The employment-related benefits are the old-age pension, the pension for incapacity for work and survivors' pensions. They are financed by 20 percentage points (or 16 in the case of members of the mandatory funded pillar) of the 33% social tax, paid by employers. The purpose of the national pension is to guarantee a minimum income for those who are not entitled to an employment-related benefit. They are financed from the general State budget. The coverage of the PAYG system is practically universal.

The retirement age for men is 63 and for women it will be the same age by 2016. There is a possibility for early retirement three years prior to the normal retirement age if the person has a work record of at least 15 years. For every month of early pension the pension entitlement is reduced by 0.4%. Where the pension is deferred the entitlement is increased by 0.9% for every month after the normal retirement age.

**The compulsory funded DC scheme** was introduced in 2002 by diverting a portion of contributions from the statutory PAYG scheme into private funds. This has reduced the problem of contribution evasion. Participation is mandatory only for persons born in 1983 or later. For people born between 1942 and 1982 joining the scheme was voluntary, but there is an upper age limit for choosing the system, which is reduced until 2010, when joining will become compulsory. By 2005 around 75% of the labour force has joined the new system. The scheme is financed by 4 percentage points of the 20% pension contribution paid by the employer and an employee's contribution of 2% of the gross wage, withheld by the employer. Benefits can be received upon reaching the standard retirement age. First benefits should be paid in 2009, but so far the payout phase has not been developed (neither detailed products nor logistics of the system). Invalidity and survivor risks are not covered by this scheme.

**Individual provision:** In 1998, voluntary private pension schemes were introduced, participation in which can take two different forms: pension insurance policies offered by licensed private insurance companies or units of pension funds managed by private asset managers. Occupational pension provisions are not promoted by the authorities in Estonia. Nevertheless, under the individual pension provision there is a possibility for the employer to make contributions on an employee's behalf, but as this is subject to high taxation it is not widely used.

To encourage participation in the voluntary private pension schemes, tax incentives have been introduced. For income tax, contributions are deductible from the taxable income up to the limit of 15% of the annual income, and benefits are taxable at a lower 10% rate (normal rate is 26%) while lifelong annuities are not taxable. Nevertheless participation in the voluntary individual scheme is low (around 8% of labour force) and therefore, its contribution to older people's incomes is projected to be rather marginal.

**Minimum income guarantees and other benefits for older people:** Although the Estonian pension system and the social protection system in general include some minimum income guarantees (national pension; minimum old age pension; social assistance subsistence benefit), these benefits do not necessarily take the beneficiary above the poverty line. About 1% of all persons of pension age receive a national pension and about 2.6% receive social assistance subsistence benefit in addition to their pension (mainly during the winter months to compensate for heating costs).

### 2. Situation and perspectives in light of the common objectives

#### 2.1. Current situation

**Adequacy:** Adequacy of pensions is already an issue in Estonia as replacement rates are low. According to ISG calculations the theoretical net replacement rate is 41% in 2005, while the gross replacement rate is 33%. The pension formula favours low-wage recipients: the theoretical net replacement rate for persons with earnings at two thirds of the average wage is 58%, while the theo-



retical net replacement rate to a person earning twice the average wage stands at 23%.

The poverty rate among the elderly currently lies at 17%, slightly lower than for the 0–64 population (19%), reflecting that neither the national pension nor minimum old-age pensions can currently take beneficiaries above the poverty line. Furthermore, the old-age pension formula (introduced in 1999), including a coefficient on personal contributions to the pension system which is expected to lead to a strong increase of recipients of minimum pensions. According to national projections, the current level of 1% of those in receipt of the minimum pension will increase to 17% by the time reforms take full effect (when those entering the labour market in 1999 retire).

Under the current indexation rules, pensions are indexed on the basis of 50% CPI and 50% of the increase in social contribution revenues. The plans to increase the share of social contribution revenues and reduce the share of CPI in the indexation formula have been postponed.

**Financial sustainability:** The Estonian pension system is currently financially stable – expenditure has stayed around 7% of GDP for almost a decade, there is a small reserve, a balanced budget strategy and debt level is low. At the same time, however, demographic trends suggest future pressure on public finances.

The total employment rate in Estonia in 2004 was 63% and has been on an increasing trend since 2000. Employment rates of workers aged 55–64 (52.4%) fulfils the Lisbon target already and the employment rates for women (60%) are almost in line with this target. Focusing in particular on reducing early retirement options for special favourable pension schemes could have a significant impact on employment rates.

The average exit age from the labour market (62.3 in 2004) reflects the increase in the retirement age (an ongoing process for women until 2016), the reduction of pension rights in cases of early retirement and incentives for deferred retirement. Recently a new rule was introduced enabling further accrual of pension rights, when working beyond the public retirement age. Besides early retirement pensions there are other pathways in the system for earlier retirement including in some special pensions (e.g. for military and police

officers) the right to a pension before the general pension age. So far there has been a lack of political consensus on the way to reform these pension rights.

The development of the mandatory funded pension scheme results in lower contribution for the State PAYG scheme while the accumulation of funded pensions is projected to maintain the level of pensions in payment. In the first years after launching the funded tier of the statutory scheme – in 2002 and 2003 – the PAYG pillar budget surplus increased, due to improvements in the labour market and increased incentives to contribute. In 2004 direct transfer costs amounted to 0.1% of GDP, which was financed by the government from the surplus of social tax revenues from previous years. According to forecasts of the Ministry of Finance, the existing reserves of the State pillar (1.4% of GDP at the end of 2004) will be exhausted due to pension reform transition costs by 2006 and in 2007–12 the State pension insurance budget will need additional public subsidies.

**Modernisation:** The Estonian pension system encourages transparency and adaptation to labour market evolutions. Further reforms under discussion regarding the pension formula and reform of special favourable pensions are ongoing.

Members' rights in the State pillar as well as in the funded pillars are well-protected. Rights in the funded pillars are secured through internationally recognised prudential rules, transparency of fund operations and a regulated fee structure. Pension funds are transparent and information is widely provided to members and non-members.

The pension system makes great use of the Internet. Not only is a lot of information available, but the paying of taxes and contributions is done electronically; people can follow their PAYG pillar records as well as funded-pillars statements over the Internet and even join funded pillars or change the funds there. As most of the transactions are done electronically, the system is also swift and transparent.

## 2.2. Outlook, reform measures and policy debates

According to Eurostat population projections, low fertility rates and increases in life expectancy will lead to the old-age dependency ratio increasing from its present 24% to 31% by 2025 and to 43% by 2050.

Estonia acknowledges a consolidated general government budget surplus of 2.6% of GDP in 2003 and the total government sector debt was only 5.8%. By the end of 2003, the stabilisation reserve (established to reduce macro economic risks and to finance long-term structural reforms, including pension reform) amounted to about 3.9% of GDP. There is also a reserve for the State pension insurance scheme, the size of which also depends on future decisions concerning exceptional pension increases.

According to the AWG 2005 projections, Estonia will see a noticeable fall in spending on public pensions (from 6.7% of GDP in 2004 to 4.2% in 2050) linked to the diversion of part of the social security pension contributions into privately funded schemes (taking into account the mandatory funded system, pension expenditures will move from 6.7% in 2004 to 6.6% in 2050). Total age-related expenditure is expected to decrease by the same percentage of GDP. Such budgetary developments would allow it to eliminate the small current public debt of about 5% of GDP by 2020.

ISG projections of replacement rates reflect an increasing role of the defined-contribution mandatory funded pillar. By 2050 the theoretical net replacement rate of a worker retiring at 65 after 40 years at the average wage are projected to remain roughly constant at 43%. This reflects a steady decrease of the replacement rate provided by the first tier of the first pillar (from 33% of gross replacement rate in 2005 to 15% in 2050), while the contribution of the funded tier is projected to reach 13% of gross replacement in 2030 and 21% in

2050. At two thirds of average earnings the net replacement rate is projected to decline to 46%, while the replacement rate for pensions based on earning twice the average will increase to 31%.

### 3. Conclusion

The pension reform in Estonia, started in 1998, modified the pay-as-you-go scheme and introduced new mandatory and voluntary funded components. The reformed system is financially well-balanced at present as well as sustainable in the long run. Transition costs are estimated to be moderate, requiring additional public subsidies only during the period from 2007 to 2012. Moreover, transparency of the system is outstanding, especially due to high levels of Internet usage of the public and availability of most information and transactions via electronic channels. While poverty rates among the elderly currently remain moderate, the main challenge concerns the future adequacy of pensions, as current replacement rates are already rather low and projected to decline even further. Although the employment rate of older workers is higher than the EU average, for a number of special pension schemes the retirement age remains considerably lower, than in the public PAYG old-age pension scheme, while in some cases these schemes offer additionally much higher pensions than contributions made would allow. Attention should be paid to such early retirement schemes. Furthermore, the benefits payout system in the mandatory funded tier needs to be developed before 2009, when first payments should be made.

## 4. Background statistics

	EE			EU-25				
Adequacy								
Current situation								
	Total	Men	Women	Total	Men	Women		
At-risk-of-poverty rate <sup>(1)</sup>	18	17	20	16	15	17		
0–64	19	18	19	16	16	17		
65+	17	7	22	18	15	20		
75+	18	3	24	Nd	Nd	Nd		
Income inequality <sup>(1)</sup>								
0–64	6.1							
65+	4.7							
Income of people aged 65+ as a ratio of income of people aged 0–64 <sup>(1)</sup>	0.76	0.80	0.72					
Median pensions relative to median earnings <sup>(2)</sup>	0.68	0.70	0.68					
Long-term projections								
Theoretical replacement rates <sup>(3)</sup>	2004	2030	2050					
Total net replacement rate	41	42	43					
Total gross replacement rate	33	34	36					
Gross replacement rate 1st pillar	33	21	15					
Gross replacement rate 2nd/3rd pillar	0	13	21					
Financial sustainability								
Current situation								
Esspros Pension expenditure <sup>(4)</sup> , % of GDP	1995	2000	2003	1995	2000	2003		
		6.9	6.3		12.5	12.6		
Employment (2004) <sup>(5)</sup>	Total	Men	Women	Total	Men	Women		
Employment rate (25–54)	78.8	89.2	76.2	76.8	85.2	68.5		
Employment rate (55–64)	52.4	56.4	49.4	41.0	50.7	31.7		
Effective labour market exit age (2004) <sup>(6)</sup>	62.3			60.7p				
Public finances (2003) <sup>(7)</sup>								
Public debt, % of GDP	5.3			63.3				
Budget balance, % of GDP	3.1			-2.8				
Long-term projections (EPC 2006)								
	2004	Level 2030	2050	Increase 2004–50	2004	Level 2030	2050	Increase 2004–50
Old-age dependency ratio <sup>(8)</sup>	23.8	33.4	43.1	+81%	25	40	52	+108%
Public pensions expenditure, % of GDP <sup>(9)</sup>	6.7	5.3	6.6	-0.1	10.6	11.9	12.8	+2.2
Factors determining the evolution of public pensions expenditure (2000–50) <sup>(10)</sup>	Contribution to change in percentage points of GDP				Contribution to change in percentage points of GDP			
Demographic dependency	3.1				8.6			
Employment	-0.6				-1.1			
Eligibility	-1.5				-2.1			
Level of benefits	-3.8				-2.7			
Total (including residual)	-3.0				2.2			

### Notes

<sup>(1)</sup> Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).

<sup>(2)</sup> Source: Eurostat. Median individual pension income of retirees aged 65–74 in relation to median earnings of employed persons aged 50–59 excluding social benefits other than pensions.

<sup>(3)</sup> Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first- and second-pillar pension schemes, retiring at the age of 65 years in 2005.

<sup>(4)</sup> Source: Esspros, Eurostat. Includes expenditure by certain private social protection schemes.

<sup>(5)</sup> Source: European Labour Force Survey, 2004.

<sup>(6)</sup> Source: European Labour Force Survey, 2004.

<sup>(7)</sup> Source: European Commission, DG ECFIN.

<sup>(8)</sup> Source: Eurostat (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15–64.

<sup>(9)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.

<sup>(10)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.

(\*) Negligible proportion

## Greece

### 1. Main characteristics of the pension system

The first-pillar pension system includes primary and auxiliary pensions. Primary pensions consist of pay-as-you-go financed schemes, which are dispersed across industrial sectors and provide varying levels of pension. The largest funds are IKA (for wage earners) and OGA (for farmers) while a separate scheme (OAEE) also covers the self-employed. Employees' and self-employed pensions are defined-benefit. The equal retirement age for men and women was stipulated for those persons who entered the pension system from 1993, the current legal retirement age for men is 65 and 60 for women. A second tier of the first pillar consists of occupation-based auxiliary funds which provide supplementary pensions. They cover all employees and a small percentage of the self-employed and typically offer additional replacement rates of up to 20%. In 2001, they accounted for 1.8% of GDP (14.5% of pensions expenditure), a proportion which is growing over time. In the public sector, lump-sum severance payments are also common.

All funds are financed through the pay-as-you-go system and benefit levels are implicitly guaranteed by the State. The implicit rates of return (taking into account contributions, age limits and benefits) differ among funds, reflecting possible different retirement provisions. As far as contributions to IKA are concerned, a worker insured to IKA pays 6.67% of their gross salary for the primary pension and 3% for the auxiliary pension (9.67% in total). Employers pay 13.33% of the employees' gross salary for the primary pension and 3% for the auxiliary pension.

Second-pillar occupational pensions are not widespread. Third-pillar life insurance benefits, not as popular as in several other Member States, typically come in the form of a lump sum and only rarely as an annuity.

Means-tested benefits are provided to those aged 65 and over without a sufficient insurance record, whilst a large number of pensioners receive contributory pensions at a guaranteed minimum level. Pensioners whose total income (from any source, including pensions) is below a guaranteed minimum level and

whose other income and household situation fulfill additional criteria are provided with a pension supplement (known as EKAS, to which OGA pensioners are not eligible).

### 2. Situation and perspectives in light of the common objectives

#### 2.1. Current situation

Concerning **adequacy**, the 2002 law permits pension rights to insured persons with 37 years of contributions independent of age. It also reduces divergences between insured people from the 'old' (before 1993) and 'new' (after 1992) regimes, as well as between the private and the public sector. The gradual implementation of the new measures will begin after 2007. From 2017 on, a common replacement rate of 70% for the primary pension (for 35 years of contributions) will be applied to both 'old' and 'new' insured persons both in the private and the public sector. This entails an increase for the primary pension replacement rate for the new system entrants up from 60% to 70%; on the other hand, it entails a reduction for public sector employees from 80% to 70%.

The 2002 reform took measures to increase the minimum pension level, which should reach 70% of the minimum salary of a married, fully-employed person. Despite the progress that has been achieved in recent years, old age is still the most important factor in determining risk of poverty. According to SILC figures for 2003 (income year 2003), the poverty rate of people aged 65 or more stands at 28% (35% for pensioners aged more than 75, but with very low gender difference), 10 p.p. higher than the poverty risk of people aged 0–64, despite the fact that pension expenditure represents 13% of GDP in 2002. When interpreting these figures, it should be borne in mind that older people are much less likely here than elsewhere in the EU to live in old peoples' homes, hospitals or other communal institutions (less than 3% of the retired population). They also have higher rates of home ownership. Both these factors may lead to an over-estimation of poverty risks. Partly due to the fact that a large proportion of pensioners live with their children, pensions constituted a smaller share of their household income

than elsewhere<sup>(48)</sup>. Nevertheless, a large number of pensioners rely on the protection of minimum pensions and on the means-tested pension supplement EKAS.

Concerning **sustainability**, the total employment rate has been on a rising trend over the last few years, but continues to stay far below the Lisbon target (59% versus 70% in 2004). Unemployment has been declining since 2000, but remains higher than the EU-25 average and continues to affect mainly the young and women. There are significant differences in employment rates between men (89% for 25–54) and women (58%). The employment rate of older workers has slightly increased since the beginning of the 1990s and reached 42% in 2003. In 2004 this figure decreased to 39% and remains below the Lisbon target. Incentives to prolong working life have recently been increased for insured persons to remain in service for the full 35-year period: if one works until 67 years of age (instead of 65), an individual receives an increase of 1% to their pension.

The pension system appears to adapt to changes in the labour market, in particular with regard to the protection it offers to part-time employees, but also in relation to the principle of equal treatment of part-time and full-time employees. Part-time employees are entitled to equivalent rights to those of full-time employees, while their insurance coverage for working four hours a day gives them the right to insurance for a full day's employment.

Concerning **modernisation**, while the legal system provides for equal treatment of men and women, women are indirectly affected in their pension incomes, in particular because of their shorter working records. The quantitative and qualitative improvements of the services and of the benefits for pensioners are steadily progressing through the computerisation and simplification of administrative procedures.

## 2.2. Outlook, reform measures and policy debates

Greece is projected to face unfavourable demographic trends, similar to most other EU Member States, in the coming decades. Fertility rates have rapidly decreased since the 1980s. Life expectancy at birth, currently close to the EU average, is expected to grow

by 4.6 years for men and 4.5 years for women between 2004 and 2050. Net migration flows are not projected to be substantial. As a consequence, the old-age dependency rate will grow from a moderate 26% in 2005 to 60% in 2050, among the highest in the EU.

An important policy direction refers to the adequacy of those with lower pension incomes. This issue will constitute an important item of the national dialogue on pension system reform. In that respect, a recent measure is the abolition of contributions of pensioners to the main and auxiliary insurance organisations introduced in 2004, this is estimated to increase pensioner income by 1–5%.

Current adequacy issues also reflect the limited years of contributions for people currently retiring (the average length of contribution careers is 27.5 years for men and 20.8 years for women), as well as contribution evasion and the fact that in a number of cases contributions are paid for only a part of actual individual wages.

According to ISG projections for workers insured to IKA achieving a complete career of 40 years of contributions, the net replacement rate for someone retiring at 65 in 2005 will increase by 6 p.p. by 2030 and then decline by 15 p.p., with a 9 p.p. deduction between 2005 and 2050 due to the effect of recent reforms. For workers having achieved a complete career of 40 years of contributions, according to ISG calculations, the total net replacement rate for someone retiring at 65 would currently be 115% (total gross 105%). If, instead of the hypothesis of 40 years of contributions, the current weighted average of contribution years is taken into account (25 years), and instead of the 65 retirement age we consider the current weighted average retirement age (which is 60), then the replacement rate for the primary pension is 33%.

A main challenge is to address the multiplicity of systems of compulsory insurance for different professional groups which results in the fragmentation and legislative complexity of the social security system, with a view to reducing inequities that might undermine social acceptance of the system. Since even within one fund, different occupational categories may be subject

(48) According to EU-SILC 2003, 65% of the total income of individuals over 65 years comes from pensions, 26% from employment and 3% from other social benefits.

to different conditions and different pay-as-you-go rules, schemes may provide varying levels of pension. Recent reforms, such as the unification of different funds and the reforms in the banking sector suggest the direction currently taken is the right one.

Greece can expect strong budgetary pressure resulting from the process of ageing populations. Adverse demographic trends will contribute to a very high increase in public spending on age-related items. According to the budgetary projections made by the AWG in 2001, expenditure on pensions is projected to almost double reaching a level of 24.8% of GDP in 2050, almost twice the EU-15 average of 13.4%. Such developments are confirmed by the budgetary projections included in the 2004 update of the Stability and Growth Programme in the context of the assessment of the long-term sustainability of public finances, which project public spending on pensions increasing from 12.3% of GDP to 22.6% between 2009 and 2050. While the 2002 reform addresses a number of issues with the aim of making the system more credible and socially acceptable, the still-large projected increase in expenditure, despite the high starting level, suggests that significant further efforts will be required.

Many of the recent measures are aimed at tackling the existing problems to clear the path for further reform measures needed in order to prepare for the demographic problem. The extra public funding of IKA by on average 1% of GDP between 2003 to 2032 has been established with the double aim of managing the cash flow of the main pension fund (IKA) over the medium-term but also of transferring resources for the use of the fund for the period from now until 2030.

There is substantial scope for improving the adequacy and sustainability of the pension system in the medium and long term by increasing employment rates. In that respect, increases of the employment rate of women and older people represent very important potential resources. Recent initiatives such as promoting part-time employment and active labour market policies could contribute to especially improve women's participation.

### 3. Conclusion

Implementation of the 2002 reform is considered to be crucial for rebuilding confidence in the pension system and for laying the groundwork for further reform efforts. In order to meet the financial challenge of ageing, the process of pension reform needs to continue with financial consolidation in due course, building on the modernisation that started with the 2002 reform. However, further steps need to be taken.

There is substantial scope for improving the adequacy and viability of the pension system in the medium term by increasing employment rates (in particular of women) and curbing contribution evasion. Nevertheless, significant further efforts will be needed to stabilise expenditure growth in order to ensure the long-term financial sustainability of the pension system.

In addition, while most recent reforms have translated into strengthened incentives to work longer, further measures are needed to raise employment rates especially for women and older workers. Thus, active labour policies in this direction need to be strengthened. Gradually equalising the legal retirement age for men and women and for people already contributing to the system before 1993 might be taken into consideration.



## 4. Background statistics

	EL			EU-25				
Adequacy								
Current situation								
	Total	Men	Women	Total	Men	Women		
At-risk-of-poverty rate <sup>(1)</sup>	20	19	21	16	15	17		
0–64	18	18	19	16	16	17		
65+	28	26	30	18	15	20		
75+	35	35	34	Nd	Nd	Nd		
Income inequality <sup>(1)</sup>								
0–64	6.0							
65+	5.1							
Income of people aged 65+ as a ratio of income of people aged 0–64 <sup>(1)</sup>	0.78	0.81	0.77					
Median pensions relative to median earnings <sup>(2)</sup>	0.60	0.62	0.57					
Long-term projections								
Theoretical replacement rates <sup>(3)</sup>	2005	2030	2050					
Total net replacement rate	115	121	106					
Total gross replacement rate	105	112	94					
Gross replacement rate 1st pillar	105	112	94					
Gross replacement rate 2nd/3rd pillar	(*)	(*)	(*)					
Financial sustainability								
Current situation								
Esspros Pension expenditure <sup>(4)</sup> , % of GDP	1995	2000	2003	1995	2000	2003		
	11.2	12.5	12.9		12.5	12.6		
Employment (2004) <sup>(5)</sup>	Total	Men	Women	Total	Men	Women		
Employment rate (25–54)	73.5	89.3	57.6	76.8	85.2	68.5		
Employment rate (55–64)	39.4	56.4	24.0	41.0	50.7	31.7		
Effective labour market exit age (2004) <sup>(6)</sup>	59.5			60.7p				
Public finances (2003) <sup>(7)</sup>								
Public debt, % of GDP	109.9			63.3				
Budget balance, % of GDP	-4.6			-2.8				
Long-term projections (EPC 2006)								
	2004	Level 2030	2050	Increase 2004–50	2004	Level 2030	2050	Increase 2004–50
Old-age dependency ratio <sup>(8)</sup>	26.4	39.5	60.4	+129%	25	40	52	+108 %
Public pensions expenditure, % of GDP <sup>(9)</sup>	Nd	Nd	Nd	Nd	10.6	11.9	12.8	+2.2
Factors determining the evolution of public pensions expenditure (2000–50) <sup>(10)</sup>	Contribution to change in percentage points of GDP				Contribution to change in percentage points of GDP			
Demographic dependency	Nd				8.6			
Employment	Nd				-1.1			
Eligibility	Nd				-2.1			
Level of benefits	Nd				-2.7			
Total (including residual)	Nd				2.2			

### Notes

<sup>(1)</sup> Source: Income and living conditions data. Based on equivalised incomes. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, Income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).

<sup>(2)</sup> Source: Eurostat. Median individual pension income of retirees aged 65–74 in relation to median earnings of employed persons aged 50–59 excluding social benefits other than pensions.

<sup>(3)</sup> Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first- and second-pillar pension schemes, retiring at the age of 65 years in 2005.

<sup>(4)</sup> Source: Esspros, Eurostat. Includes expenditure by certain private social protection schemes.

<sup>(5)</sup> Source: European Labour Force Survey, 2004.

<sup>(6)</sup> Source: European Labour Force Survey, 2004.

<sup>(7)</sup> Source: European Commission, DG ECFIN.

<sup>(8)</sup> Source: Eurostat (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15–64.

<sup>(9)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.

<sup>(10)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.

(\*) Negligible proportion



## Spain

### 1. Main characteristics of the pension system

The first pillar of the Spanish pension system consists of a general earnings-related scheme financed through contributions (and special schemes for civil servants working for the central government or the justice system and for people working for the armed forces). The general scheme is mandatory for all employees and the self-employed and provides pension entitlements after a minimum contribution period. For retirement pension, this period is 15 years (of which at least 2 must have occurred in the last 15 years). The contribution rate is 28.3% of earnings (4.7 percentage points paid by the employee and 23.6 by the employer). It covers in addition to old-age pensions, disability and survivors and other risks including maternity and temporary incapacity.

Benefits are calculated as a percentage of a so-called 'base pension', which is an average of the contributions paid during the 15 years before retirement (up to an annual ceiling of EUR 33 760.8 corresponding to about 190% of the average wage; contributions are revalorised with prices for the 13 first years). A full pension of 100% of the 'base pension' is reached after 35 contribution years (or retirement at the standard age of 65). The percentage of the base pension that is paid increases with the number of years a person contributed to the system: it increases from 50% after 15 years by 3% a year between the 16th and the 25th year (reaching 80% after 25 years) and by 2% a year until the 35th year (reaching 100%).

Pensions are, in principle, adjusted annually in line with the consumer price index, but, in practice, they have increased in real terms in recent years, particularly the guaranteed minimum pensions which raise low contributory pension entitlements to the guaranteed level.

Two mechanisms contribute to providing minimum pensions: a guaranteed minimum contributory pension and non-contributory pensions. The earnings-related pensions are topped up to the minimum levels for pensions. The share of pensioners receiving top-ups, which was 28.3% in 2005, declines as a result of the higher pension entitlements of new retirees (the propor-

tion of new pensioners eligible for top-ups decreased from 30.1% in 1995 to 18.4% in 2004). Introduced in 1990, non-contributory pensions cover 6.3% of pensioners and provide a means-tested guaranteed minimum income for those without earnings-related pension benefits (e.g. because of insufficient contribution periods or a lack of contributions). In addition, pensioners can benefit from additional services: right to healthcare, social services and future protection through new legislation focused on situations of dependency.

Supplementary pension schemes of the second or third pillar were estimated to cover nearly 7.3 million people in 2003 (around 41% of the employed). As a result of the development of occupational pensions in the public sector, the number of members increased by more than 500 000 in 2004. Along with this, autonomous communities are promoting parallel schemes, which could increase the total number of members by 2 million approximately. Pension plans tend to be more often adhered to on an individual basis or through membership in a group (association, trade union, etc.) and about 10% of the members participate in an occupational scheme established by a collective agreement. The benefits can be drawn in the form of regular or lump-sum payments covering retirement, invalidity, death and survivors' benefits. In 2003, about 40% of pension plan beneficiaries chose to take only lump sum payments (corresponding to around 60% of benefits). Proportions are comparable for individual insurance beneficiaries.

The legal framework for private pension provision was reformed in 2002 regulating in particular the tax treatment of these schemes and enhancing the protection of beneficiaries. The book reserve financing system traditionally used for occupational pension plans is being abolished (except in the financial services sector, for the staff who were employed prior to 1999) in favour of external funds to enhance the safety of pensions in the event of bankruptcy of the employer company.

Individuals can have a choice of personal pension plans (made up of individual pension plans and group pension plans) and individual insurance contracts, enjoying the same fiscal treatment as pension plans.

## 2. Situation and perspectives in light of common objectives

### 2.1. Current situation

The living standard of people aged 65 or more represents 78% of the 0–64 population, with a small gap between men (75%) and women (81%) (albeit not in terms of individual pension entitlements). Inequality of income is comparable among the population of 65 and more than among the 0–64 population (as measured by the ratio of the fifth quintile to the first quintile of income).

The statutory scheme provides a high replacement rate for low or average wages (about 91% of gross replacement rate and 97% of net replacement rate for a worker retiring at 65 after 40 years of contributions), which decreases for higher wages, due to the ceiling.

The risk of poverty for people aged more than 65 was 28% in 2002 (at the 60% threshold), which is higher than for the general population (19%), although the share of pensioners that are not eligible for the earnings-related pension is decreasing. Poverty is slightly higher among older pensioners (31% for people aged 75 and more).

The general employment rate has increased by more than 10 p.p. since 1996 up to 61% in 2004, mainly driven by an increase in women's employment and foreign workers entering the system, and employment growth is expected to continue, according to recent national sources<sup>(49)</sup>. In the meantime, the employment of workers aged 55–64 increased by 8 p.p., with a 2004 level of 413%, still below the Lisbon target. The Spanish employment rates for women remains amongst the lowest, thus providing considerable potential for employment growth and hence a stronger contribution base for financing pensions. The large numbers of foreign workers are expected to continue to sustain the relatively fast employment growth in Spain.

Measures to reduce women's unemployment focus on promoting education and training and on reducing employers' social contributions if women are given

open-ended contracts. Moreover, some steps have been made to facilitate the reconciliation of family and work responsibilities through measures such as the extension of the right to a reduced working day or leave for people who are caring for dependent people (not only children) and through the facilitation of paternity leave (as an alternative to maternity leave).

In recent years, some steps were taken with the aim of increasing the employment rate of older people notably through better opportunities for flexible and gradual retirement. Working beyond the age of 65 now allows an individual to accrue higher pension entitlements, whilst it is also possible to draw a (partial) pension while continuing to work after 65. It is also possible to receive an early retirement pension at the age of 61, for people who are registered as unemployed, are actively looking for a job and have long contribution histories. Furthermore, Spain seeks to promote the employment of people over 45 through considerable reductions of social security contributions.

Thanks to sustained economic growth and the discipline required by the budgetary stability law, Spain has made major efforts to achieve balanced budgets both at the level of the central government and in the sub-sectors of the general government (autonomous communities and local authorities). Moreover, the social security system shows surpluses since 1999. These surpluses have been transferred to the reserve fund created in 1997 to help to cover increased future pension expenditure. In July 2005, the assets of the fund amounted to 3.2% of GDP. The accumulation of funds will continue as long as the social security system produces surpluses, which is projected to be until 2015.

Although eligibility requirements and ways of calculating pensions awarded are neutral according to genders, poverty rates are slightly higher among women (30% for women and 26% for men) and the proportion of women receiving minimum pensions is greater than that of men (the difference is reducing mainly due to the increasing number of women in the labour market). Contributions are provided during the first year of unpaid leave for the care of children (or dependent family members). Moreover, minimum contribution periods entitling a worker to a pension are calculated

(49) According to recent national data, the number of foreigners covered by the Social Security system increased from around 330 000 in 1999 to around 1 700 000 in 2005, the increase being essentially from non EU-25 foreigners.

by multiplying the time worked by a factor of 1.5 for part-time workers, which increases the pension entitlements of part-time workers (about 3% of men and 18% of women in employment).

In terms of transparency and information for citizens, workers are being offered substantial information on their pension rights, in particular through the social security website which is continuously updated.

## 2.2. Outlook, reform measures and policy debates

Due in particular to low fertility rates, Spain faces one of the largest increases in the old-age dependency ratio in the EU over the coming 50 years: the old-age dependency ratio will increase from 25% in 2004 (in line with the EU-25 average) to 67% in 2050 (above EU-25 average of 52%). In recent years important regularisations of migrants have occurred and future demographic developments (and hence the old-age dependency ratio) will also depend on migratory flows which are projected to stabilise at a lower level in the future compared with the recent high flows but are difficult to predict. However, as a consequence of low birth rates during the Spanish Civil War, Spain will experience the impact of ageing somewhat later than most other Member States.

Spain is trying to tackle the issue of adequate and sustainable pensions on the basis of a large political consensus. The Toledo Pact concluded in 1995, put into law in 1997 and renewed in 2003 and the Declaration for Social Dialogue of July 2004 represent important steps forward in facilitating the management of the financing of the social security system, in particular by separating contributory from non-contributory benefits, the latter being financed through the general budget.

According to the new projections of replacement rates of the ISG, the replacement rate provided by the earnings-related scheme for average earning workers, retiring at 65 after 40 years of contributions should decrease by 6 p.p. in 2050, reaching a level of about 85% of gross replacement rate for the average wage in 2050 (92% of net replacement rate).

Recent reforms should reduce poverty rates amongst pensioners in the near future. In January 2004, survivors' pensions and minimum pensions were increased

(on average by about 6%), while in January 2005, the government initiated an increase in minimum pensions (ranging from 6% to 8%, depending on why the recipient was entitled to the benefit) as part of an overall announced increase of 26% of minimum pensions over the legislature. It is expected that reforms of minimum and survivors' pensions will translate into a reduction of gender differences in living standards and poverty risks.

In 2005 the government also modified the means; test of minimum pensions, by taking into account increases in value of personal assets. The government also wishes to increase coverage of occupational pension provision, notably through changes to fiscal incentives for pension funds, in order to encourage the use of annuities after retirement age, instead of lump sums.

Low participation rates and high unemployment, particularly among older people and women, are being addressed by a number of new reform efforts. Exemptions of social contributions for older workers range from around 50% and can reach 100% for workers aged 60 or over who are on permanent contracts and who have been with the company for at least five years. Furthermore, the unemployment protection system has been reformed allowing workers aged over 52 to draw unemployment benefits while working. A draft law has been approved regarding work beyond the normal retirement age, reflecting the clauses of collective agreements, limiting the scope for employers to terminate a contract when a worker reaches legal retirement age (65), subject to several conditions linked to quality of employment. The government plans to propose measures that could contribute to significantly strengthening incentives to work longer, through establishing a closer link between the level of contributions and the level of benefits for earnings-related pensions, and to simplify early retirement schemes and bring them closer to the legal retirement age. Moreover, the government proposes calculating the level of permanent incapacity pensions according to the number of years of contributions in cases where the pension is for a non-work related accident or illness. It also plans to tighten controls of temporary incapacity and to overhaul the widow's pension system, by reducing payment in cases where the recipient has a high level of personal income, or is receiving large social security pensions.

Demographic trends are expected to translate into pressure on the public finances in Spain. According to projections made by the AWG in 2005, public spending on pensions is set to increase from 8.6% to 15.7% of GDP, far more than the EU average<sup>(50)</sup>. Nearly the entire increase is projected to occur after 2020, due to Spain's relatively late ageing profile. Surpluses of social security should accumulate in the reserve fund until 2015; between 2015 and 2020, the fund should cover any deficits but not beyond this point. Further measures proposed by the government would open the possibility to prolong this period. All age-related expenditure is projected to increase from 19.6% to 27.9% of GDP, somewhat more than spending on pensions alone.

The conclusions of the renewed Toledo Pact underline the importance of dialogue with the social and economic players involved when it comes to monitoring both present and future reform measures. They also recommend that after five years Parliament should revise compliance with the recommendations using specific parliamentary instruments, in order to offer an ongoing assessment of the problems and variables associated with an ageing population. A permanent observatory of the evolution of the social protection system is to be created to carry out an ongoing analysis of the system and to make proposals for the legislative changes necessary to address the problems caused by the ageing population.

### 3. Conclusion

Recent reforms, in particular through a strengthened link between contributions and benefits and the gradual implementation of the reform of minimum pensions should translate into improvement of adequacy.

Spain faces a major challenge with regard to financial sustainability due to demographic trends. Nearly all the pension expenditure increase is projected to occur after 2015. Although, according to the National Strategy Report, the reserve fund will cover any deficits until 2020, additional reforms to ensure the financial sustainability of the pension system in the long term will soon be necessary to ensure a smooth transition. In this regard, actual work in the Social Dialogue Table on Social Protection has been recently intensified.

Given the low female employment rate and the low participation rate of older people, further efforts are also necessary in order to enable a higher participation in the labour market. This could be achieved through further measures proposed by the government, notably a closer link between the level of contributions and the level of benefits for the earnings-related pensions and further facilitating of flexible and gradual retirement, as well as further restrictions of early retirement schemes.

(50) According to projections of the 2005 NSR, public spending on pensions is set to increase from 7.7% in 2005 to 14.5% of GDP in 2050.

## 4. Background statistics

	ES			EU-25				
Adequacy								
Current situation								
	Total	Men	Women	Total	Men	Women		
At-risk-of-poverty rate <sup>(1)</sup>	20	19	21	16	15	17		
0–64	18	18	18	16	16	17		
65+	30	27	32	18	15	20		
75+	34	32	35	Nd	Nd	Nd		
Income inequality <sup>(1)</sup>								
0–64	5.2							
65+	4.2							
Income of people aged 65+ as a ratio of income of people aged 0–64 <sup>(1)</sup>	0.77	0.79	0.76					
Median pensions relative to median earnings <sup>(2)</sup>	0.63	0.64	0.62					
Long-term projections								
Theoretical replacement rates <sup>(3)</sup>	2004	2030	2050					
Total net replacement rate	97	92	92					
Total gross replacement rate	91	85	85					
Gross replacement rate 1st pillar	91	85	85					
Gross replacement rate 2nd/3rd pillar	(*)	(*)	(*)					
Financial sustainability								
Current situation								
Esspros Pension expenditure <sup>(4)</sup> , % of GDP	1995	2000	2003	1995	2000	2003		
	10.3	9.6	9.2		12.5	12.6		
Employment (2004) <sup>(5)</sup>	Total	Men	Women	Total	Men	Women		
Employment rate (25–54)	72.7	86.1	58.9	76.8	85.2	68.5		
Employment rate (55–64)	41.3	58.9	24.6	41.0	50.7	31.7		
Effective labour market exit age (2004) <sup>(6)</sup>	62.2			60.7p				
Public finances (2003) <sup>(7)</sup>								
Public debt, % of GDP	50.7			63.3				
Budget balance, % of GDP	0.4			-2.8				
Long-term projections (EPC 2006)								
	2004	Level 2030	2050	Increase 2004–50	2004	Level 2030	2050	Increase 2004–50
Old-age dependency ratio <sup>(8)</sup>	24.6	38.2	65.6	+167%	25	40	52	+108 %
Public pensions expenditure, % of GDP <sup>(9)</sup>	8.6	11.8	15.7	+7.1	10.6	11.9	12.8	+2.2
Factors determining the evolution of public pensions expenditure (2000–50) <sup>(10)</sup>	Contribution to change in percentage points of GDP				Contribution to change in percentage points of GDP			
Demographic dependency	12.4				8.6			
Employment	-1.8				-1.1			
Eligibility	-2.3				-2.1			
Level of benefits	-0.8				-2.7			
Total (including residual)	7.0				2.2			

### Notes

<sup>(1)</sup> Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).

<sup>(2)</sup> Source: Eurostat. Median individual pension income of retirees aged 65–74 in relation to median earnings of employed persons aged 50–59 excluding social benefits other than pensions.

<sup>(3)</sup> Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first- and second-pillar pension schemes, retiring at the age of 65 years in 2005.

<sup>(4)</sup> Source: Esspros, Eurostat. Includes expenditure by certain private social protection schemes.

<sup>(5)</sup> Source: European Labour Force Survey, 2004.

<sup>(6)</sup> Source: European Labour Force Survey, 2004.

<sup>(7)</sup> Source: European Commission, DG ECFIN.

<sup>(8)</sup> Source: Eurostat (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15–64.

<sup>(9)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.

<sup>(10)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.

(\*) Negligible proportion

## France

### 1. Main characteristics of the pension system

The French retirement system is essentially made up of statutory pay-as-you-go schemes, which account for about 98% of total pension expenditure and are financed by social security contributions and taxes.

The functioning of these schemes varies according to the sector of activity. The scheme covering employees of the private sector absorbs about 63% of total expenditure. This general scheme, with strong solidarity elements, cohabits with statutory supplementary schemes established by collective agreements and are pay-as-you-go financed, in which benefits are calculated on the basis of a point system, ensuring a close link between benefits and contributions. Financial equalisation mechanisms exist between the various schemes.

Compulsory schemes for farmers and liberal professions also have a two-tier architecture. Civil servants and the employees of public sector companies are covered by several special schemes organised in one tier only, which account for 28% of pension expenditure.

Elderly people and the households to which they belong benefit from a minimum pension in the form of a means-tested complement (to pensions paid by other arrangements). The level of the minimum gross pension for one person was EUR 599 per month in 2005, corresponding to about 45% of the median equivalised income at the time. The number of beneficiaries has been declining for decades, due to the progressive increase of pension rights in the statutory schemes; in 2003 about 630 000 people (5% of people aged more than 65) benefited from the minimum pension.

The extensive role that the statutory pay-as-you-go scheme in France leaves little room for the development of voluntary, individual or sectoral schemes, which nevertheless benefit from tax incentives. The most recent reforms also encouraged the development of privately-managed pension provision. Introduced in 2004, in the framework of collective investment undertakings directives, the PERCO is a plan created at the enterprise or branch level, while social partners are to negotiate professional branches agreements on the creation of PERCOs. Two types of individual pension

provisions are encouraged by tax deductions: life insurance and since 2004, the PERP, an individual retirement plan, both under insurance directives.

### 2. Situation and perspectives in light of the common objectives

#### 2.1. Current situation

Concerning **adequacy**, pension income accounts for more than 80% of all income of persons aged 65 and over. When one takes all sources of income into account, it is noticeable that the living conditions of pensioners are very close (90%) to those of the working population.

The general poverty risk at 14% is close to that of the European average. Pensioners are exposed to a slightly higher risk of poverty (16% in 2003) than people in the age group 0–64 (13%).

Achieving **financial sustainability** in light of the projected increase of demographic dependency ratio during the coming decades can be seen as a key challenge. According to Esspros figures, pension expenditure was at 13% of GDP in 2003, slightly above the EU average (12.6% of GDP).

Reforms of the pension system in 1993 were widened to the public sector in 2003. These reforms limit the increase in pension expenditure by increasing the number of years of service required to obtain a full pension from 37.5 to 40 years and by confirming pension indexation (based on prices only, while in 2003 the rules of indexation of the ARRCO statutory complementary scheme were reformed, the accumulation value of points being indexed on wages, while the decumulation value was indexed on prices). These reforms should encourage an increasing number of people to retire after 60 (in order to obtain a higher pension).

Incentives to extend working lives have been strengthened and will gradually be harmonised between public and private sectors (system of *décote-surcote*): the reform introduces a bonus (of 1.5 p.p. of replacement rate for every year worked beyond 60 with 40 years



of service in the general statutory scheme), while a progressive harmonisation towards a malus (of 2.5 p.p. of replacement rate per missing year is foreseen by 2015 in the general statutory scheme)<sup>(51)</sup>. The 2003 reform also includes the possibility for an individual to retire before 60 where they have at least 42 years of service (under certain conditions).

In addition, the latest reform envisages a rise of 0.2 p.p. of contributions to old-age pensions from 2006 and the use of unemployment contributions within the pension system, if unemployment falls sufficiently, while assets of the general statutory scheme are planned to be accumulated until 2020 (*Fonds de réserve des retraites*, FRR).

The reform also proposes a further rise of one year to the number of contributory years required for a full pension, between 2009 and 2012 for employees of the public and private sectors. Thereafter, the length of contribution will periodically be revised (every four years) so as to develop in line with increases in life expectancy.

Employment rates for 55–64 year olds are far below the Lisbon target (37.3% in 2004) in spite of an increase in recent years. It should be noted that recent reforms will only achieve their full effectiveness if they are accompanied by a concurrent increase in the employment rates of older workers. This is also linked to the evolution of entry flows in schemes enabling early exit from the labour market (in particular through early retirement and unemployment).

With the reform of 2003, an important step was taken for the **modernisation** of the retirement system, especially by reducing differences between the pension schemes of the public and private sectors and by proposing a rise in the number of contribution years necessary to obtain a full pension in accordance with increases of life expectancy. There are no significant gender differences in relation to pension adequacy. Nevertheless, the important diversity among pension schemes (in particular in relation to the accrual of rights and the formulae of calculation of pensions for some of the special schemes) makes it important to improve the transparency of the pension system as a whole.

There are plans to develop information to be provided to active persons regarding the future level of their pensions. The latest reforms will see the development of pension forecasts for active people by late 2005–early 2006 and it is planned that individual information and estimation of pension rights will be provided from 2007.

## 2.2. Outlook, reform measures and policy debates

Even if fertility rates remain high in comparison with European levels, life expectancy is also high and the projections are for a continuation of this rising trend. On the whole, projections reveal a slight population fall from 2040. The demographic dependency ratio should increase somewhat slower than the average EU, from 25% in 2003 to 46% in 2050 (while the EU average is projected to be 52% in 2050).

According to the calculations carried out in the framework of the ISG, total net theoretical replacement rates represent 80% of net income (66% gross) for a worker retiring at 65 after 40 years of contributions at the average wage. However, projected replacement rates are expected to significantly decline in the future. For instance, in the case of a worker retiring at 65 after 40 years of career at the average wage, the net replacement rate will decrease from 80% in 2005 to 63% in 2050 (gross replacement rate would decline from 66% to 49%). This decline is due in the main to the latest reforms of the general statutory scheme and to the latest reforms of the statutory complementary schemes.

Pensioners on lower incomes should nevertheless be partly protected from this adverse trend as the latest reforms foresee an increase of net replacement rates for those earning the minimum wage of up to 85% by 2008. However, in the case of a worker retiring at 65 after 40 years of career at two thirds the average wage, current projections show a decline of the net replacement rate from 81% in 2005 to 62% in 2050 (from 66% to 49% for the gross replacement rate). As a consequence, the future level of pensions should be monitored closely, in particular for the most vulnerable groups of the population.

(51) The decrease corresponds to 1.25 by quarter and the increase to 0.75 by quarter. As this applies on the 'taux plein' of 50%, this corresponds for the replacement rate to yearly decreases of 2.5 percentage points and yearly increases of 1.5 percentage points in the general statutory scheme.



Despite the major pension reform in 2003, France is expected to face pressure on its public finances due to its ageing population, resulting in growing age-related public expenditure. According to the budgetary projections made by the AWG in 2005, public spending on pensions is expected to increase by a further 1.9 p.p. between 2004 and 2050, in contrast with the level of 3.7 p.p. increase projected in the 2001 AWG projections between 2005 and 2040<sup>(52)</sup>.

### 3. Conclusion

The financing of the pension system for the decades ahead has been significantly improved by the 2003 reform, which preserved the basic architecture of the current system and contributed to a more equitable treatment of members of different schemes, and, in particular, of public and private sector employees. However, further measures will be needed in order to put the pension system on a financially sustainable footing in the long run.

Current adequacy does not constitute a key issue as pensioners have a living standard and rates of pover-

ty close to the average. However, projected replacement rates are expected to decline significantly in the future. As a consequence, the level of pensions will have to be closely monitored, in particular for the most vulnerable groups of the population.

The employment rate of older workers remains relatively low, in spite of recent increases. Current reforms will only have their optimal effect, for ensuring both adequacy and sustainability, if they are actually accompanied by a significant increase of older workers in employment. While incentives to work longer have been strengthened by the last reform, further steps may be necessary as regards early exits from the labour market.

It will be important for the government to develop an effective and sustainable strategy to guarantee a greater participation of older workers in the labour market and to raise employment in general. Ensuring better opportunities for older workers is clearly an area in which social partners have an important responsibility.

(52) In the 2001 exercise of the AWG projections, pension expenditures for France were projected until 2040.

## 4. Background statistics

	FR			EU-25				
Adequacy								
Current situation								
	Total	Men	Women	Total	Men	Women		
At-risk-of-poverty rate <sup>(1)</sup>	14	13	14	16	15	17		
0–64	13	13	14	16	16	17		
65+	16	14	17	18	15	20		
75+	18	15	19	Nd	Nd	Nd		
Income inequality <sup>(1)</sup>								
0–64	4.2							
65+	4.2							
Income of people aged 65+ as a ratio of income of people aged 0–64 <sup>(1)</sup>	0.90	0.93	0.75					
Median pensions relative to median earnings <sup>(2)</sup>	0.72	0.72	0.74					
Long-term projections								
Theoretical replacement rates <sup>(3)</sup>	2004	2030	2050					
Total net replacement rate	80	66	63					
Total gross replacement rate	66	53	49					
Gross replacement rate 1st pillar	66	53	49					
Gross replacement rate 2nd/3rd pillar	(*)	(*)	(*)					
Financial sustainability								
Current situation								
Esspros Pension expenditure <sup>(4)</sup> , % of GDP	1995	2000	2003	1995	2000	2003		
	13.4	13.0	13.0		12.5	12.6		
Employment (2004) <sup>(5)</sup>	Total	Men	Women	Total	Men	Women		
Employment rate (25–54)	79.6	86.6	72.5	76.8	85.2	68.5		
Employment rate (55–64)	37.3	41.0	33.8	41.0	50.7	31.7		
Effective labour market exit age (2004) <sup>(6)</sup>	58.9			60.7p				
Public finances (2003) <sup>(7)</sup>								
Public debt, % of GDP	63.7			63.3				
Budget balance, % of GDP	-4.1			-2.8				
Long-term projections (EPC 2006)								
	2004	Level 2030	2050	Increase 2004–50	2004	Level 2030	2050	Increase 2004–50
Old-age dependency ratio <sup>(8)</sup>	25.2	40	46.4	+84%	25	40	52	+108 %
Public pensions expenditure, % of GDP <sup>(9)</sup>	12.8	14.3	14.8	+2.0	10.6	11.9	12.8	+2.2
Factors determining the evolution of public pensions expenditure (2000–50) <sup>(10)</sup>	Contribution to change in percentage points of GDP				Contribution to change in percentage points of GDP			
Demographic dependency	8.7				8.6			
Employment	-0.9				-1.1			
Eligibility	-1.8				-2.1			
Level of benefits	-3.5				-2.7			
Total (including residual)	2.0				2.2			

### Notes

<sup>(1)</sup> Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).

<sup>(2)</sup> Source: Eurostat. Median individual pension income of retirees aged 65–74 in relation to median earnings of employed persons aged 50–59 excluding social benefits other than pensions.

<sup>(3)</sup> Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first- and second-pillar pension schemes, retiring at the age of 65 years in 2005.

<sup>(4)</sup> Source: Esspros, Eurostat. Includes expenditure by certain private social protection schemes.

<sup>(5)</sup> Source: European Labour Force Survey, 2004.

<sup>(6)</sup> Source: European Labour Force Survey, 2004.

<sup>(7)</sup> Source: European Commission, DG ECFIN.

<sup>(8)</sup> Source: Eurostat (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15–64.

<sup>(9)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.

<sup>(10)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.

(\*) Negligible proportion

## Ireland

### 1. Main characteristics of the pension system

The first-pillar basic pension provides for flat-rate payments and is financed through pay-related contributions from employers, employees and the self-employed. Non-contributory pensions (slightly lower benefits) are payable on a means-tested basis to those without a sufficient social insurance record. Pensions paid out of this pillar are not related to previous income and are intended to provide for basic living expenses. Supplements are payable for dependants, for those living alone and to pensioners over 80. The pension payments are adjusted each year in line with targets set periodically by government and taking account of budgetary considerations. That said, pensions have been increasing faster than both the consumer price index and gross earnings, since the last NSR in 2002 (over 20%), while the rise in CPI over the period amounted to approximately 8%.

The old-age (insurance-based) pension currently pays an amount equivalent to approximately 32% of gross average industrial earnings. The means-tested pension pays slightly less. Payments have increased significantly in recent years and the government has committed itself to a policy of ongoing real increases to the basic pension rates until 2007 in order to reach a target rate of EUR 200 per week. At the same time, the share of those claiming means-tested pension payments has fallen since 1994 to 2004 from 45% to 30% and is projected to fall to 14% in 2017. The overall target is an income in retirement of 50% of gross pre-retirement income, including income from other sources (first-pillar pension, income from a supplementary pension, investments and other income).

Voluntary supplementary pensions account for approximately one quarter of overall income in retirement (2000). The role of supplementary pensions in the Irish system is to supplement the basic rate pensions provided through the social welfare system to ensure that income in retirement is related to the income received by a person when they were employed. The pensions can be provided through a person's employment or directly through pension providers such as banks or insurance companies. The State facilitates and encourages second- and third-pillar

pensions through favourable tax treatment of contributions and investment returns and by a regulatory system designed to safeguard pension entitlements. 33% of existing pensioners have an occupational or personal pension which contributed to about 25% of post-retirement income. However, the numbers with supplementary pensions are likely to grow in the years ahead due to the higher proportion of people in work participating in pension schemes (just over 59% of the workforce who are older than 30 years of age or 52.4% of all workers).

Approximately 69% of members of occupational pension schemes are in DB type with the remainder in defined-contribution schemes. Ireland has not seen the same level of shift from defined-benefit to defined-contribution pension provision as has been seen elsewhere, though the trend is still very apparent in the Irish system with most new schemes operating on a defined-contribution basis. In 2004 the Pensions Board reviewed the Funding Standard by which the health of defined-benefit schemes is measured. The Board's recommendation was to continue the current funding standard, which is a discontinuance standard, including the retention of temporary measures, introduced in 2003, for an extended funding period in certain circumstances, together with a modification of the calculation of the standard for active and deferred members.

### 2. Situation and perspectives in light of common objectives

#### 2.1. Current situation

Concerning **adequacy**, partly as a result of the quick rise of average wages and increases in household income resulting from improved labour force participation and reduced taxes, the incomes of older people have generally lagged behind those of the working age population. Pensioners' incomes are among the lowest in the EU-25, relative to the overall population. The relative income situation of older people (61% of 0–64 living standards) reflects the level of the basic pension paid by the State and the fact that Ireland is currently the only Member State without some form of compulsory income-related pension provision for a majority of workers.

Persons aged 65 or more are more than twice as likely as those aged 0–64 to be in poverty. In 2003 it stood at 40% (men 34%, women 45%) and for those aged 75+, it was 44% (men 35% and women 50%). With lower thresholds, the differences in poverty rate are significantly smaller, although the poverty rate in Ireland remains among the highest in the EU-25, probably reflecting the fact that the 60% threshold is higher than the flat-rate pension. This high risk of poverty for elderly persons can be partly explained by the uniquely rapid increase in household incomes over the last decade (around 100% from 1994 to 2001)<sup>(53)</sup>.

The expansion of occupational pension coverage seems not to have developed as the Irish government expected. It is considered that supplementary pension cover is essential for up to 70% of the workforce who are over 30 years of age (currently only 59%), if they are to obtain a pension that will maintain a reasonable replacement of their pre-retirement standard of living. The coverage target for workers in general is 60% and currently stands at 52.4%. Introduction of PRSAs in 2003, enabling individuals with no supplementary pension cover or with inadequate cover to begin saving, led to 59 000 opening a PRSA account by September 2005.

Concerning **financial sustainability**: Employment rate of older persons rose in the past 10 years by 10% to 50% in 2004 and remains in line with the Lisbon target. This rise was driven by an increase in the movement of non-employed into jobs rather than by a delay in retirement. The increase was mainly due to women entering jobs from home duties, though previously unemployed men made a significant contribution as well. However, labour participation of women in the 55–64 cohort is 31.3 p.p. lower than their male counterparts. Early retirement is common in Ireland. Two thirds of people who had already retired had left employment before age 65. The most common reason, which accounted for one third of early retirements, was illness or disability.

Concerning **modernisation**, equal treatment between men and women in the context of occupational pensions was introduced under Part VII of the Pensions Act 1990. Legislation permits the different treatment of men and women in schemes, based on actuarial fac-

tor, to enable the achievement of equality of outcomes. Recent research shows that the overall average income of women in retirement is much lower than that of men. The difference between gender incomes is due to the differences in supplementary provision. Women tend to have lower earnings than men over their working lives and have consequently lower private pension coverage rates (which contribute to 18% of their income, as compared to 41% for men).

In view of the important role of occupational schemes in the Irish pension system, it will be important to ensure not only improved access for all workers, but also greater portability of pension rights, particularly under defined-benefit schemes. The Pensions (Amendment) Act 2002 reduced maximum vesting periods to two years and also improved transfer, preservation and the revaluation of entitlements for members of occupational pension schemes. PRSAs pension entitlements can be maintained without penalty when an account holder changes or ceases employment.

## 2.2. Outlook, reform measures and policy debates

Regarding demographic developments, Ireland is expected to face more favourable demographic trends than most other EU Member States. The old-age dependency ratio is projected to grow from the EU-25 lowest 16% in 2004 to 45% in 2050, still among the lower ratios in the European Union, while the currently high fertility rate is assumed to decrease to EU-15 level. Theoretical pension replacement rates are expected to stay stable until 2050 (67% total gross and 78% total net).

The government has declared its obligation to raise basic pensions and supplements for dependent spouses and partners significantly, so that the lowest pension will reach EUR 200 per week by 2007. The two main challenges for financial sustainability arises firstly from the ageing of the population resulting in greater public pension costs and a declining ratio of contributors to pensioners and secondly from the maturing of the social insurance scheme as the extension of cover in recent decades translates into a growing proportion of those who reach pension age qualifying for a non-means-tested pension in their own right.

(53) The underlying adjustments in the basic pensions from more than 20% since 2002 could not reduce the risk of poverty but consistent poverty. The overall percentage of persons aged over 65 experiencing consistent poverty (percentage below 70% of median income, national figures) fell from 8.4% in 1997 to 3.9% in 2001.

According to the AWG 2005 projections, public spending on first-pillar pensions (including public service pensions) is projected to rise from 4.6% of GDP in 2004 to 11.1% in 2050. The rise is relatively continuous and stable over the whole period. Ireland is expected to experience growing pressures from ageing populations on its public finance system, but somewhat later than most of the EU countries, while in the first part of the projection period the increasing pension level due to the maturing of the social security pension system will push expenditure level up. However, the current stance is far from being alarming and significant reserves have been and are being accumulated with the aim of preparing to deal with the ageing of the population.

A key element of the Irish strategy is to build up a reserve fund to partially pre-finance public pensions to be paid out after 2025. The assets of the Reserve Fund will be drawn down from 2025 until at least 2055. The government is required by law to contribute 1% of GNP to the fund each year. The current amount of assets, at 9.6% of GNP, is estimated to reach a level of 43% by 2025.

In order to reduce early retirement, Ireland may consider tightening the conditions for early retirement, increasing the contributions required for full pensions, providing for flexibility in the retirement age, creating incentives for workers who want to remain in the labour market after the age of 65 and facilitating a gradual move into retirement through changed working arrangements. There are no plans at present to increase the retirement age. Increasing female participation in the labour market is likely to reduce the differential between male and female retirement incomes in the longer term.

Recognising the need to monitor the sustainability of the Irish pension system, the government decided in 1998 to carry out regular actuarial reviews of the financial situation of the Social Insurance Fund (SIF); the capacity of the National Pension Reserve Fund to meet future pension liabilities is also to be assessed regularly. The second review of the SIF covered the period 2001–56 and focused on the adequacy of current contribution rates under alternative scenarios for indexation and target levels of pensions.

The adequacy of DC arrangements needs to be closely monitored. Quality information needs to be furnished to such members in order to protect their rights and allow them to make informed decisions. Further proposals for measures to increase the participation in supplementary schemes are expected from the Pension Board at the end of 2005. These and related issues are addressed through the provision of better information at a general level. In addition, disclosure regulations are currently being amended to further protect members through the compulsory provision of better quality information.

### 3. Conclusion

Ireland has made progress in making provisions for increasing the adequacy of pensions and further steps have been announced by the government. Pensions (and in particular the lowest pensions) have been increasing faster than both the consumer price index and gross earnings, since the last NSR in 2002. Nevertheless, an extended coverage of supplementary pension provisions is important to ensure the effectiveness of the income replacement function of pension systems.

The government is committed to accumulating a considerable reserve fund in order to partially pay for future liabilities. The public system therefore appears to be, in broad terms, financially sustainable despite projected major increases in future pensions expenditure. The commitment to monitoring the adequacy of contribution rates through regular actuarial reviews should help to react to indications of a need for adjustments, and thus help to keep the system on a sustainable footing.

The national strategy report pointed out that early retirement is common in Ireland, though the effective retirement age of workers remains higher than in most other EU countries. The main reasons for early retirement include illness or disability and the availability of occupational retirement pensions which allow for retirement before age 65. Although employment rates of older workers have already reached the European target of 50%, further strengthening of incentives to work longer would contribute to ensure future adequacy and sustainability.

## 4. Background statistics

	IE			EU-25				
Adequacy								
Current situation								
	Total	Men	Women	Total	Men	Women		
At-risk-of-poverty rate <sup>(1)</sup>	21	19	23	16	15	17		
0–64	19	17	20	16	16	17		
65+	40	34	45	18	15	20		
75+	44	35	50	Nd	Nd	Nd		
Income inequality <sup>(1)</sup>								
0–64	5.1							
65+	3.4							
Income of people aged 65+ as a ratio of income of people aged 0–64 <sup>(1)</sup>	0.62	0.63	0.61					
Median pensions relative to median earnings <sup>(2)</sup>	0.63	0.64	0.62					
Long-term projections								
Theoretical replacement rates <sup>(3)</sup>	2004	2030	2050					
Total net replacement rate	78	78	78					
Total gross replacement rate	67	67	67					
Gross replacement rate 1st pillar	31	34	34					
Gross replacement rate 2nd/3rd pillar	36	33	33					
Financial sustainability								
Current situation								
Esspros Pension expenditure <sup>(4)</sup> , % of GDP	1995	2000	2003	1995	2000	2003		
	5.0	3.6	3.9		12.5	12.6		
Employment (2004) <sup>(5)</sup>	Total	Men	Women	Total	Men	Women		
Employment rate (25–54)	76.8	87.8	65.8	76.8	85.2	68.5		
Employment rate (55–64)	49.5	65.0	3.7	41.0	50.7	31.7		
Effective labour market exit age (2004) <sup>(6)</sup>	62.8			60.7p				
Public finances (2003) <sup>(7)</sup>								
Public debt, % of GDP	32.1			63.3				
Budget balance, % of GDP	0.1			-2.8				
Long-term projections (EPC 2006)								
	2004	Level 2030	2050	Increase 2004–50	2004	Level 2030	2050	Increase 2004–50
Old-age dependency ratio <sup>(8)</sup>	16.4	28.3	45.2	+176 %	25	40	52	+108 %
Public pensions expenditure, % of GDP <sup>(9)</sup>	4.6	7.9	11.1	+6.4	10.6	11.9	12.8	+2.2
Factors determining the evolution of public pensions expenditure (2000–50) <sup>(10)</sup>	Contribution to change in percentage points of GDP				Contribution to change in percentage points of GDP			
Demographic dependency	7.9				8.6			
Employment	-0.5				-1.1			
Eligibility	-1.4				-2.1			
Level of benefits	0.8				-2.7			
Total (including residual)	6.5				2.2			

### Notes

<sup>(1)</sup> Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).

<sup>(2)</sup> Source: Eurostat. Median individual pension income of retirees aged 65–74 in relation to median earnings of employed persons aged 50–59 excluding social benefits other than pensions.

<sup>(3)</sup> Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first- and second-pillar pension schemes, retiring at the age of 65 years in 2005.

<sup>(4)</sup> Source: Esspros, Eurostat. Includes expenditure by certain private social protection schemes. The value of pension expenditure for Ireland is underestimated as data on occupational pension from private sector employees with constituted reserves are not available.

<sup>(5)</sup> Source: European Labour Force Survey, 2004.

<sup>(6)</sup> Source: European Labour Force Survey, 2004.

<sup>(7)</sup> Source: European Commission, DG ECFIN.

<sup>(8)</sup> Source: Eurostat (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15–64.

<sup>(9)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.

<sup>(10)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.

(\*) Negligible proportion



## Italy

### 1. Main characteristics of the pension system

In 2004 Italy undertook new pension reforms, building on previous reforms of those in 1992, 1995 and 1997. The reforms of the 1990s have progressively unified the basic rules of a previously fragmented **statutory pension system**. Most of the schemes are administered by the social security institution for the private sector (INPS) which accounts for two thirds of expenditure and insures the majority of private sector employees and the self-employed. Public sector employees' pensions are administered by a separate institution (INPDAP).

100% of the registered employed population in Italy are covered by the statutory pension schemes, including old-age, invalidity and survivors' pensions. The pension contributions amount to 32.7% of employees' gross remuneration (8.9% paid by the employee and 23.8% paid by the employer). The self-employed and some workers with atypical contracts (*parasubordinati*) pay around 17.5%, gradually increasing to 19%.

The 1995 reform of the statutory pension is leading to a gradual shift from the current defined-benefit scheme to a notional defined-contribution scheme, applied fully to all entrants in the labour market from 1996.

Under the new system, benefits are calculated on the basis of the amount of contributions paid throughout the entire career, capitalised at the average growth rate of GDP over the previous five years. Such notional capital is multiplied by age-of-retirement-specific transformation coefficients (similar to the annuity rates in private schemes) to obtain the final pension settlement.

To workers with a contributory record equal to or exceeding 18 years on 31 December 1995, the previously defined benefit system applies, as amended by the reforms. Accordingly (till the end of 2007), entitlements to the old-age pension are acquired at the age 65 for men and 60 for women (with a minimum requirement of 20 years of payments); entitlement to the seniority pension is acquired at age 57 (58 for self-employed workers) with 35 years of contributions, or at any age, with 38 years of contributions (2005, rising to 39 in 2006 and 40 in 2008).

Workers with less than 18 years of contribution at the end of 1995 have their pension calculated in part with the old (taking into account both old-age and seniority pensions) and the new system (mixed system), according to the proportion of working life spent in the both regimes.

The pension reforms of 2004 introduced an increase in the legal retirement age for seniority pensions and in the new defined-contribution system in 2008, from 57 to 60 years (the additional requirement of 35 years of contributions remains unchanged and the age requirement is 1 year higher for the self-employed). The age requirement will increase further for men to 61 from 2010 to 2014, and to 62 from 2014 (still with 35 years of contributions). Women will be allowed until 2015 to retire on seniority pensions at 57 years with 35 years of contribution, although in that case, they will have to choose to have their pension entirely calculated by the new notional defined-contribution system. Nevertheless, even after the 2004 reform it will be possible to retire regardless of age, with 40 years of contributions.

The 2004 reform also doubles the time a worker has to wait between the moment they attain the right to a seniority pension and the moment they can actually retire: 9 months on average for employees, and from 7.5 to 15 months on average for the self-employed.

In the old system top-up benefits are available to raise the lowest contributory pensions to a **minimum** level, while older people without sufficient income can claim a social assistance pension. In the new system the minimum mirrors the social assistance pension, which can be claimed after 65 and is means-tested. The minimum and social assistance pensions are increased for those aged 70 and over by EUR 7.069/year.

**Occupational schemes** are represented by supplementary, voluntary funded pensions. The reformed system (created in 1993) is based on three options: closed (negotiated) funds regulated by collective agreements; open funds managed by financial intermediaries that can be joined by workers individually or in groups; and pension insurance policies. According to the 2004 reform (applied from 2008), the TFR (*Trattamento di Fine Rapporto*) 'end-of-service allowance' (a por-



tion of the worker's pay set aside by the employer and then paid as a lump sum at the end of employment) will be automatically transferred to occupational pension schemes (except in the case the employee refuses it, according to the so-called 'silent-assent' mechanism). This should favour the development of supplementary benefits. In 2001, the participation rate in supplementary schemes (both open and closed) was around 10% of the employed population. In 2003, occupational open and closed funds assets represented about 3% of GDP.

All forms of private pension arrangements are favoured by tax incentives. Contributions up to 12% of gross earnings (with a cap of EUR 5 164.57) are tax exempt while pension funds' financial returns are taxed at 11% and private pension benefits are taxable only for the part not already subject to taxation at the previous stages (hybrid ETT system). The 2004 reform aims at further strengthening fiscal incentives to private pension funds. Pension insurance policies cover around a further 2.3% of the working force.

## 2. Situation and perspectives in light of the common objectives

### 2.1. Current situation

**Adequacy:** Older people experience close to average living standards (the living standard of people aged 65 or more is 95% of those aged 0–64). Inequality of income distribution among people aged 65 or more is lower than among the overall population. In 2003, the risk of poverty of people aged 65 or more was, at 16%, slightly below the average rate of the age group 0–64 (of 20%). But regional differences remain vast with poverty still overwhelmingly concentrated in the south (two thirds of all families at risk of poverty live in the south, which accounts for only one third of all families). Besides, the poverty rate of people aged 75 and more is close to the one of people aged 65 and more, partly reflecting the increase in the minimum pension and social assistance pension for people aged 70 and over introduced in 2002.

According to ISG calculations, a current worker, on average earnings, retiring in Italy today at 65 after 40 years of contributions can expect a gross replacement rate of 79% with all pension income arising from the statutory scheme (net replacement rate of 88%). Due to

the index-linking of pensions in payment to prices, the replacement rate after 10 years in retirement is lower (68% of gross replacement rate). Replacement rates for a worker on average earnings retiring today at 60 after 35 years of contributions are about 10 percentage points lower. This is relevant as actual data show that the average insurance record amounts to not more than 32.1 years for the new flow of retirees in 2004 while the effective age of withdrawal from the labour force was, in the same year, around 61.

**Sustainability:** Italy spends about 14% of its gross domestic product on pensions. The social insurance pension system currently runs a deficit of 0.8% of GDP. The 2004 reform aims to make annual savings of 0.7% from about 2013 to the early 2030s.

The large numbers of undeclared jobs – many of them held by pensioners – remain an issue. To tackle this issue the possibility of cumulating, without losses, work and pension income was extended in 2001 and 2002. Italy acknowledges that late entry into the labour market is a challenge that needs to be addressed by appropriate policies.

In spite of recent increases, a major challenge – and an opportunity for ensuring future adequacy and financial sustainability – is the low employment rate in general (57.6% in 2004) and for 55–64 year old workers in particular (30.5% in 2004). As long as the old rules apply, disincentives to continue to work are strong. The gradual increase of minimum eligibility requirements for public pensions coupled with new incentive mechanisms (introduced in 2004) are a concerted attempt to incentivise work for this particular cohort. Until the end of 2007, private sector employees have the opportunity to continue working, while freezing their pension benefits and cashing their pension contributions on a tax-exempt base.

Concerning **modernisation**, the 2004 reform improves portability of pension rights within the statutory pension system, and increases transparency of the private pension system and information on costs and prospective returns, aiming at guaranteeing full transferability among private pension schemes and competition in the private pension sector. It also continued to pursue the harmonisation process of the different statutory pension schemes rules. Although there is a trend towards equalisation of retirement ages, differences will remain after 2008.

Preventing future adequacy problems will also require improvements in the social protection of workers in flexible forms of employment, and with a special status of self-employment, mainly characterised by a close and continuous relation to a single company (*parasubordinati*).

## 2.2. Outlook, reform measures and policy debates

Italy is expected to face strong adverse demographic trends in coming decades, due in particular to one of the lowest fertility rates in the EU and the highest life expectancy (82.8 years for men and 87.8 years for women by 2050). The demographic changes will lead to a sharp rise in the old-age dependency ratio, which is already now the highest in the EU. Between 2004 and 2050 it is expected to increase from 29% (compared to the EU-25 average of 25%) to 65% (compared to the EU-25 average of 52%).

The gradual transition to the new notional defined-contribution public pension scheme will lead to a progressive decline in the gross replacement rate from the statutory scheme. According to ISG calculations, for a worker contributing 40 years on average earnings and retiring at 65, the gross replacement rate will decline from 79% today to 64% in 2050. For people retiring at 60 after a career of 35 years, the decline in replacement rates is even more pronounced (about 20 p.p. between 2005 and 2050). For the self-employed, due to the low level of pension contributions (19% of earnings as against 32.7% for the employees), the decline of the replacement rate would be even sharper.

As a result of this decline in replacement rates in the statutory scheme, future adequacy of pensions will depend, in addition to longer working lives, on the development of the supplementary social security entitlements. The diversion of the TFR towards private pension funds is indeed expected to complement public pension gross replacement rates by 16 p.p. by 2050. According to ISG calculations, for a worker retiring at 65 after 40 years of contributions and under the assumption of contribution rates of 6.9%, the total gross replacement rate would in that case stay stable (today 79% and 80% in 2050) while the total net replacement rate would even increase (88% to 92%). As mentioned in the Italian NSR, it should be borne in mind, however, that the diversion of the entire TFR to private pension funds means that the future private pro-

vision is obtained at the cost of workers losing their lump-sum end-of-service allowance (TFR).

Despite unfavourable demographic trends, Italy is as a result of the four pension reforms undertaken since 1992, expected to face only small additional budgetary pressures due to ageing populations. According to the budgetary projections made by the AWG in 2005, public expenditures on pensions will increase only marginally, from 14.2% of GDP in 2004 to 14.7% in 2050 and all age-related expenditure from 24.7% to 25.7% of GDP. Both increasing trends are considerably slower than those of the EU average.

Under the reformed public pension scheme, once fully in force the incentive to work longer is achieved in part by the close link between contributions and benefits and actuarial adjustment mechanisms. More and longer employment will be important to allow increasing benefit entitlements that help address potential adequacy issues.

## 3. Conclusion

Recent reforms complement the reforms enacted in the 1990s, which are projected to stabilise the public pension spending, in particular through the gradual maturation of the notional defined-contribution pension scheme. Nevertheless, the high overall level of expenditure and contributions to the pension system remain major challenges.

The 1995 reform created a stronger link between contributions and benefits, thus providing appropriate incentives for new entrants to the labour market to work longer. New measures were introduced in 2004 with the aim of strengthening further longer working incentives that also affect those who still have the right to retire early under the old rules.

However, these measures are predicated on long transition periods and raising employment rates, particularly of women and older workers, remains crucial for meeting future challenges. Ensuring that older workers can effectively remain in employment would benefit from further labour market measures. One measure to be considered could be a gradual reduction of the gender gap of the legal retirement age for men and women which would help to increase the employment rates of women. Ensuring adequacy will also require

tackling the issue of pension rights for workers with atypical contracts and future adequacy could gain from anticipating entry into the labour market.

As recent reforms are projected to result in a decline of replacement rates provided by the statutory scheme, future adequacy of pensions will also depend on the development of the supplementary social security enti-

tlements, through the transformation of the end-of-service allowance TFR. The mechanism of automatic transfer of the TFR to occupational pension schemes (except in cases where the employee refuses it, according to the so-called 'silent-assent' mechanism) could contribute strongly to the development of supplementary pensions. It remains to be seen whether expectations will be reached by this voluntary measure or not.

## 4. Background statistics

	IT			EU-25				
Adequacy								
Current situation								
	Total	Men	Women	Total	Men	Women		
At-risk-of-poverty rate <sup>(1)</sup>	19	18	11	16	15	17		
0–64	20	20	19	16	16	17		
65+	16	13	18	18	15	20		
75+	15	12	17	Nd	Nd	Nd		
Income inequality <sup>(1)</sup>								
0–64	6.0							
65+	4.2							
Income of people aged 65+ as a ratio of income of people aged 0–64 <sup>(1)</sup>	0.95	0.98	0.94					
Median pensions relative to median earnings <sup>(2)</sup>	0.74	0.76	0.71					
Long-term projections								
Theoretical replacement rates <sup>(3)</sup>	2005	2030	2050					
Total net replacement rate	88	90	92					
Total gross replacement rate	79	80	80					
Gross replacement rate 1st pillar	79	71	64					
Gross replacement rate 2nd/3rd pillar	0	9	16					
Financial sustainability								
Current situation								
Esspros Pension expenditure <sup>(4)</sup> , % of GDP	1995	2000	2003	1995	2000	2003		
	14.5	14.7	15.1		12.5	12.6		
Employment (2004) <sup>(5)</sup>	Total	Men	Women	Total	Men	Women		
Employment rate (25–54)	72.2	86.7	57.8	76.8	85.2	68.5		
Employment rate (55–64)	30.5	42.2	19.6	41.0	50.7	31.7		
Effective labour market exit age (2004) <sup>(6)</sup>	Nd			60.7p				
Public finances (2003) <sup>(7)</sup>								
Public debt, % of GDP	106.2			63.3				
Budget balance, % of GDP	-2.4			-2.8				
Long-term projections (EPC 2006)								
	2004	Level 2030	2050	Increase 2004–50	2004	Level 2030	2050	Increase 2004–50
Old-age dependency ratio <sup>(8)</sup>	28.9	44.4	62.2	+115%	25	40	52	+108 %
Public pensions expenditure, % of GDP <sup>(9)</sup>	14.2	15.0	14.7	+0.4	10.6	11.9	12.8	+2.2
Factors determining the evolution of public pensions expenditure (2000–50) <sup>(10)</sup>	Contribution to change in percentage points of GDP				Contribution to change in percentage points of GDP			
Demographic dependency	11.5				8.6			
Employment	-2.0				-1.1			
Eligibility	-3.2				-2.1			
Level of benefits	-5.3				-2.7			
Total (including residual)	0.4				2.2			
Notes								
<sup>(1)</sup> Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).								
<sup>(2)</sup> Source: Eurostat. Median individual pension income of retirees aged 65–74 in relation to median earnings of employed persons aged 50–59 excluding social benefits other than pensions.								
<sup>(3)</sup> Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first- and second-pillar pension schemes, retiring at the age of 65 years in 2005.								
<sup>(4)</sup> Source: Esspros, Eurostat. Includes expenditure by certain private social protection schemes.								
<sup>(5)</sup> Source: European Labour Force Survey, 2004.								
<sup>(6)</sup> Source: European Labour Force Survey, 2004.								
<sup>(7)</sup> Source: European Commission, DG ECFIN.								
<sup>(8)</sup> Source: Eurostat (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15–64.								
<sup>(9)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.								
<sup>(10)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.								
(*) Negligible proportion								

## Cyprus

### 1. Main characteristics of the pension system

The pension system in Cyprus is almost entirely public, with private provision playing a minor role. The statutory **General Social Insurance Scheme**, compulsory for every person gainfully employed or self-employed, consists of two parts: a basic part replacing 60% of the lower part of earnings and a supplementary part replacing earnings in excess of this limit at an accrual rate of 1.5%. The basic part is based on insured earnings since October 1964 whereas the supplementary part is based on earnings since October 1980.

The financing of the basic part is on a pay-as-you-go basis and the financing of the supplementary part on a partially-funded basis. The pension system has traditionally been financed by tripartite contributions. The employer pays 6.3%, the employee 6.3% and the State 4% of earnings up to a ceiling of EUR 3 205 per month (2003 figures). The contribution rate for the self-employed is 15.6% of which 4% is paid by the State. The social insurance Scheme cover in addition to old age, invalidity pensions, widow's pensions, orphan's pensions and disability pensions as well as short-term benefits (sickness, unemployment, maternity and work injuries). Basic pensions increase in line with earnings, whereas supplementary pensions are linked to the price index. Persons with insufficient insurance records are entitled to a minimum pension.

The **Social Pension Scheme**, that is also part of the statutory pillar, guarantees an old-age pension to everyone over the age of 65 who is not entitled to a pension from the General Social Insurance Scheme or from any other source and fulfils residence eligibility conditions.

Under the General Social Insurance Scheme the pensionable age is 65. However, old-age pension can be paid at the age of 63, under specific contribution conditions. Incentives for postponing retirement translate into an increase in pension benefits (in particular, increase by 0.5% for every postponed month from the date the beneficiary is entitled to a pension, up to a maximum at age 68). The payment of a pension is not conditional on retirement from regular employment

and is not subject to ~~any reduction on account of~~ earnings from employment.

A 'self-employment scheme' has also been established, that provides grants to people over 63 in order to support them being involved in economic activity when self-employed.

Employees in the public sector enjoy supplementary mandatory pension schemes (that of the **Government Employees Pension Scheme** or the **Semi-Government Employees Pension Schemes**). The statutory retirement age is 60, but early retirement is allowed after 55 without any reduction of benefits. As from July 2005 the age of retirement for civil servants will gradually increase to 63 by July 2008. Participation of the employees in the financing of government schemes is limited to a share in the cost of survivors' pensions, which is 2.4% of the total of all pensions.

A major proportion of the private sector's employees have supplementary coverage in the form of lump-sum payments under non-statutory **provident funds** established by collective agreements.

### 2. Situation and perspectives in light of the common objectives

#### 2.1. Current situation

**Adequacy:** The risk of poverty of the 65 or above age group is the highest among all Member States, reaching as high as 52% in 2003. The highest incidence of poverty occurs amongst persons living in one-adult households, while the gender gap is moderate (48% for men and 55% for women). The main reason for the very high poverty risk of older persons seems to be the low level of flat-rate minimum pension and the fact that the level of social insurance pensions is still influenced by the insurance record accrued under the scheme in force before October 1980. In addition, access to second-pillar schemes is limited and lump sums are paid out each time the employee changes or loses their job. Moreover, the self-employed people contribute on the basis of notional incomes fixed by category of occupation without any obligation to declare the actual

income where this is higher. This leads to lower than expected replacement rates in the future.

Current replacement rates are rather low. According to the ISG theoretical replacement rate calculations, the gross replacement rate from the statutory pillar in the case of a worker retiring at 65 after 40 years of employment at the average wage is 46% in 2005, leading to a net replacement rate of 52%. However, the replacement rates are expected to increase as the earnings-related insurance of 1980 approaches maturity.

**Financial sustainability:** The employment rate (68.9%) has almost reached the Lisbon target and unemployment is low (5.2% in 2004). The employment rate for workers aged 55–64 was 49.9%, in line with the Lisbon target, although the gender gap is significant (70.8% for men and 30% for women). The average exit age from the labour force was 62.7 in 2004. There is an accumulated reserve fund that amounts to 37% of GDP. In order to improve financial sustainability, several reform measures are under consideration with the social partners.

**Modernisation:** On gender equality, although most pension rights in the General Social Insurance Scheme appear gender neutral, the eligibility to widower's pension rights is restricted to cases of permanent incapacity for self-support.

Informing the public about their pension rights is increasingly important. Currently transparency of pension benefits is pursued by regular triennial actuarial studies, presented to social partners. These actuarial studies involve information on levels of pension benefits and contributions.

## 2.2. Outlook, reform measures and policy debates

According to Eurostat projections Cyprus will see an increase in population over the coming decades, as a consequence of high life expectancy and total fertility rate (around 1.8 in the period 1995–2000, although dropping to 1.5 during the period 2001–03). Hence, although the overall demographic situation still appears relatively favourable, demographic ageing will play a crucial role in Cyprus in the next decades. It is expected that the old-age dependency ratio will

more than double between 2004 and 2050 from the present very low 17% to 43% (staying well below the EU-25 average of 52% in 2050).

According to the ISG theoretical replacement rate calculations, the gross replacement rate from the statutory pillar in the base case was 46% (net 52%) in 2005, increasing to 57% (net 66%) by 2030 and 57% (net 70%) by 2050.

The Cyprus economy grew at approximately 3.7% per year during 1995–2003, when there occurred a sudden widening of the fiscal deficit in 2003, as the real GDP growth slowed down. Due to the strong impact of fiscal consolidation measures both on the expenditure and revenue side, the deficit has declined to 4.2% of GDP in 2004, down from 6.3% of GDP on the previous year. A further decline of deficit is projected as an outcome of the recent successful negotiations with social partners on a number of key planned consolidation measures and the ongoing implementation of other measures planned for 2005. According to the AWG projections, Cyprus is expected to increase its spending on public pensions (including public sector employees' pensions) from 6.9% of GDP in 2004 to 19.8% of GDP in 2050. The projected growth of 12.9 percentage points of GDP is the largest in EU-25 countries and will exhaust the reserve fund by about 2040.

A major concern for the pension system in Cyprus is its sustainability in the face of the ageing population. As today's contribution rates do not seem to be sufficient to maintain the financial balance beyond 2010, the Social Insurance Scheme in Cyprus will require further reforms. In order to improve the financial sustainability of the Social Insurance Scheme, reform measures are under discussion with the social partners. These include the gradual increase of the social insurance contributions, the increase of the minimum qualifying period for pensions under the Social Insurance Scheme, the reconsideration of the method of indexation of the basic part of pensions and the right to an early pension between the ages 63 and 65. In addition, the increase of the notional incomes of the self-employed persons is being considered in order to make their insurable income become more representative of their actual income.

### 3. Conclusion

Although the coverage by the pension system is practically universal, further efforts are needed to ensure adequacy, as the poverty rate of the elderly remains high. The main reason for the very high poverty risk of older persons seems to be the low level of flat-rate minimum pension. Another reason lies in the build-up of the occupational pension scheme that offers lump sum payouts in the case of job mobility, thus leading to an outcome, where in case of repetitive changes of employment no pension capital is accumulated. Furthermore the low contribution levels of the self-employed are likely to lead to low pensions in retirement.

While Cyprus currently reaches the European employment targets, a major concern for the pension system is its sustainability, as projections show that the social

insurance fund with the current rate of contributions is only viable until 2010 (according to the AWG projections, pension spending will grow significantly only after 2025 (from 10.8% GDP to 19.8% by 2050) and the reserve fund will be exhausted by about 2040).

Large pension reforms in Cyprus took place in 1964 and 1980, making it one of the few countries with no recent reforms. Currently the Government has taken an active position regarding the pension system and several steps have been planned in order to improve the adequacy of pensions and the financial sustainability of the system. Reforms under consideration refer mainly to the General Social Insurance Scheme and include the gradual increase of Social Insurance contributions, the increase of the minimum qualifying period for pensions and the re-examination of the indexation formula.



## 4. Background statistics

	CY			EU-25				
Adequacy								
Current situation								
	Total	Men	Women	Total	Men	Women		
At-risk-of-poverty rate <sup>(1)</sup>	15	14	17	16	15	17		
0–64	10	10	11	16	16	17		
65+	52	48	55	18	15	20		
75+	67	67	67	Nd	Nd	Nd		
Income inequality <sup>(1)</sup>								
0–64	3.7							
65+	4.3							
Income of people aged 65+ as a ratio of income of people aged 0–64 <sup>(1)</sup>	0.55	0.58	0.54					
Median pensions relative to median earnings <sup>(2)</sup>	0.42	0.44	0.41					
Long-term projections								
Theoretical replacement rates <sup>(3)</sup>	2005	2030	2050					
Total net replacement rate	52	66	70					
Total gross replacement rate	46	57	57					
Gross replacement rate 1st pillar	46	57	57					
Gross replacement rate 2nd/3rd pillar	(*)	(*)	(*)					
Financial sustainability								
Current situation								
Esspros Pension expenditure <sup>(4)</sup> , % of GDP	1995	2001	2002	1995	2000	2003		
		6.4%	7.0%					
Employment (2004) <sup>(5)</sup>	Total	Men	Women	Total	Men	Women		
Employment rate (25–54)	82.4	92.5	72.8	76.8	85.2	68.5		
Employment rate (55–64)	49.9	70.8	30.0	41.0	50.7	31.7		
Effective labour market exit age (2004) <sup>(6)</sup>	62.7			60.7p				
Public finances (2003) <sup>(7)</sup>								
Public debt, % of GDP	70.9			63.3				
Budget balance, % of GDP	-6.4			-2.8				
Long-term projections (EPC 2006)								
	2004	Level 2030	2050	Increase 2004–50	2004	Level 2030	2050	Increase 2004–50
Old-age dependency ratio <sup>(8)</sup>	17.5	32.9	43.2	+147%	25	40	52	+108 %
Public pensions expenditure, % of GDP <sup>(9)</sup>	6.9	12.2	19.8	+12.9	10.6	11.9	12.8	+2.2
Factors determining the evolution of public pensions expenditure (2000–50) <sup>(10)</sup>	Contribution to change in percentage points of GDP				Contribution to change in percentage points of GDP			
Demographic dependency	10.2				8.6			
Employment	-1.2				-1.1			
Eligibility	1.2				-2.1			
Level of benefits	2.2				-2.7			
Total (including residual)	12.8				2.2			

### Notes

<sup>(1)</sup> Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).

<sup>(2)</sup> Source: Eurostat. Median individual pension income of retirees aged 65–74 in relation to median earnings of employed persons aged 50–59 excluding social benefits other than pensions.

<sup>(3)</sup> Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first- and second-pillar pension schemes, retiring at the age of 65 years in 2005.

<sup>(4)</sup> Source: Esspros, Eurostat. Includes expenditure by certain private social protection schemes.

<sup>(5)</sup> Source: European Labour Force Survey, 2004.

<sup>(6)</sup> Source: European Labour Force Survey, 2004.

<sup>(7)</sup> Source: European Commission, DG ECFIN.

<sup>(8)</sup> Source: Eurostat (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15–64.

<sup>(9)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.

<sup>(10)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.

(\*) Negligible proportion

## Latvia

### 1. Main characteristics of the pension system

**Statutory social security PAYG pillar:** A fundamental reform of the PAYG pension scheme was implemented in Latvia in January 1996<sup>(54)</sup>. Social insurance contributions for pensions (20% of gross wage) are recorded in **notional individual accounts**, and are accumulated at a given rate of return (indexed with increase in average social insurance contributions' wages) until retirement. Pensions are calculated by dividing the amount accumulated in the notional account by projected cohort unisex life expectancy at retirement.

The statutory minimum retirement age will gradually increase until it reaches 62 for both men and women. Men reached this point in January 2003, and women will reach it in 2008. A benefit can be claimed at any time from the minimum pension age and it is possible to receive a full pension whilst continuing work after retirement<sup>(55)</sup>. It is also possible to retire 2 years before the minimum retirement age, receiving 80% of the pension calculated according to the general formula. In addition, working and receiving benefits is not allowed during this early retirement period. As of July 2008 (postponed from 2005) the possibility of early retirement will be eliminated.

Pensions are indexed in Latvia – until 2002 this was based on the consumer price index and from 2002 to a combination of changes in consumer price index and increases in the average wage on which contributions are paid. The level of indexation depends on the level of pensions. It is higher for low pensions (the actual consumer price index (CPI) plus 50% of the average real increase of wages on which contributions are paid), while average pensions are indexed by the CPI only. The highest pensions (1.5% of all pensions) are not indexed at all.

There is a guaranteed minimum pension that establishes a base income guarantee for pensioners. From January 2002 the level of the minimum pension also depends on the length of the individuals' pension insurance record. By the end of 2006, the minimum pen-

sion will be equal to the State social security benefit multiplied by the coefficient 1.1 if a person's insurance record does not exceed 20 years, 1.3 in case of 20–30 years and 1.5 in case of insurance records of more than 30 years.

**Mandatory funded pillar:** The funded defined-contribution pension scheme started operation in July 2001. It is a fully-funded statutory pension scheme, where a part of the social insurance contributions are invested in privately-managed pension funds or a pension plan of the State Treasury.

The contribution rate to the mandatory funded pillar will gradually increase: 2% from 2001 to 2006, to 4% in 2007, 8% in 2008, 9% in 2009 and 10% from 2010 onwards. As these contributions are part of the total social insurance contributions for old-age pensions, an increase of contributions paid into the mandatory funded pillar results in a decrease of contribution revenues for the notional defined-contribution pillar (NDC). That will result in equal shares going to both pillars by 2010 and onwards. Membership in the funded pillar is mandatory for those under 30 and voluntary for the age group 30 to 49 on 1 July 2001.

In the first phase, assets were only invested by the State Treasury, but since January 2003, participants are able to choose among State or private asset managers. Upon retirement members can either convert their capital into annuities provided by life insurance companies or add their accumulated capital to their NDC pension capital to increase their PAYG pension benefits.

The pension funds managing the mandatory funded scheme held total assets of 0.6% of GDP at the end of 2004. Scheme assets (together with the higher number of participants as well as increased contributions) are projected to reach 95% of GDP by 2070.

The **voluntary private pension pillar** is incentivised by some income tax exemptions. In 2004 there were five private pension funds operating in Latvia. When members of voluntary private pension funds reach the

(54) Pensions awarded before 1996 were not affected by the introduction of the new scheme.

(55) Working pensioners continue to contribute and accumulate additional notional pension capital. This newly accrued pension capital also yields a rate of return, and the benefit is recalculated upon final retirement.

retirement age, they can either take the accumulated capital as a lump sum (and purchase an annuity) or take phased withdrawals from the fund.

This type of pension provision covered around 3% of the working age population at the end of 2004. Private pension funds held total assets of around 0.3% of GDP at the end of 2004. 88% of contributions into voluntary funds are made by employers and the rest by individual participants.

## 2. Situation and perspectives in light of the common objectives

### 2.1. Current situation

**Adequacy:** The risk of poverty of the 65 or above age group is rather low, 14% (in 2003), but there is a gender gap: 7% for men (one of the lowest in EU) and 17% for women. The risk of poverty of the elderly is much lower than that of the age group 0–64 (17% in 2003).

Although the risk of poverty is currently among the lowest in EU-25, the new pension formula, which establishes a strong link between personal contributions to the system and benefits, could lead to an increase of poverty among the lower income earners and people with breaks in their careers, notably women. To mitigate that problem, pension rights were granted in 2002 for employment periods without contribution payments, and pension accrual was ensured for people who were unemployed or had very low incomes between 1996 and 1999. A minimum pension related to the total length of the career is available to those with low pension entitlements.

The closer link between contributions and benefits resulting from the introduction of the (compulsory) funded pension component may help to increase declared work, implying increased contributions to the State scheme and thus improved pension adequacy. Currently the grey economy is still an issue as its size has been estimated to be between 20–40% of GDP.

**Financial sustainability:** The employment rate in Latvia was 62.3% in 2004, which is far below the Lisbon target. Meanwhile, the employment rate of the age group 55–64 was 47.9%, which is higher than the EU average but still below the Lisbon target for older workers (50%). In order to encourage employment of older

workers, the Latvian labour law stipulates that in case of redundancies the selection criteria are performance and qualifications of employees. However, if employees have similar performance and qualification levels, then employees who are within 5 years of their retirement should preferably be retained. It remains to be seen whether this measure will improve the employment situation of the elderly.

Despite efforts to increase the elderly employment rate, early retirement options for certain professional groups (as for artists, workers of the system of internal affairs, etc.) were reintroduced recently. Although the number of recipients of these pensions is low (around 1% of all old-age pensions), this may lead to re-establishing, more widely, long-service pensions, abolished in the mid-1990s.

Total pension expenditures accounted for 7.5% of GDP in 2003, below the EU average of 12.6%. As the pension contribution directed into the mandatory funded pillar will increase gradually (reaching half the total contribution rate in 2010), it will be important to monitor the financing of PAYG pensions. While the social security PAYG scheme currently produces a surplus, remaining surpluses will depend on whether future improvements in employment materialise.

**Modernisation:** The pension system in Latvia is neutral with regard to different employment forms, mobility and individual choice. Equal treatment of men and women is being introduced and retirement ages are to be equalised by 2008. Changes in the demographic and economic situation will lead to automatic adjustments in Latvia's statutory pension pillar.

### 2.2. Outlook, reform measures and policy debates

According to Eurostat projections Latvia will encounter the fastest decrease in population among the EU-25: population is expected to decrease by 10.8% by 2025 and 19.2% by 2050. Low fertility rates are the main reason for this steep decrease (combined with low migration). However, there are no strong imbalances in the population structure compared to other Member States and the share of the 65 or above age group is expected to remain lower than for the EU-25. Consequently, absolute falls in the population size are only accompanied by a moderate increase in the old-age dependency ratio, from 23% in 2003 to 44% in 2050, noticeably slower than the EU-10 average rising from 19 to 50%.

Currently the gross replacement rate of pensions is 61% (78% net replacement rate) for a worker retiring at 65 after 40 years of contributions at the average wage. According to the ISG projections, the net replacement rate will fall from 78% in 2005 to 67% in 2030 and then increase to 72% in 2050 (gross replacement rates will decline from 61% in 2005 to 51% in 2030 and then increase to 55% in 2050).

While the risk of poverty of those aged 65 and older is comparatively low in Latvia, an important share of newly granted pensions in recent years were minimum pensions. Moreover, within the age group of older workers, the risk of poverty is relatively high, mainly due to long-term unemployment. These cohorts will probably receive low or only guaranteed minimum pensions when they retire.

Ageing, notably regarding pensions, does not seem to constitute a major risk to the sustainability of public finances in Latvia because, in the future, the longevity risk is shared between the State and the individuals through the two-tier statutory pension system and both schemes provide defined-contribution benefits. According to the AWG projections of 2005, Latvia forecasts a decrease in public pension expenditure from 6.8% to 5.2% between 2004 and 2009 and thereafter a marginal increase from 5.2% to 5.6% of GDP over the period 2009–50, an overall fall of 1.2 p.p. in public pension spending over the period 2004–50. Taking into account pension expenditures from the mandatory funded scheme, expenditures are projected to increase from 6.8% of GDP in 2004 to 8.3% of GDP in 2050.

A similar fall of 1.3 p.p. is projected in all age-related public expenditure as well.

### 3. Conclusion

Latvia introduced an NDC pension system in 1996 and supplemented the pension system with mandatory- and voluntary-funded tiers. A gradual increase of the retirement age is foreseen until harmonisation of retirement ages between men and women by 2008. Early retirement options are planned to be eliminated according to present plans by 2008.

Regarding the impact of ageing on pensions, policy aims at a balanced budget position in the long rather than medium term. The government expects to compensate the decline in contribution rate in the NDC scheme by increased employment and an increase in the declaration of work. Pension expenditures are projected to decline as a share of GDP over the next 50 years, while the share of mandatory private pensions will increase. The risk of poverty in Latvia is currently lower than for the working-age population. Still the new pension formula, which establishes a strong link between personal contributions to the system and benefits, could lead to adequacy issues as the overall replacement rate is expected to fall until 2030, then increase again when the mandatory private pensions come to fruition. This could affect the lower income earners and people with breaks in their careers, notably women. Thus attention has to be given to the development of poverty rates.

## 4. Background statistics

	LV			EU-25				
Adequacy								
Current situation								
	Total	Men	Women	Total	Men	Women		
At-risk-of-poverty rate <sup>(1)</sup>	16	16	16	16	15	17		
0–64	17	17	17	16	16	17		
65+	14	7	17	18	15	20		
75+	16	5	21	Nd	Nd	Nd		
Income inequality <sup>(1)</sup>								
0–64	6.6							
65+	3.5							
Income of people aged 65+ as a ratio of income of people aged 0–64 <sup>(1)</sup>	0.80	0.84	0.78					
Median pensions relative to median earnings <sup>(2)</sup>	0.54	0.62	0.54					
Long-term projections								
Theoretical replacement rates <sup>(3)</sup>	2005	2030	2050					
Total net replacement rate	78	67	72					
Total gross replacement rate	61	51	55					
Gross replacement rate 1st pillar	61	46	36					
Gross replacement rate 2nd/3rd pillar	0	6	19					
Financial sustainability								
Current situation								
Esspros Pension expenditure <sup>(4)</sup> , % of GDP	1995	2000	2003	1995	2000	2003		
		9.6	7.5		12.5	12.6		
Employment (2004) <sup>(5)</sup>	Total	Men	Women	Total	Men	Women		
Employment rate (25–54)	77.9	80.4	75.5	76.8	85.2	68.5		
Employment rate (55–64)	47.9	55.8	41.9	41.0	50.7	31.7		
Effective labour market exit age (2004) <sup>(6)</sup>	62.9			60.7p				
Public finances (2003) <sup>(7)</sup>								
Public debt, % of GDP	14.4			63.3				
Budget balance, % of GDP	-1.5			-2.8				
Long-term projections (EPC 2006)								
	2004	Level 2030	2050	Increase 2004–50	2004	Level 2030	2050	Increase 2004–50
Old-age dependency ratio <sup>(8)</sup>	23.6	33.4	44.1	+87%	25	40	52	+108 %
Public pensions expenditure, % of GDP <sup>(9)</sup>	6.8	6.0	8.3	+1.5	10.6	11.9	12.8	+2.2
Factors determining the evolution of public pensions expenditure (2000–50) <sup>(10)</sup>	Contribution to change in percentage points of GDP				Contribution to change in percentage points of GDP			
Demographic dependency	3.4				8.6			
Employment	-0.7				-1.1			
Eligibility	-1.3				-2.1			
Level of benefits	-2.4				-2.7			
Total (including residual)	-0.9				2.2			

### Notes

<sup>(1)</sup> Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).

<sup>(2)</sup> Source: Eurostat. Median individual pension income of retirees aged 65–74 in relation to median earnings of employed persons aged 50–59 excluding social benefits other than pensions.

<sup>(3)</sup> Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first- and second-pillar pension schemes, retiring at the age of 65 years in 2005.

<sup>(4)</sup> Source: Esspros, Eurostat. Includes expenditure by certain private social protection schemes.

<sup>(5)</sup> Source: European Labour Force Survey, 2004.

<sup>(6)</sup> Source: European Labour Force Survey, 2004.

<sup>(7)</sup> Source: European Commission, DG ECFIN.

<sup>(8)</sup> Source: Eurostat (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15–64.

<sup>(9)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.

<sup>(10)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.

(\*) Negligible proportion

## Lithuania

### 1. Main characteristics of the pension system

Lithuania's statutory **social insurance pension system** consists of two tiers: the State pay-as-you-go defined-benefit pensions and a mandatory funded defined-contribution scheme. The **State social insurance pension system** was reformed in 1995, introducing the insurance principle, extending the requirement for contributory years, abolishing early retirement provisions and increasing the retirement age. The 1995 reforms created the two-tier system which functions in different ways: the main part (basic pension) is almost flat-rate and dependent entirely on years of service. The supplemental part is calculated using a formula comprising years of service, individual wage coefficient and average insurable income in the country.

In principle all those employed are covered by the pension social insurance to receive old-age, disability and survivors' social insurance pensions. Nevertheless, some categories of self-employed persons (farmers, sportspeople, persons working under authorship agreements) are not mandatorily insured (although they may insure themselves on a voluntary basis), and some are only covered for the main part of the social insurance pensions scheme (those taking care of children under three or other dependent family members and soldiers in their compulsory primary military service).

The pension system is contributory, 23.5% of gross wage paid by the employer and 2.5% by the employee (data as of 2005). The regular legal retirement age for men is 62.5 years and for women 59.5 (rising to 60 by 2006). The qualifying period to receive full pension is 30 full years (a minimum qualifying period being 15 years), with a full year consisting of at least 12 minimum monthly salaries. The average old-age pension received at retirement amounted to 31% of average gross income, 44% of net salary in 2002 and adjustments are made in line with wage increases. No tax is applied to pension benefits.

While early retirement provisions for certain professions were terminated in 1995, an early retirement pension scheme was introduced for the long-term unemployed in 2004. Under that scheme pensions are reduced by 0.4% for every full month remaining until

the retirement age and the reduced pension is fixed at this level. Staying longer in the labour force is rewarded by pension benefit increases of 8% per annum.

The **mandatory funded pension scheme** was introduced on 1 January 2004. The second tier of the statutory system is actually voluntary though opting out from the scheme after joining is not permitted. There are no restrictions for participation except being insured by the State social insurance pension system and aged below the legal retirement age. Currently, already 54% of eligible persons have joined a funded scheme. This scheme is a defined-contribution scheme financed by a fraction of the social insurance contribution (increasing from 2.5% to 5.5% of gross wage by 2007). At retirement, the participant has to purchase a pension annuity from an insurance company. Only in cases of very small annuities (half the amount of the basic pension) or for sums exceeding the annuity being three times larger than the basic pension, can an individual choose to receive pension benefits as a lump sum or as phased withdrawals from the fund.

**Supplementary voluntary pension provision** is possible through either pension insurance or special voluntary pension funds (these started operating in 2004, although the law was adopted in 1999). The voluntary pillar can take two different forms: DC if supplemental contributions are invested into pension funds or unit-linked life insurance, or DB when purchasing a classical life insurance product. Contributions to the system may be made by the individual or his employer, and tax allowances are available, providing contributions do not exceed 25% of the person's annual earnings.

It is possible to establish **occupational pension schemes** though as yet none have been created.

Those not having the minimum qualifying period for entitlement to social insurance pensions may receive a social **assistance pension** when they reach old age. This is also available for those disabled in youth (under 24 years of age) and orphaned children. The amount of the social assistance pension in case of old age is equal to 90% of the basic pension which equates to 31% of the minimum monthly salary or 18.5% of the average net wage as of 2004. No minimum old-age social insurance pension is provided for in law.



## 2. Situation and perspectives in light of the common objectives

### 2.1. Current situation

**Adequacy:** The poverty risk of the elderly is rather low: for 65+ it was 12% in 2003, but the gender difference is significant: for older (65 or above) men it was 5% and 15% for women. The risk of poverty for the elderly is lower than that of the age group 0–64, which was 15%.

Adequacy is threatened by a rather high level of unemployment (10.9% in 2004), the minimum requirement for contributions made (more than 12 minimum monthly salaries), low coverage rate (83% of labour force) and undeclared work. All of which could contribute to difficulties earning adequate pension rights, which may result in greater reliance on social assistance (minimum) pension in the future. However, the closer link between contributions and benefits resulting from the reform of the PAYG system and the introduction of the funded pension components should improve incentives to contribute.

**Financial sustainability:** Employment rates of older workers aged 55–64 in 2004 are higher in Lithuania (47.1%) than in the EU-25 average but below the Lisbon target. There are also gender differences – the employment rate of older men is higher (57.6%) than that of older women (39.3%). Early retirement option has been reintroduced in 2004, although only for the long-term unemployed. Deferred retirement is rewarded. The latter fact may cause problems in the future, if the legal retirement age is not raised resulting in larger cohorts benefiting from deferred pension benefit enhancements.

The level of pension's expenditure was 6.8% of GDP in 2003 and is one of the lowest in the EU-25. As the total contribution to the mandatory-funded pension pillar will be increased only gradually and constitute only a relatively small share of the total pension insurance (5.5 p.p. of the total 26% contribution rate), transition costs to the public PAYG scheme are expected to remain low as well. Moreover, the State social insurance fund has started to produce surpluses, thanks to improved employment.

**Modernisation:** The pension system in Lithuania is neutral regarding different employment forms, mobility issues, as well as individual choice. There is still inequality in retirement ages.

Information about the pension system in general is widely available to the public. The Ministry of Social Security and Labour provides comprehensive information to the public and institutions about any reform in its annual Social Report. The public is also informed about developments and changes to the pension system through the Ministry's website. A special public awareness raising campaign was implemented when preparing for the establishment and launching of the private pension system in 2003–04. Pension companies have an obligation to inform their clients about the investment performance of the second tier of the first pillar. However, predicting pension outcomes remains problematic.

### 2.2. Outlook, reform measures and policy debates

According to Eurostat projections Lithuania is facing one of the fastest decreases in population amongst the EU-25. The total population (3.4 million) is expected to decrease by 9.1% by 2025 and by 16.4% by 2050. Reasons for the decrease are low fertility rates and negative net migration. However, life expectancy compared to other EU countries is projected to remain rather low. The share of both 0–14 and 15–64 remains higher than the EU-25 average and the 65 or above age group is expected to be less of a factor than for the EU-25 (15.0% in 2004 compared to the EU-25 average of 16.4% and 26.7% in 2050 while EU-25 average is projected to be 29.9%). Consequently, the increase in the old-age dependency ratio is projected to be moderate, from 22% in 2003 to 45% in 2050, noticeably smaller than the EU-10 average.

While the risk of poverty of the 65 and older cohort is currently lower than for the working-age population, Lithuania may face an increase in the number of those dependant on social assistance pensions only. Furthermore, the State social insurance scheme does not cover farmers.



According to the AWG projections of 2005, Lithuania is projecting a moderate 1.9 p.p. of GDP increase in public pension expenditure (3.7% of GDP when taking into account the funded tier of the statutory scheme) over the period 2004–50 and a somewhat lower rise in overall age-related public spending (1.4%) over the same period. As the total contribution to the mandatory-funded pension pillar remains rather low (contributions at 5.5 p.p. of gross wages), transition costs are expected to remain low as well. The State social insurance fund is expected to be in balance or surplus up to 2020. Thereafter, a deficit is anticipated, peaking at 0.7% of GDP in 2030. The Government is considering the strategies to tackle the financing gap, including further reforms in the public PAYG scheme such as increasing the retirement age and employability and employment opportunities for older workers.

### 3. Conclusion

Since the 2004 reform, the State-managed statutory pay-as-you-go pension scheme is associated with a privately-managed funded pension scheme. These schemes cover gainfully employed persons while social assistance pension provides a minimum retire-

ment income to those not entitled to a social insurance pension, including farmers and other self-employed persons. However, the introduction of the minimum retirement income could lead to disincentives to work or to not declaring income.

Financial sustainability of the public pension scheme will have to be closely monitored although the transition costs are not expected to cause problems before 2020. However, the ageing of the population beyond this point risks a deficit in the social insurance pension scheme. Further measures with the aim of increasing employment rates as well as the retirement age would contribute to both the future adequacy and sustainability of pensions. In that respect, while early retirement provisions were terminated in 1995, the introduction of an early retirement pension scheme for the long-term unemployed in 2004 seems to be in contradiction to the general trend.

Regarding the modernisation of the system, equalising statutory retirement ages for men and women would help to reduce the gender gap in pension entitlements and would also contribute to increasing employment rates of older workers.

## 4. Background statistics

	LT			EU-25				
Adequacy								
Current situation								
	Total	Men	Women	Total	Men	Women		
At-risk-of-poverty rate <sup>(1)</sup>	15	14	15	16	15	17		
0–64	15	15	15	16	16	17		
65+	12	5	15	18	15	20		
75+	15	6	19	Nd	Nd	Nd		
Income inequality <sup>(1)</sup>								
0–64	4.8							
65+	3.0							
Income of people aged 65+ as a ratio of income of people aged 0–64 <sup>(1)</sup>	0.89	0.96	0.85					
Median pensions relative to median earnings <sup>(2)</sup>	0.63	0.68	0.61					
Long-term projections								
Theoretical replacement rates <sup>(3)</sup>	2005	2030	2050					
Total net replacement rate	55	48	51					
Total gross replacement rate	40	39	42					
Gross replacement rate 1st pillar	40	39	42					
Gross replacement rate 2nd/3rd pillar	(*)	(*)	(*)					
Financial sustainability								
Current situation								
Esspros Pension expenditure <sup>(4)</sup> , % of GDP	1995	2000	2003	1995	2000	2003		
		7.8	6.8		12.5	12.6		
Employment (2004) <sup>(5)</sup>	Total	Men	Women	Total	Men	Women		
Employment rate (25–54)	79.4	81.7	77.3	76.8	85.2	68.5		
Employment rate (55–64)	47.1	57.6	39.3	41.0	50.7	31.7		
Effective labour market exit age (2004) <sup>(6)</sup>	60.8			60.7p				
Public finances (2003) <sup>(7)</sup>								
Public debt, % of GDP	21.6			63.3				
Budget balance, % of GDP	-1.9			-2.8				
Long-term projections (EPC 2006)								
	2004	Level 2030	2050	Increase 2004–50	2004	Level 2030	2050	Increase 2004–50
Old-age dependency ratio <sup>(8)</sup>	22.3	33.4	44.9	+101%	25	40	52	+108 %
Public pensions expenditure, % of GDP <sup>(9)</sup>	6.7	8.3	10.4	+3.7	10.6	11.9	12.8	+2.2
Factors determining the evolution of public pensions expenditure (2000–50) <sup>(10)</sup>	Contribution to change in percentage points of GDP				Contribution to change in percentage points of GDP			
Demographic dependency	5.4				8.6			
Employment	-1.0				-1.1			
Eligibility	-2.1				-2.1			
Level of benefits	-0.2				-2.7			
Total (including residual)	1.9				2.2			

### Notes

<sup>(1)</sup> Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).

<sup>(2)</sup> Source: Eurostat. Median individual pension income of retirees aged 65–74 in relation to median earnings of employed persons aged 50–59 excluding social benefits other than pensions.

<sup>(3)</sup> Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first- and second-pillar pension schemes, retiring at the age of 65 years in 2005.

<sup>(4)</sup> Source: Esspros, Eurostat. Includes expenditure by certain private social protection schemes.

<sup>(5)</sup> Source: European Labour Force Survey, 2004.

<sup>(6)</sup> Source: European Labour Force Survey, 2004.

<sup>(7)</sup> Source: European Commission, DG ECFIN.

<sup>(8)</sup> Source: Eurostat (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15–64.

<sup>(9)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.

<sup>(10)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.

(\*) Negligible proportion

## Luxembourg

### 1. Main characteristics of the pension system

The **statutory pension system** consists of a general scheme for private sector employees and the self-employed and a special scheme for civil servants. Pension benefits are related to earnings and survivors' and invalidity pensions are also provided.

The general pension scheme is financed through a contribution on wages of 24% which is paid in equal shares by employers, employees and the State budget. The contribution rate is determined for a period of seven years on the basis of an actuarial evaluation of the scheme. This medium-term commitment aims at stabilising the contribution rate at a level which allows maintaining a minimum reserve fund of the magnitude of 1.5 times the annual amount of benefit payments over the 7-year period. Presently the reserve fund of the general pension scheme amounts to more than three times annual expenditures of the system (24% of GDP).

The net replacement rates for a full insurance career under the general scheme are high, reaching almost 100% of the pre-retirement income for a worker on about average earnings after 40 years of insurance. A minimum pension of EUR 1 353 per month (October 2005) is guaranteed after 40 insurance years.

The monthly old-age pension consists of two parts:

- a basic part, equivalent to around 12% of average earnings, subject to 40 years' coverage and an 'end-of-year allowance'. For incomplete insurance, these benefits are reduced proportionally. Coverage periods include contributory periods as well as non-contributory periods (educational training or child education);
- an income-related part with an accrual rate of one-twelfth of 1.85% of the sum of all incomes from work. The earnings measure used in the formula is lifetime average pay revalued in line with nominal earnings. The accrual rate is higher for older workers and those with longer contribution periods<sup>(56)</sup>.

Under current legislation, pensions in payment are automatically adjusted to price evolution each time prices increase by more than 2.5%. In addition, pensions are reviewed every two years in light of the evolution of real wages. Whereas price indexation is automatic, the adjustment of pensions to wage development is to be decided by the government and approved by the parliament. Index-linking to wages was common practice in the past.

The means-tested **guaranteed minimum income** (RMG) scheme ensures a basic income for those without adequate pension entitlements or other resources. The monthly amount for a single person is EUR 1 071 per month (October 2005).

This leaves only a limited need for **supplementary schemes**. Occupational pension schemes are voluntary for employees and have developed mainly in foreign or very large industrial and commercial companies, as well as in the banking sector. In 2002, new legislation on individual old-age savings was introduced, favouring their development through tax incentives. They are fully funded and their assets amount to about 0.6% of GDP.

### 2. Situation and perspectives in light of the common objectives

#### 2.1. Current situation

In 2003, the risk of poverty of people aged 65 or more was 6% (close for men and women and 12% for the 0–64 population), while the living standard of people aged 65 or more was nearly equal (100%) to the one of those aged 0–64.

The theoretical gross replacement rate from the general pension scheme amounts to nearly 91% for a worker on average earnings retiring at 65 after 40 years of contributions. The corresponding net replacement rate is just over 98%. Replacement rates are higher for workers on two thirds of average earnings (107% net) and lower for people with rising earnings during their careers (74% net for a worker with earnings rising from 100 to 200% of the average).

(56) For each year of work after age 55, the accrual rate is increased by 0.01 percentage points. Furthermore, each year of contributions beyond 38 also attracts an additional accrual of 0.01 percentage points. The maximum accrual rate is 2.05% per year.

There is scope for raising employment rates so as to widen the contribution base for the resident population. In spite of a very low rate of unemployment, the employment rate of residents aged between 15 and 64 years was 62.6% in 2003. Employment rates of women were also comparatively low. In spite of recent increases, about 31% of residents between 55 and 64 are in employment, which is significantly below the Lisbon target (50%).

According to Esspros data, pension expenditures were 10.9% of GDP in 2003, below the EU-15 average of 12.6% of GDP. The Luxembourg pension system's financial sustainability hinges not only on the contribution of relatively high rates of economic growth in the future, but also on the major contribution of non-resident workers to the economy. Currently, about 40% of beneficiaries are non-residents. Fluctuations in the number of foreign workers will have much larger effects on the long-term financial sustainability of the pension system than demographic ageing of the resident population. Two reforms were introduced in 2002, aiming at addressing the problem of the low employment rates of older workers. One is the reform of the disability pension system with the aim of promoting rehabilitation instead of retirement. The other measure was the introduction of a new mechanism of staggered pension increments, based on age and contribution history, for workers aged at least 55 years and with a contribution history of 38 years, intending to encourage people to extend their working lives.

## 2.2. Outlook, reform measures and policy debates

Luxembourg is expected to experience favourable demographic developments over the coming decades, mainly due to the sharp increase in the total population leading up to 2050, due in particular to net migration inflows (among the highest in the EU-25). The old-age dependency ratio (21% in 2004 and 36% in 2050) is already somewhat lower than the EU average of 24% and

is projected by 2050 to become the far lowest in the whole European Union (respectively 36% and 52%).

According to ISG calculations, projected replacement rates will remain at current levels, on average, about equal to the net wage level.

The 2005 projections of the AWG show an important increase of 7.4 p.p. of GDP in public pension expenditures over the projection period, from 10% of GDP in 2004 to 17.4% of GDP in 2050, while the increase in other age-related expenditure is expected to be relatively minor, resulting in only an increase of 7.6 p.p. of GDP in total age-related expenditure.

## 3. Conclusion

The Luxembourg pension system is based on a strong political consensus and ensures a high level of adequacy. Its financial sustainability hinges, however, not only on relatively high rates of economic growth in the future, but also on the major contribution of non-resident workers to the Luxembourg economy and the pension scheme.

Although the reserve fund of the general pension scheme is projected to increase up to 40% of GDP by 2025, the long-term financial sustainability of the pension system is not ensured in the long run. In the event of a decline of non-resident employment the deterioration of the financial balance of the scheme would accelerate.

Financial sustainability would depend less on the availability of non-resident workers if the employment rates of residents were raised – and in particular those of women and people over 55. In spite of recent increases and strengthening of incentives to work longer, employment rates of 55–64 year olds remain significantly below the Lisbon target.

## 4. Background statistics

	LU			EU-25				
Adequacy								
Current situation								
	Total	Men	Women	Total	Men	Women		
At-risk-of-poverty rate <sup>(1)</sup>	11	11	11	16	15	17		
0–64	12	12	12	16	16	17		
65+	6	6	6	18	15	20		
75+	8	7	9	Nd	Nd	Nd		
Income inequality <sup>(1)</sup>								
0–64	3.8							
65+	3.0							
Income of people aged 65+ as a ratio of income of people aged 0–64 <sup>(1)(1.01)</sup>	1.01	0.99						
Median pensions relative to median earnings <sup>(2)</sup>	0.67	0.64	0.77					
Long-term projections								
Theoretical replacement rates <sup>(3)</sup>	2005	2030	2050					
Total net replacement rate	98	98	99					
Total gross replacement rate	91	90	91					
Gross replacement rate 1st pillar	91	90	91					
Gross replacement rate 2nd/3rd pillar	(*)	(*)	(*)					
Financial sustainability								
Current situation								
Esspros Pension expenditure <sup>(4)</sup> , % of GDP	1995	2000	2003	1995	2000	2003		
	12.7	9.7	10.9		12.5	12.6		
Employment (2004) <sup>(5)</sup>	Total	Men	Women	Total	Men	Women		
Employment rate (25–54)	78.7	92.5	64.6	76.8	85.2	68.5		
Employment rate (55–64)	30.8	38.5	22.9	41.0	50.7	31.7		
Effective labour market exit age (2004) <sup>(6)</sup>	57.7			60.7p				
Public finances (2003) <sup>(7)</sup>								
Public debt, % of GDP	5.4			63.3				
Budget balance, % of GDP	0.8			-2.8				
Long-term projections (EPC 2006)								
	2004	Level 2030	2050	Increase 2004–50	2004	Level 2030	2050	Increase 2004–50
Old-age dependency ratio <sup>(8)</sup>	21	31.6	36.1	+72%	25	40	52	+108 %
Public pensions expenditure, % of GDP <sup>(9)</sup>	10.0	15.0	17.4	+7.4	10.6	11.9	12.8	+2.2
Factors determining the evolution of public pensions expenditure (2000–50) <sup>(10)</sup>	Contribution to change in percentage points of GDP				Contribution to change in percentage points of GDP			
Demographic dependency	7.2				8.6			
Employment	-4.4				-1.1			
Eligibility	2.5				-2.1			
Level of benefits	2.1				-2.7			
Total (including residual)	7.4				2.2			
Notes								
<sup>(1)</sup> Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, Income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).								
<sup>(2)</sup> Source: Eurostat. Median individual pension income of retirees aged 65–74 in relation to median earnings of employed persons aged 50–59 excluding social benefits other than pensions.								
<sup>(3)</sup> Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first- and second-pillar pension schemes, retiring at the age of 65 years in 2005.								
<sup>(4)</sup> Source: Esspros, Eurostat. Includes expenditure by certain private social protection schemes.								
<sup>(5)</sup> Source: European Labour Force Survey, 2004.								
<sup>(6)</sup> Source: European Labour Force Survey, 2004.								
<sup>(7)</sup> Source: European Commission, DG ECFIN.								
<sup>(8)</sup> Source: Eurostat (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15–64.								
<sup>(9)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.								
<sup>(10)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.								
(*) Negligible proportion								

## Hungary

### 1. Main characteristics of the pension system

Since the 1997 pension reform the mandatory public pension system consists of two tiers. The **first tier** is a publicly-managed, pay-as-you-go financed, defined-benefit, social security pension scheme, which covers all employees and the self-employed. It provides earnings-related old-age, disability and survivors' benefits, which are financed mainly from separate pension contributions. The statutory retirement age for claiming a full pension was 55 for women and 60 for men under the former system and is being gradually raised to 62 years (for men by 2002 and for women by 2009).

About 30% of the population receive a public pension. About a quarter of pensions are disability pensions with a majority (57%) of recipients being younger than the statutory pensionable age. Old-age pensions, disability pensions, survivors' pensions and accident-related benefits are indexed by the average of wage and price increases (weighted 50:50).

The statutory contribution rate for employers and individuals went down from 31% in 1998 to 26.5% in 2003. The 18% pension insurance contribution paid by employers goes into the Pension Insurance Fund. Participants of the second tier pay 8 p.p. of these contributions into the funded scheme. Non-members of the second tier contribute exclusively to the public pension scheme. Employees are only required to pay contributions on income up to a certain level (in 2005 that level was over three times average earnings). There is no ceiling on the wage in which an employer is required to pay contributions. In 2004, revenues from contributions covered 76.4% of Pension Insurance Fund pension-related expenditures. The rest came from the central budget.

The pension scheme combines with other supplementary provisions of the social safety net that are means-tested. At least 20 years of contribution payments are required for a minimum pension from the statutory pension scheme. Equalising the legal retirement age for men and women would help reduce the gender gap in pension entitlements and contribute to increasing employment rates of older workers. An individual is entitled to a partial pension, for which there is no set

minimum, after 15 contributory years. In 2004 the minimum pension amounted to 40% of the average old-age pension and only 2% of people are in receipt of this benefit. Individuals who are not entitled to a pension in their own right, or if the amount of that pension is below a certain level, may be entitled to an old-age allowance.

The **second tier of the statutory scheme** will, in the long term, cover all who are engaged in gainful employment. Those entering the labour market for the first time are automatically enrolled into this two-tier scheme and those who had already acquired pension rights before 1998 could voluntarily opt for the new system at the time of its inception (about 50% of the labour force did, although they lost 25% of their accumulated rights for future pay-as-you-go pillar benefits). Those who did not join the second tier of the system remain in the pure PAYG scheme (paying a higher level of contributions and receiving higher benefits). Currently about 60% of the labour force are members of the second tier. As a consequence of mandatory membership for new entrants, the coverage will progressively increase.

The second tier of the statutory pension system is composed of fully-funded, defined-contribution, private pension funds (MPPFs). Funds accumulate and invest contributions paid by their members into individual accounts. At retirement the accumulated units are converted into a life annuity (provided by either the fund itself or a life insurance company). Benefits are also provided in case of death (right to a lump sum payment of the individual endowment to a previously designated person) or disability (benefit calculated according to general rules of annuity calculation).

Occupational schemes are not common in Hungary, but voluntary **individual schemes** have been in existence since 1994 in the form of *Voluntary Mutual Benefits Funds* (VMBFs). At present, 32% of the employed population are members of a voluntary pension plan (increases are expected in the future). Contribution rates vary widely. In 2004, the average membership fee payment amounted to 3.6% of gross earnings (from which two thirds are paid by employers). There are tax incentives provided in the scheme and by the end of 2000, about 320 VMBFs had been estab-

lished, but their numbers have declined rapidly. In 2005 only 75 voluntary supplementary retirement funds are in operation. Assuming an average of 30 years of membership to the voluntary pension schemes, the expectation would be for a supplementary pension of to be worth 8–10% of earnings.

## 2. Situation and perspectives in light of the common objectives

### 2.1. Current situation

**Adequacy:** The relative living standard of older people is around 90% of that of the 0–64 population. Hungary's poverty rates are relatively low and slightly lower for the 65 or above cohort (10%) than for the 0–64 population (12%). According to ISG calculations, the theoretical net replacement rate for a worker retiring at 65 after 40 years of contributions at the average wage in 2005 is 102%, total theoretical gross replacement rates are 66%. The net replacement rate calculations on a more typical case (retiring at 62, after 38 years of employment) though, show a lower level of 83% (for 2005).

The number of those who joined the funded scheme voluntarily was higher than expected. A motivation of voluntary membership was the expectation of higher pensions from private funds in addition to those from the PAYG scheme. This hope could be frustrated in the case of those who will have only a short accumulation period. Moreover, legislation describes several types of annuities, but there are currently no annuity products on the market that satisfactorily fit the law's requirements.

After years of ad hoc increases, a wage indexation formula was introduced in 1991, but was then changed several times. In general, lower pensions were increased at higher rates. Medium and higher pensions received low and irregular increases and the new indexation rules of 1998 were changed again in 1999. Since 2001, the net wage indexation has gradually been replaced by the so-called 'Swiss indexation'.

In 2003, over 30% of contributors made payments on minimum wages, which could significantly raise the

risk of future poverty if this becomes a permanent phenomenon. In addition a significant portion of those whose main economic activity is private farming stay outside the mandatory pension insurance system (their taxable income is insufficient to qualify for contribution payments).

**Financial sustainability:** In 2003, pension expenditures represent 9.3% of GDP, below the EU-25 average of 12.6%, while the total spending on social protection was significantly lower (21.4% vs. 28%). During the 1990s, the pension system was also used to cover people who became redundant due to the industrial restructuring that withdrew large groups from the labour market (thus being an important factor explaining the high rate of inactivity). This measure poses major problems for the financial sustainability of the system, reinforced by the decline of wage share in GDP (whereas in 1992 the wage share was at 40% of GDP, it dropped to 34% by 2000).

Employment rates, in particular those of older workers (in 2004 at 31.1%), are far below the Lisbon target and put at risk the system's long-run sustainability. Moreover, contribution evasion attributed to undeclared work remains a problem. Previous combinations of a short minimum contributory period of 15 years for obtaining an old-age pension and declining accrual rates were disincentives to prolong working lives which has led to an increase in early retirement today.

Several measures have been introduced to reduce the incentives for early exit from the labour market. In particular, the accrual rates for the old-age pension formula will be made linear from 2013<sup>(57)</sup>, and the minimum contributory period to be eligible for an old-age pension has been raised to 20 years.

**Modernisation:** The poverty rate of older women stays at a significantly higher level than for men (10% for women (65 or above), against 5% for men in 2002), reflecting more favourable career records for men and possibly low levels of survivors' benefits.

In the more complex mixed private-public system there is ample need for information. Employers are obliged to report the contribution of each employee yearly, but

(57) This will correspond to 1.65% of earnings for every service year for those who stay 100% in the pay-as-you-go tier and to 1.22% for those who partially opt out and join the second tier (from which they will receive an additional pension).



there were some mismatches between actual contribution revenues and contributions reported by employers. Moreover, reports on individuals and their records are incompletely computerised.

## 2.2. Outlook, reform measures and policy debates

Hungary is projected to face similar demographic trends to the other Member States. The old-age dependency ratio is expected to more than double from 22% to 48% between 2003 and 2050.

Prospective ISG replacement rates resulting from reforms adopted (including the two tiers of the mandatory scheme) are expected to remain nearly constant for workers at the average wage (about 100% as a net replacement rate for a 40 years career length retiring at 65 and about 80% for a 38 years career length retiring at 62). Also, replacement rates for people at two thirds of average earnings are expected to be rather constant with a slight increase from 90% in 2005 to 92% in 2050. Total theoretical gross replacement rates rise from the current level of 66% to 78% by 2050 due to the significant contribution of the funded elements of the system (which are expected to compensate for the reduced level of public pensions), while no significant change is expected in the total net replacement rate (it will slightly decrease from 102% to 98%)<sup>(58)</sup>.

The 1997 reform introduced a funded tier in the statutory social security scheme, causing a deficit in the first tier when a proportion of the contributions were redirected to the funded scheme. Moreover, contribution evasion seems to remain an issue in both the Pension Insurance Fund and private funds. The reform also gradually reduced employers' pension contributions from 24% of gross wages to 18% while employees' contributions were increased from 6% to 8.5% by 2003, thus reducing the total contribution rate from 31% of gross wages to 26.5% (for the two tiers of the mandatory scheme). This reduction of contributions was intended to increase employment but since employment did not react flexibly to this incentive, the decreasing wage share of GDP has resulted in reduced contribution revenues, thereby aggravating the financial balance of the Pension Insurance Fund. The introduction of linear accrual rates in the pension

formula, by enhancing transparency and fairness, will provide incentives to work longer. However, it will only be introduced from 2013 onwards.

Hungary is facing relatively small additional budgetary pressures on pension spending, mainly thanks to the recently enacted pension reform. According to the national budgetary projections included in 2004 in the context of the assessment of the long-term sustainability of public finances, Hungary is expected to be spending a broadly constant amount of around 7.5% of GDP between 2009 and 2050<sup>(59)</sup>.

Moreover, according to the AWG 2005 projections, public spending on pensions is projected to increase from 10.4% of GDP to 17.1% between 2004 and 2050, despite the partial switch to funded schemes (taking into account the development of the mandatory funded scheme, pension expenditures are projected to increase from 10.4% in 2004 of GDP to 20.3% of GDP in 2050). The increase is driven by the dynamic effect of the increasing wage level on the level of new pensions. This projected increase is amongst the highest in the EU and is strongly contributing to the overall projected increase in age-related public expenditure (increasing from 20.7% of GDP to 27.7% between 2004 and 2050).

## 3. Conclusion

Hungary has implemented major reforms in the last decade. The early reforms of the 1990s increased the statutory retirement age and strengthened the link between contributions and benefits. Moreover, the 1997 reform introduced a funded tier in the statutory social security scheme, which will contribute to the sustainability of the pension system in the long run. However, this will cause transition costs which will constitute a major challenge for the Pension Insurance Fund and public finances as a whole. Further reforms may be required in the public PAYG scheme, in particular with the aim of tightening early retirement options in order to encourage longer working. Better management and cooperation, in particular regarding contribution collection, between the Pension Insurance Fund, Tax and Financial Control Administration (APEH) and private funds could reduce

(58) Currently, pension benefits are exempt from tax and as from 2013, pensions will be taxed. Therefore their gross amount will exceed their net amount. As a result, the gross replacement rate will increase but the net replacement rate will remain roughly the same.

(59) The NSR foresees the total spending on pension (including first and second tiers of the statutory system and disability pensions) to grow from 9.5% in 2004 to about 11% of GDP in 2050.

contribution evasion. The efficiency of the second tier contribution collection might also be improved by better cooperation amongst the funds as well as by an enhanced centralisation of contribution collection.

Hungary has managed to maintain adequate pensions in recent years – relative poverty is quite low amongst older people, who enjoy on average almost a comparable income to the active population. However, some measures of the recent reforms may pose adequacy risks in the future. In addition a significant portion of people whose main economic activity is private farming are not covered

by the mandatory pension insurance system at all.

Employment rates are low in Hungary, especially for older workers, despite recent improvements. Policy efforts to further increase the employment rates of older people could make a strong contribution to future adequacy and sustainability. The introduction of linear accrual rates in the pension formula will enhance incentives to work longer as well as fairness, but this will only be introduced from 2013 onwards. An acceleration of this process may be desirable.

## 4. Background statistics

	HU			EU-25				
Adequacy								
Current situation								
	Total	Men	Women	Total	Men	Women		
At-risk-of-poverty rate <sup>(1)</sup>	12	12	12	16	15	17		
0–64	12	12	12	16	16	17		
65+	10	6	12	18	15	20		
75+	14	11	15	Nd	Nd	Nd		
Income inequality <sup>(1)</sup>								
0–64	4.0							
65+	2.5							
Income of people aged 65+ as a ratio of income of people aged 0–64 <sup>(1)</sup>	0.87	0.92	0.84					
Median pensions relative to median earnings <sup>(2)</sup>	0.71	0.68	0.72					
Long-term projections								
Theoretical replacement rates <sup>(3)</sup>	2005	2030	2050					
Total net replacement rate	102	96	98					
Total gross replacement rate	66	73	77					
Gross replacement rate 1st pillar	66	59	59					
Gross replacement rate 2nd/3rd pillar	0	14	19					
Financial sustainability								
Current situation								
Esspros Pension expenditure <sup>(4)</sup> , % of GDP	1995	2000	2003	1995	2000	2003		
		8.7	9.3		12.5	12.6		
Employment (2004) <sup>(5)</sup>	Total	Men	Women	Total	Men	Women		
Employment rate (25–54)	73.6	80.5	67.0	76.8	85.2	68.5		
Employment rate (55–64)	31.1	38.4	25.0	41.0	50.7	31.7		
Effective labour market exit age (2004) <sup>(6)</sup>	60.5			60.7p				
Public finances (2003) <sup>(7)</sup>								
Public debt, % of GDP	59.1			63.3				
Budget balance, % of GDP	-6.2			-2.8				
Long-term projections (EPC 2006)								
	2004	Level 2030	2050	Increase 2004–50	2004	Level 2030	2050	Increase 2004–50
Old-age dependency ratio <sup>(8)</sup>	22.6	35.1	48.3	+114%	25	40	52	+108 %
Public pensions expenditure, % of GDP <sup>(9)</sup>	10.4	13.9	20.3	+9.9%	10.6	11.9	12.8	+2.2
Factors determining the evolution of public pensions expenditure (2000–50) <sup>(10)</sup>	Contribution to change in percentage points of GDP				Contribution to change in percentage points of GDP			
Demographic dependency	10.5				8.6			
Employment	-1.1				-1.1			
Eligibility	-4.5				-2.1			
Level of benefits	-7.5				-2.7			
Total (including residual)	6.4				2.2			

### Notes

<sup>(1)</sup> Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).

<sup>(2)</sup> Source: Eurostat. Median individual pension income of retirees aged 65–74 in relation to median earnings of employed persons aged 50–59 excluding social benefits other than pensions.

<sup>(3)</sup> Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first- and second-pillar pension schemes, retiring at the age of 65 years in 2005.

<sup>(4)</sup> Source: Esspros, Eurostat. Includes expenditure by certain private social protection schemes.

<sup>(5)</sup> Source: European Labour Force Survey, 2004.

<sup>(6)</sup> Source: European Labour Force Survey, 2004.

<sup>(7)</sup> Source: European Commission, DG ECFIN.

<sup>(8)</sup> Source: Eurostat (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15–64.

<sup>(9)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.

<sup>(10)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.

(\*) Negligible proportion

## Malta

### 1. Main characteristics of the pension system

In Malta the mandatory earnings-related pension scheme covers old-age pensions, survivors' benefits and invalidity pensions for employed people. It is called 'two-thirds pension' because the initial benefits at the moment of retirement are calculated as two thirds of the average income of the best three years during the 10 last years prior to retirement, after a contribution period of 30 years. For self-employed people the income averaging period is extended to the last 10 years. The contribution base is such that all income higher than 133% of average annual earnings (2004) is not taken into account when calculating pension entitlement. Retirement age is 61 for men and 60 for women (equalisation is proposed to take place by 2007). Presently, the full rate of a pension is payable to a person who has paid (or has been credited) contributions over a 30-year period. The lower the number of years of contribution, the lower the pension will be. At least nine years of contributions are required.

So far voluntary **occupational pension schemes** and **individual provision** are still in the initial stages of development. However, occupational schemes existed before the 'two-third pension' was introduced in 1979.

The 2004 **Minimum Pension Guarantee** stood at around 50% of the average wage and is calculated at 80% of the national minimum wage in the case of married persons and two thirds for single pensioners. In addition, there is a non-contributory means-tested assistance, called 'age pension' which is payable to those aged more than 60 with little or no other means to support themselves.

### 2. Situation and perspectives in light of the common objectives

#### 2.1. Current situation

Concerning **adequacy**, the current relative income of older persons (aged 65 or older) is on average about 90% of the relative income of the age group 0–64 (96% for men and 86% for women). Presently, according to the ISG calculations, theoretical total gross replacement rates stand at around 72% (net 88%) for a worker retiring at 65 after 40 years of contributions at the average wage. The risk of poverty of people aged more than 65 is 20%, significantly higher than the one of people aged 0–64 (14%). The risk of poverty for the oldest pensioners aged 75 and over is higher for women than for men (24% compared to 18%).

**Sustainability:** The Maltese government regards its statutory pension scheme with reference to the deteriorating old-age dependency ratio as potentially financially unsustainable in the future. Pension expenditure increased in the last years from 8.5% of GDP in 2000 to 9.5% of GDP in 2003. In 2003 it was due to increasing old-age and survivors' outlay. Moreover, a high proportion of Maltese people claim invalidity benefits: in 2004 the number of beneficiaries in this category stood at 8 824 while in 2002 this number stood at 7 560 i.e. a 16.7% increase in only two years, which represents 10.7% and 12.84%<sup>(60)</sup> of the total cost of old-age pensions.

The employment rates for both genders and all age cohorts is currently much lower than in almost all other new Member States. The 2004 employment rate for women (32.7%) is considerably below the Lisbon tar-

(60) Based on ESSPROS statistics.

get (60%), as is the employment rate of older workers (31.5%). Female older workers' employment rate (11.5%) is among the lowest in the EU-25 and decreased from 2003 to 2004 by 1.5 p.p.. However, the female employment rate in the youngest group of 15–24 years is equal to that of men, suggesting that there are strong cultural reasons for current low employment rates for older women and that a strong cohort effect will lead, over time, to an equalisation of employment rates between men and women.

Concerning **modernisation**, Malta is the country with the widest gender gap in the EU-25 concerning employment rates (except for the youngest group of people). It amounts to 54 p.p. at the age 25–54 and 41.9 p.p. by age 55–64. In addition, more women are working part-time than men (3.5% men and 19.9% women). The Maltese government expects an increase of female labour participation rate over time, but also a decrease in the black economy. Nevertheless, the gender gap in regard to the risk of poverty in the age group of 65 or above is negligible, but does increase for those 75+, up to 6 p.p.

## 2.2. Outlook, reform measures and policy debates

Malta is expected to face similar demographic trends as most other new Member States, due to a current<sup>(61)</sup> falling fertility rate (1.48 in 2003). The old-age dependency ratio is projected to increase between 2004 and 2050 by 22 p.p., noticeably less than for the EU-10 (31 p.p.).

The Maltese government shortly plans to introduce reforms to improve the financial sustainability and **adequacy** of the pension system, notably by gradually raising the retirement age to 65 for both men and women, gradually increasing the contribution period for the accumulation of the PAYG pension and changing the calculation base to achieve more equivalence. A White Paper on pension reform was published in November 2004, indicating that the underpinning objective of the pay-as-you-go pension should be to guarantee a minimum decent standard of living and to prevent social exclusion (providing flat-rate contributions and flat-rate benefits), while a second pillar (SPPS) still to be introduced would allow for the improvement of the pension benefit entitlement. Moreover, voluntary third private saving schemes would be introduced.

The calculation of the theoretical replacement rates shows a range of outcomes under different scenarios. In the absence of pension reforms and under the assumption that the ceiling for the accrual of the benefit level will be indexed only to prices, the gross replacement rates would fall from today's 72% to 53% in 2030 and 31% in 2050 (net today 88%, 61% in 2030 and 34% in 2050). The introduction of a mandatory SPPS by 2010 is expected to contribute to an increase in future replacement rates from 2030 onwards.

Concerning **sustainability**, adjustment of pension scheme parameters are planned, such as an increase in the contribution period required for the statutory scheme and equal treatment between the self-employed and employed persons regarding the contribution period upon which pensions are calculated.

According to the AWG 2005 projections, public spending on pensions is projected to slightly decrease from 7.4% of GDP in 2005 to 7.0% of GDP in 2050. However, there will be an increase until 2020 when the spending will peak at 10.2% of GDP and decrease thereafter. This decrease is due to the current rules regarding pension levels, which are subject to a ceiling, indexed on the rise in cost of living only, thus resulting in a decrease of the initial pension level relative to wages and making the pension more flat-rate than it is currently. At the same time, overall age-related spending is projected to remain at its current level (17.3% of GDP).

According to the Maltese National Strategy report, taking into account the new reform options – following the implementation of the reforms contemplated in the White Paper – the pension expenditures in the PAYG scheme are expected to peak at 10.0% in 2013 and then decline to 4.3% by 2050, the share of total expenditure on the second pillar SPPS is projected to be rising over the period, reaching 4.2% of GDP in 2050.

Concerning **modernisation**: Retirement age is 61 for men and 60 for women (equalisation to 61 is proposed by 2007). The current pension system is earnings-related and does not include a credit system for childcare and elderly care, which is likely to penalise women. Reform plans include measures such as credits for

(61) The unpublished figure for 2004 is 1.37.

childcare and elderly care either by introducing a 'credit system' for parents with children up to the age of four years or reducing the contributory period with each child.

### 3. Conclusion

The timing of the second round of National Strategy Reports coincided in Malta with the adoption of the recommendations of the reform strategy within the White Paper and thus fell in the middle of the decision-making process. However, Malta stated that the OMC was very helpful for the reform process, especially the calculation of the future replacement rates within the current system.

The likely evolution of the current statutory pension scheme is, in this context, still uncertain. The govern-

ment has to decide whether the system will develop in the direction of more flat-rate benefits or of a strengthening of the link between contributions and benefits. In case of flat-rate minimum pensions a reasonable level should be foreseen in order to cope with the poverty risk of older persons, especially women. In order to ensure adequate replacement incomes and sustained incentives to contribute to the scheme, easy access to the new mandatory scheme SPPS is essential.

Malta is the country with the widest gender gap in employment rates. Although the cohort effect can be expected to change this over time, further plans to increase incentives in order to retain women in employment might be a prior political issue.

## 4. Background statistics

	MT			EU-25				
Adequacy								
Current situation								
	Total	Men	Women	Total	Men	Women		
At-risk-of-poverty rate <sup>(1)</sup>	15	15	15	16	15	17		
0–64	14	14	14	16	16	17		
65+	20	19	21	18	15	20		
75+	21	18	24	Nd	Nd	Nd		
Income inequality <sup>(1)</sup>								
0–64	4.6							
65+	4.5							
Income of people aged 65+ as a ratio of income of people aged 0–64 <sup>(1)</sup>	0.90	0.96	0.86					
Median pensions relative to median earnings <sup>(2)</sup>	0.67	0.75	0.53					
Long-term projections								
Theoretical replacement rates <sup>(3)</sup>	2005	2030	2050					
Total net replacement rate	88	61	34					
Total gross replacement rate	72	53	31					
Gross replacement rate 1st pillar	72	53	31					
Gross replacement rate 2nd/3rd pillar	(*)	(*)	(*)					
Financial sustainability								
Current situation								
Esspros Pension expenditure <sup>(4)</sup> , % of GDP	1995	2000	2003	1995	2000	2003		
	8.1	8.2	9.4		12.5	12.6		
Employment (2004) <sup>(5)</sup>	Total	Men	Women	Total	Men	Women		
Employment rate (25–54)	62.1	88.8	34.8	76.8	85.2	68.5		
Employment rate (55–64)	31.5	53.4	11.5	41.0	50.7	31.7		
Effective labour market exit age (2004) <sup>(6)</sup>	57.7			60.7p				
Public finances (2003) <sup>(7)</sup>								
Public debt, % of GDP	71.1			63.3				
Budget balance, % of GDP	-9.7			-2.8				
Long-term projections (EPC 2006)								
	2004	Level 2030	2050	Increase 2004–50	2004	Level 2030	2050	Increase 2004–50
Old-age dependency ratio <sup>(8)</sup>	19	36	40.6	+114%	25	40	52	+108 %
Public pensions expenditure, % of GDP <sup>(9)</sup>	7.4	9.1	7.0	-0.4	10.6	11.9	12.8	+2.2
Factors determining the evolution of public pensions expenditure (2000–50) <sup>(10)</sup>	Contribution to change in percentage points of GDP				Contribution to change in percentage points of GDP			
Demographic dependency	7.3				8.6			
Employment	-1.2				-1.1			
Eligibility	-1.0				-2.1			
Level of benefits	-5.0				-2.7			
Total (including residual)	-0.5				2.2			

### Notes

<sup>(1)</sup> Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).

<sup>(2)</sup> Source: Eurostat. Median individual pension income of retirees aged 65–74 in relation to median earnings of employed persons aged 50–59 excluding social benefits other than pensions.

<sup>(3)</sup> Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first- and second-pillar pension schemes, retiring at the age of 65 years in 2005.

<sup>(4)</sup> Source: Esspros, Eurostat. Includes expenditure by certain private social protection schemes.

<sup>(5)</sup> Source: European Labour Force Survey, 2004.

<sup>(6)</sup> Source: European Labour Force Survey, 2004.

<sup>(7)</sup> Source: European Commission, DG ECFIN.

<sup>(8)</sup> Source: Eurostat (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15–64.

<sup>(9)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.

<sup>(10)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.

(\*) Negligible proportion



## The Netherlands

### 1. Main characteristics of the pension system

The **statutory** social security (State) old-age pension (AOW) is financed by contributions levied on earnings at a rate that is statutorily limited to a maximum of 18.25% and provides all residents of the Netherlands at the age of 65 with a flat-rate pension benefit that in principle guarantees net benefits of 70% of the net minimum wage (this is equivalent to a gross replacement rate of around 30% for a career at the average wage). As there is no means-test for the eligibility of benefits, other forms of income have no effect on the AOW benefit.

All residents of the Netherlands between the ages of 15 and 65 are insured by the AOW (no distinction is made between men and women, between civil servants, employees, the self-employed and housewives). During the period of insurance, i.e. when the person lives in the Netherlands, entitlement is accrued by 2% every insured year. This leads to a 100% entitlement when reaching the age of 65, provided there are no gaps in the period of insurance (a gap occurs when a person resides outside the Netherlands). On 1 January 2005, the gross pension rates (for the full rate of pension after 50 years of insurance) for singles are about EUR 925 gross per month, while both partners in a couple (either married or living together officially) are independently entitled to a pension of about EUR 632, which clearly contributes to lowering the risk of poverty among the elderly.

People who are not entitled to the full AOW benefit (i.e. that have not lived in the Netherlands for a period of 50 years) and who have, together with other sources of income, a total income below the subsistence level (i.e. less than 70% of the legal minimum wage) are entitled to receive social assistance.

**Occupational schemes** are very well-developed in the Netherlands, thanks to collective branch agreements

that ensure mandatory<sup>(62)</sup> coverage of over 90% of all employees. Occupational pensions are subject to negotiation between social partners and have to be financed by capital funding. In 2001, the amount of assets held by pension providers was 131% of GDP. It is expected to grow to about 195% in 2040.

Characteristically, final salary schemes and average pay schemes in general promise a yearly replacement rate of 1.75% to 2% of the final salary or average career salary (including AOW benefits), while the total pension benefit in general corresponds to around 70% of the final or average career salary. Occupational pension schemes are considered supplementary to the AOW State pension. The AOW benefit is therefore included in most calculations of occupational pension schemes in order to achieve the 70% target after 40 years of contributions (the part of the income over which no additional pensions are built up because it is expected to be covered by the AOW is known as the franchise)<sup>(63)</sup>.

On 1 January 2002, some 93% of all active members were participating in a defined-benefit scheme. There is a shift from pension schemes based on final wage to pension schemes based on average wages of the whole career: in 2000, 60% of pension funds were final wage and 32% average wage, while in 2004 the shares was 13% final wage and 77% average wage (expressed as a percentage of active pension scheme members). The way contributions are divided among social partners varies from one pension scheme to another.

The Dutch pension system also includes **individual pension provisions**, either through annuity insurance or endowment insurance (providing a lump sum), encouraged by tax rebates up to certain limits (annuity contributions to compensate gaps in pension accrual in a certain calendar year are, in principle, deductible and the payments taxed).

(62) Mandatory participation in a branch pension scheme is imposed by the Ministry of Social Affairs and Employment after a request from the branch.

(63) The franchise can be different for different pension schemes in the second pillar. In fact, there are a few branch pension funds which don't have a franchise at all and so everyone accrues pension rights. When there is a franchise and the wage is below the franchise, there is no accrual of pension rights.

## 2. Situation and perspectives in light of the common objectives

### 2.1. Current situation

**Adequacy:** Due to the AOW, which guarantees 70% of the net minimum wage, the poverty rate is one of the lowest in the EU: at 7%, the poverty risk of people aged 65 or more (7% for people aged 75 or more) is significantly lower than for the general population (13% for people aged less than 65). The living standards of people aged 65 or more are high and represent 84% of that of the 0–64 cohort and 76% of those aged 45–54. It is noticeable that these figures remain stable for people aged 75 or more.

For a worker on average earnings, the flat-rate public pension represents a gross replacement rate of nearly one third. As AOW is flat-rate, the associated replacement rate is higher for people on lower incomes, and lower for people on high earnings. Occupational pensions generally supplement AOW pension to achieving a replacement rate of about 70%. They are gradually shifting from benefits based on final earnings to benefits based on career average earnings. This will not affect workers with flat earnings profiles, but it will lead to lower replacement rates for people with rising earnings profiles especially at the end of their career.

Social-security pensions are linked to minimum wages, while the indexation of occupational pension schemes varies from prices to wages. Indexation is generally not guaranteed in occupational schemes and the adjustment of pensions in payment can be suspended or lag behind inflation or earnings if this is required by the financial situation of the scheme.

Due to the AOW (that provides a flat-rate benefit based on residence), the risk of poverty is very similar between men (6%) and women (7%) aged 65 and older. In contrast, because of the Netherlands' large number of part-time workers, who are predominantly women, the gender difference in the relative income of elderly persons is among the highest in the EU. To counter this, since 1994, part-time workers can not be excluded from participation in a supplementary pension scheme and, since 2002, no distinction can be made in any pension scheme upon the length of contract.

**Financial sustainability:** The 2004 employment rate for people aged 55–64 (45.2%) has increased significantly in the past decade (from 36.4% in 1999). The share of part-time employment is important (about 10% of older people work less than 12 hours a week) and the government has defined an objective of a 40% employment rate of 55–64 year olds in 2007 (45% in 2010), taking into account only 'bigger jobs' (at least 12 hours a week). A series of measures favour greater employment for older people, such as employers do not pay WAO (disability insurance) basic contributions for employees of 55 years or older who are already employed, and for employees of 50 years and older who are taken on. Moreover, if an employee changes to a part-time job or a job with lower pay than the current job in the 10 years before reaching pensionable age, the pension accrual can continue, on the basis of the previous (higher) wage. And since 2002, it has been more attractive for older people to continue working, with the introduction of the increase in the employed person's tax deduction for this group.

To cope with its ageing population and the financial sustainability of the social security scheme, governments have been pursuing a threefold policy, based on the reduction of public debt, an increase in labour market participation, and an adjustment of collective schemes other than the AOW. The reduction of government debt aims at reducing the interest burden and at financing rising public expenditure as a consequence of the ageing population. The AOW Savings Fund was established in 1997 to pave the way for a broad base of support within society for the reduction of government debt before increases of public expenditure linked with ageing, although in recent years, this strategy has been difficult to pursue due to deficits in public finances. The government remains committed to the strategy of reducing government debt with the aim of building up a 'virtual' old-age pension savings fund consisting of allocations earmarked for financing public pensions from 2020 onwards when around EUR 125 billion should be available.

Since 2001, the situation on the financial markets has changed substantially, in particular with low interest rate level and low returns on shares. This had unfavourable consequences for the Dutch pension funds, because the required coverage ratios came under pressure. To improve the coverage ratio, in many schemes, pension contributions were increased, indexing was limited, and pension scheme parameters were adapted.

## 2.2. Outlook, reform measures and policy debates

**Adequacy:** Private occupational pensions are expected to make a major contribution to adequacy as they are of an almost equal magnitude with public pensions. Their financial sustainability depends largely on stable macroeconomic developments. The headlines for a new Financial Assessment Framework (FTK) for supplementary pensions were established in 2004. Implementation of this framework will take place by law. The FTK will increase the surveillance of private funds and tighten the requirements for their financial sustainability. An important aspect of the FTK stems from the criteria for the financial solvency of the pension funds (in particular valuation of obligations of pension funds at market value, as well as conditions on the size of the reserves). It should be noted, however, that contribution rates necessary to maintain replacement rates in the future are very sensitive to assumptions made on future rates of return and conditional indexation.

The linkage between the basic State pension and earnings (both for the level of the flat-rate benefit and for indexation) and the still maturing occupational schemes, should ensure persisting good records for adequacy. Moreover, the government and social partners are committed to raising the participation rates in occupational pensions. To ensure that every employee has a supplementary old-age pension, the employers' organisations and trade unions want to reduce the no-coverage from 7% to 3.5% through collective bargaining. If this approach does not prove effective, the government will decide in 2007 whether it is necessary to make it mandatory for an employer who offers pensions (for 2% of employed people, the employer does not have a pension plan), to offer the possibility to take part in a pension scheme to all his employees.

**Financial sustainability:** The Netherlands will remain one of the Member States with the lowest old-age dependency ratio (population 65 or above as a share of 15–64). It currently lies at a relatively low level in comparison to the EU-25 average (respectively 21 and 25 in 2004), and is projected to remain below the EU-25 average (respectively 41 and 52 in 2050), due to moderate fertility and low increases in life expectancy. The negative effects of ageing populations will be somewhat smoothed by the labour market performance, as according to the AWG labour force projections to be used in its 2005 budgetary projection exer-

cise, average employment rates in the Netherlands are projected to remain among the highest in the EU-25 by 2050, though the share of part-time work is currently also among the highest the projected increase would be slower than the average.

In 2002, total pension expenditures, including occupational pensions, were on a relatively high level of 13.1% of GDP, slightly above the EU average, and are projected to rise to 20% of GDP in 2050. Also, regarding public expenditure, the Netherlands can expect relatively strong budgetary pressures due to the ageing population. According to the AWG 2005 projections, the public spending on pensions is expected to increase by 3.5 p.p. to reach 11.2% of GDP in 2050.

In spite of the significant increase in public spending caused by ageing, the Netherlands is committed to maintaining the basic pension in its present form. The financing is to be secured through transfers from the general budget as soon as the maximum contribution rate of 18.25% is no longer able to cover expenditures. The government remains committed to the strategy of reducing government debt in order to reduce the interest burden and with the aim of building up a 'virtual' old-age pensions savings fund consisting of earmarked allocations for financing public pensions from 2020 onwards when around EUR 125 billion should be available (the AOW Savings Fund was established in 1997). Moreover, in the coming decades, tax revenues are expected to rise because of the increase of pension payments due to many more people receiving supplementary pensions.

Raising labour market participation in general and of older workers in particular will also have to make a significant contribution to securing the future funding of the pension system. In order to raise the level of participation in the labour market, all tax facilities for early retirement schemes will be abolished by 1 January 2006 (there is more favourable treatment for people over 55 years of age at 1 January 2005). Moreover, the initiative to introduce a life-course arrangement, aiming at a better combination of work with, e.g. care and education, could contribute to slowing flows into early retirement benefits.

In addition to plans aimed at reducing the use of early exit from the labour market, it is planned to remove obstacles preventing people from working after they

reach the current retirement age of 65. The government will respond in early 2006 to advice from the SER (Social and Economic Council), the Labour Foundation (STAR) on the question of what adjustments are desirable and necessary to remove obstacles to continuing to work longer.

Moreover, eligibility conditions for occupational disability have been reformed. Since 1 January 2004, the primary responsibility for dealing with leave during the first two years of illness lies with the employer and the worker. Employers now have to continue to pay a sick worker's salary for two years instead of one as was previously the case: this is intended to intensify reintegration efforts and to reduce the number of cases of occupational disability. A new reform will come into effect in 2006 and plans to provide incentives to employers and employees to stimulate the reintegration of people who are partially incapacitated for work. People who are fully and permanently incapacitated for work receive a benefit amounting to 70% of their former wage. People who are partially incapacitated for work who do not find work end up with a benefit based on the minimum wage. If they do find work, they will receive a supplement of their income from work to 70% of the difference between the former and new wage.

**Modernisation:** Increasing transparency in the implementation of pension schemes may increase support for maintenance of the current pension system. A key aim here is to raise the public's 'pension awareness'. The provision of information and the collection of data on supplementary pensions are currently strongly linked to the supervisory function, and take place on a fragmentary and ad hoc basis. The new Pension Act will establish a legal basis for setting up and maintaining a pension database and the government plans to improve the information furnished by pension providers about individual entitlements. Moreover, there is a discussion about pensioners' participation in the decision-making process and accountability structures of supplementary pension schemes either through agreements or statutory regulations.

### 3. Conclusion

The Dutch strategy for the first pillar relies on an ambitious goal of achieving budgetary surpluses over a long period of time, supported by intensified employment policies and a reform of disability pension schemes designed to reduce incentives for early exit from the labour market. However, public finances have been in deficit in 2002 and 2003 and are expected to remain in deficit for some years, which gives rise to a concern over the likelihood of success of this policy. Regarding second-pillar pensions, the strategy relies on conducting sound macroeconomic policies and safe funding margins. The new Financial Assessment Framework lays down tighter requirements for the financial sustainability of private funds and will increase surveillance on these funds.

The Dutch pension system performs well in terms of adequacy, as it is based on a universal flat-rate public pension and on earnings-related supplementary pensions which cover a very large share of the population. However, it remains to be seen whether increased labour-force participation and the inclusion of part-time workers in occupational pension schemes will allow women to catch up with men in terms of incomes in old age.

While employment rates for people aged 55–64 have increased significantly in the past decade, an important share reflects part-time employment. The government has defined an objective of 40% in 2007 (45% in 2010) of employment rates of 55–64 year olds, taking into account only 'bigger jobs' (of at least 12 hours a week). While further steps are planned in order to remove obstacles preventing people from working after they reach the current retirement age of 65, measures introduced aimed at reducing the use of early exit from the labour market (early retirement and disability schemes) are gradual and could be further strengthened.

## 4. Background statistics

	NL			EU-25				
Adequacy								
Current situation								
	Total	Men	Women	Total	Men	Women		
At-risk-of-poverty rate <sup>(1)</sup>	12	12	12	16	15	17		
0–64	13	12	13	16	16	17		
65+	7	6	7	18	15	20		
75+	7	7	7	Nd	Nd	Nd		
Income inequality <sup>(1)</sup>								
0–64	4.2							
65+	3.2							
Income of people aged 65+ as a ratio of income of people aged 0–64 <sup>(1)</sup>	0.84	0.88	0.83					
Median pensions relative to median earnings <sup>(2)</sup>	Nd	Nd	Nd					
Long-term projections								
Theoretical replacement rates <sup>(3)</sup>	2004	2030	2050					
Total net replacement rate	92	90	90					
Total gross replacement rate	71	68	69					
Gross replacement rate 1st pillar	30	30	30					
Gross replacement rate 2nd/3rd pillar	41	39	39					
Financial sustainability								
Current situation								
Esspros Pension expenditure <sup>(4)</sup> , % of GDP	1995	2000	2003	1995	2000	2003		
	14.1	13.0	12.6		12.5	12.6		
Employment (2004) <sup>(5)</sup>	Total	Men	Women	Total	Men	Women		
Employment rate (25–54)	82.5	90.2	74.6	76.8	85.2	68.5		
Employment rate (55–64)	45.2	56.9	33.4	41.0	50.7	31.7		
Effective labour market exit age (2004) <sup>(6)</sup>	61.1			60.7p				
Public finances (2003) <sup>(7)</sup>								
Public debt, % of GDP	54.1			63.3				
Budget balance, % of GDP	-3.2			-2.8				
Long-term projections (EPC 2006)								
	2004	Level 2030	2050	Increase 2004–50	2004	Level 2030	2050	Increase 2004–50
Old-age dependency ratio <sup>(8)</sup>	20.5	41.1	40.6	+98%	25	40	52	+108 %
Public pensions expenditure, % of GDP <sup>(9)</sup>	7.7	10.7	11.2	+3.5	10.6	11.9	12.8	+2.2
Factors determining the evolution of public pensions expenditure (2000–50) <sup>(10)</sup>	Contribution to change in percentage points of GDP				Contribution to change in percentage points of GDP			
Demographic dependency	6.3				8.6			
Employment	-0.2				-1.1			
Eligibility	-1.6				-2.1			
Level of benefits	-0.4				-2.7			
Total (including residual)	3.8				2.2			

### Notes

<sup>(1)</sup> Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).

<sup>(2)</sup> Source: Eurostat. Median individual pension income of retirees aged 65–74 in relation to median earnings of employed persons aged 50–59 excluding social benefits other than pensions.

<sup>(3)</sup> Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first- and second-pillar pension schemes, retiring at the age of 65 years in 2005.

<sup>(4)</sup> Source: Esspros, Eurostat. Includes expenditure by certain private social protection schemes.

<sup>(5)</sup> Source: European Labour Force Survey, 2004.

<sup>(6)</sup> Source: European Labour Force Survey, 2004.

<sup>(7)</sup> Source: European Commission, DG ECFIN.

<sup>(8)</sup> Source: Eurostat (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15–64.

<sup>(9)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.

<sup>(10)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.

(\*) Negligible proportion

## Austria

### 1. Main characteristics of the pension system

The key elements of the pension reform 2004 (which came into force on 1 January 2005) were the introduction of a uniform pension law and personal defined-benefit pension accounts for blue-collar workers, white-collar workers, the non-farm self-employed, farmers and federal civil servants aged 49 years and younger. For people having accrued rights before 1 January 2005 and who had not reached the age of 50 on 1 January 2005, their entitlement will be calculated on the basis of the old and the new law, according to the proportions of their active life spent before and after this date. Further major reform elements have been the introduction of a 'pension corridor' in combination with a gradual phase out of early retirement possibilities and a new – inflation-orientated – indexation of pensions.

The key elements of the 2003 reform were raising the retirement age for men to 65 (and women to 60) by 2017, the gradual extension of the assessment period for pension calculation from 15 years up to 40 years by 2028, the gradual reduction of increment points from 2 to 1.78 by 2009 (a pension of 80% after 45 insurance/contribution years instead of 40), the modification of the provisions on actuarial additions and deductions. Any losses occurring through these reforms are to be limited. Occupational retirement provisions are developing but so far only 13% of employees are covered. Since 1 July 2002 the Occupational Staff Provision Act ('*Betriebliches Mitarbeitervorsorgegesetz*') – better known as 'new severance pay' – has been in force in Austria. In accordance with the new law, every employer has to transfer 1.53% of an employee's monthly salary to a staff provision fund (*Mitarbeitervorsorgekasse/MVK*). After termination of employment the employee can keep the capital in this fund, transfer it to another fund or take a cash sum.

Private pensions are considered an individual option for the maintenance of a person's living standard. Traditionally, life insurance has played a major role and these contracts have shown a significant upward trend over the past years (in 2004 plus 8.5%). Austria has always promoted specific private old-age pension schemes by granting tax incentives (e.g. the capital

earnings of the retirement provision are tax-free). A new premium-aided pension savings scheme '*Zukunftsvorsorg*' has been available since early 2003 and is already successfully established.

A compensation supplement is provided to those receiving a pension below a specific threshold (as well as a possible other income) to ensure a minimum income in retirement.

### 2. Situation and perspectives in light of the common objectives

#### 2.1. Current situation

**Concerning adequacy**, people aged 65 have a living standard (disposable income) close to that of the 0–64 population (with a relative equivalised income of 93%). Poverty risk for elderly persons is higher (17% for 65 or above people with equivalised income of less than 60% of overall median equivalised income) than for persons aged 0–64 (12%). The gap between men and women aged more than 65 is more important (20% for women and 13% for men). Replacement rates are currently relatively high, notably due to the calculation of the pension from the best 15 years of income. According to calculations made in the framework of the ISG, the gross theoretical pension replacement rate for a worker retiring at 65 (after 40 years of contributions at the average wage) is 64% (total net 80%) after 2003-04 pension reforms.

Concerning **sustainability**, the 2003–04 pension reforms strengthened the actuarial principle. In addition, labour market policy prioritises keeping older persons employed or reintegrated in the labour market. The employment rate for older people has been stable over the last decade and remains at 29% in 2004, significantly below the Lisbon target.

Early retirement possibilities will be phased out by 2017. The 'corridor pension' allows retirement for men between 62 and 65, but with a deduction of 4.2% (2006) per year of retirement before the age of 65. To prevent the corridor pension from developing into a new early retirement pension, losses resulting from actuarial deductions are excluded from the loss limit described earlier (of maximum 10% by 2024).



Concerning **modernisation**, the 2004 reform introduced a pension account, where pension rights are now credited for child-rearing periods (four years per child and five years in the event of multiple birth) at a level of EUR 1 350 per month. Since these periods are also recognised in addition to any existing employment, the disadvantages of part-time employment may be outweighed at least partly. A better – income based – revaluation of former earnings and fewer restrictions on acquiring pension rights (previously 15 years of contributory economic activity are required, this has been reduced to seven and for the remaining eight years childcare periods are sufficient) will particularly affect pensions of women with periods of childcare. For each period of childcare there is also the possibility of a voluntary pension splitting. The pension reforms of 2003 mean that childcare (36 months per child) shortens the assessment period that is used for calculating an individual's pension.

## 2.2. Outlook, reform measures and policy debates

Concerning **adequacy**, the latest reforms extend the period of an individual's earning history that is used for calculating the pension to 40 years (gradually implemented by 2028) and the reduction in yearly accrual, from 2 percentage points to 1.78 percentage points, which can translate into decreases in individual's pensions. From 2006 pensions will be indexed according to the consumer price index (previously indexation was linked to wage increases). On the other hand, the pension reform of 2004 replaced the inadequate (inflation-oriented) revaluation of pension entitlements by a method based on the average increase of the respective contribution basis (income). In addition, periods of childcare or unemployment are recognised by crediting pension rights based on a special contribution basis, which may raise the individual pension level especially of those taking career breaks. In 2006 the minimum pension for unmarried pensioners will rise to the poverty threshold from EUR 663 in 2005 to EUR 690 (in 2003 the poverty threshold was EUR 673).

According to projections elaborated in the framework of the ISG, before the 2004 pension reform, the theoretical pension replacement rate was expected to decrease smoothly for a worker retiring at 65 after 40 years of contributions at the average wage from a level of 74% to 67% (2050) due in particular to the introduction of a loss limit of 10% for pension entitle-

ments gained out of the unreformed system. After the last reform Austria expects, despite a decreasing accrual rate, that the theoretical gross replacement rate will decrease to 69% (84% net) by 2050.

To secure the long-term **sustainability** of the pension system a monitoring mechanism (starting in 2007) has been introduced. An expert committee will start to monitor developments in the system from several perspectives every three years. There is no automatic adjustment mechanism but in case of increasing life expectancy the expert committee has to make proposals concerning the ways to finance the expected expenditure increase – sharing this in a balanced way between contributions, pension adjustments and retirement ages. In case of deviations from other assumptions, such as lower participations rate or productivity growth, the government is to report this to parliament with legislative recommendations.

Thanks to the major pension reform of 2004, Austria is expected to mitigate considerably the pressure on its public finances due to an ageing population. From a spending level of 13.4% of GDP in 2004, an increase of 0.6 p.p. of GDP is expected between 2004 and 2030, while thereafter a decrease of 1.7 p.p. between 2030 and 2050 is projected, resulting in an overall lower level of public pension spending in 2050 by 1.2 p.p. than in 2004. Also, total age-related expenditure is projected to decline from the level of 24.5% of GDP in 2004 to 23.7% in 2050. These projections would allow the elimination of general government debt by 2050.

**Modernisation:** As pensions will be calculated in a more actuarial way, many women will probably not have enough contribution years in order to reach the aimed replacement rates calculated on the basis of 45 contribution years. This will remain an issue at least until 2024-33 when the equalisation of the legal retirement age between women and men will start/end. Nevertheless, the increasing pension rights for childcare and the better revaluation of former earnings will increase pensions for many women.

## 3. Conclusion

The 2004 reform makes a major step towards modernised and more sustainable pensions. By introducing a uniform pension law for all professions for those



under 50, Austria has harmonised the pension systems of blue-collar workers, white-collar workers, the self-employed, farmers and especially federal civil servants. In addition, the pension reform contains a rather thorough redesign of the calculation of the benefits leading to a much stronger link between contributions and benefits, including a bonus/malus system for deferred/earlier retirement and a switch of the indexation of pensions to consumer prices as of 2006. To review the long-term sustainability of the pension system a triennial monitoring mechanism will begin in 2007. At the same time long transition periods are foreseen for the phasing in of the measures including the earlier adopted harmonisation of retirement ages

by sex. There is a possibility that such long phasing in periods could weaken the message that change is necessary.

There is agreement that the pension reform needs to be accompanied by a significant increase of older workers' employment in order to ensure both adequacy and sustainability of future pensions. This could lead to a further decrease of the poverty risk for pensioners, as well as to a stabilisation of the future replacement rates at its current level. It will be important to monitor the poverty risk for pensioners as well as replacement rates, in particular, for women and review policy options if necessary.

## 4. Background statistics

	AT			EU-25				
Adequacy								
Current situation								
	Total	Men	Women	Total	Men	Women		
At-risk-of-poverty rate <sup>(1)</sup>	13	11	14	16	15	17		
0–64	12	11	13	16	16	17		
65+	17	13	18	18	15	20		
75+	18	10	21	Nd	Nd	Nd		
Income inequality <sup>(1)</sup>								
0–64	3.7							
65+	4.5							
Income of people aged 65+ as a ratio of income of people aged 0–64 <sup>(1)</sup>	0.93	0.98	0.90					
Median pensions relative to median earnings <sup>(2)</sup>	0.58	0.57	0.60					
Long-term projections								
Theoretical replacement rates <sup>(3)</sup>	2005	2030	2050					
Total net replacement rate	80	82	84					
Total gross replacement rate	64	66	69					
Gross replacement rate 1st pillar	64	66	69					
Gross replacement rate 2nd/3rd pillar	(*)	(*)	(*)					
Financial sustainability								
Current situation								
Esspros Pension expenditure <sup>(4)</sup> , % of GDP	1995	2000	2003	1995	2000	2003		
	14.3	14.2	14.7		12.5	12.6		
Employment (2004) <sup>(5)</sup>	Total	Men	Women	Total	Men	Women		
Employment rate (25–54)	82.6	89.4	75.8	76.8	85.2	68.5		
Employment rate (55–64)	28.8	38.9	19.3	41.0	50.7	31.7		
Effective labour market exit age (2004) <sup>(6)</sup>	Nd			60.7p				
Public finances (2003) <sup>(7)</sup>								
Public debt, % of GDP	65.1			63.3				
Budget balance, % of GDP	-1.2			-2.8				
Long-term projections (EPC 2006)								
	2004	Level 2030	2050	Increase 2004–50	2004	Level 2030	2050	Increase 2004–50
Old-age dependency ratio <sup>(8)</sup>	22.8	40.6	52.4	+130%	25	40	52	+108 %
Public pensions expenditure, % of GDP <sup>(9)</sup>	13.4	14.0	12.2	+1.2	10.6	11.9	12.8	+2.2
Factors determining the evolution of public pensions expenditure (2000–50) <sup>(10)</sup>	Contribution to change in percentage points of GDP				Contribution to change in percentage points of GDP			
Demographic dependency	11.3				8.6			
Employment	-1.3				-1.1			
Eligibility	-5.8				-2.1			
Level of benefits	-4.3				-2.7			
Total (including residual)	-1.0				2.2			

### Notes

<sup>(1)</sup> Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).

<sup>(2)</sup> Source: Eurostat. Median individual pension income of retirees aged 65–74 in relation to median earnings of employed persons aged 50–59 excluding social benefits other than pensions.

<sup>(3)</sup> Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first- and second-pillar pension schemes, retiring at the age of 65 years in 2005.

<sup>(4)</sup> Source: Esspros, Eurostat. Includes expenditure by certain private social protection schemes.

<sup>(5)</sup> Source: European Labour Force Survey, 2004.

<sup>(6)</sup> Source: European Labour Force Survey, 2004.

<sup>(7)</sup> Source: European Commission, DG ECFIN.

<sup>(8)</sup> Source: Eurostat (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15–64.

<sup>(9)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.

<sup>(10)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.

(\*) Negligible proportion

## Poland

### 1. Main characteristics of the pension system

Poland has introduced significant reforms of its pension system since 1999. The **statutory pension system**, fully implemented in 1999, consists of two elements, both of which are mandatory and universal (there are special schemes for farmers and some civil servants such as the military, police, judges and prosecutors): a pay-as-you-go notional defined-contribution (NDC) scheme, administered by the Social Insurance Institution (ZUS) and a fully-funded scheme, managed by independent private investment companies, supervised by the State. The retirement age is 65 for men and 60 for women.

The statutory pension is based on the defined-contribution principle, dependent on the accumulated capital in ZUS and the open pension funds (hereafter OPFs) and on the average unisex life expectancy at the age of retirement. (Pensions accumulated in the previous system were based on the defined-benefit principle). Contributions are collected by ZUS, and are transferred to OPFs, (chosen by the insured individual – in 2005, 15 OPFs could be chosen from). According to the reform programme, benefits of the funded pillar should take the form of a lifetime annuity (however the law on annuities has not been legislated yet).

The statutory scheme is financed from the old-age pension contribution (19.52% of gross salary), equally shared between employers and employees (12.22% of it is for NDC pensions and 7.3% for the statutory funded scheme). An additional contribution of 13% of wages is paid for disability and survivors' pensions<sup>(64)</sup>. A ceiling was introduced in 1999 on maximum earnings on which contributions are collected (250% of the average national earnings).

A Demographic Reserve Fund was created in 2002 to accumulate resources in order to finance future deficits of the pension system, and is financed by a part of old-age contributions (0.2% of wages in 2005 to increase to 0.4% in 2009). In the future the fund will also accumulate future possible surpluses of the old-age statutory pension scheme.

**Guaranteed minimum pension** is paid if the total pension amount of the statutory system is below the legal minimum old-age pension, conditional to a contributory requirement – 25 years of insurance for men and 20 years for women. The guaranteed minimum pensions are covered by public funds.

The recent reforms also introduced options for **voluntary pension insurance**, offering the possibility of creating supplementary employees' pension plans. This can take the form of group insurance, joint stock or life insurance, occupational funds or open investment funds. Participation is very low (only 100 000 in 2004) and in 2004 a new scheme offering tax incentives – **voluntary individual retirement accounts** (*Indywidualne Konto Emerytalne*, hereafter IKE) was set up. Persons may choose among four institutions participating in IKEs (investment funds, brokerage institutions, insurance agencies and banks) and transfer the IKE between them.

### 2. Situation and perspectives in light of the common objectives

#### 2.1. Current situation

**Adequacy:** The ratio of average statutory pension to average wage (net of social security contributions) was 58% in 2004 (64% for old-age pensions, 47% for disability pensions and 55% for survivors' pensions). The risk of poverty of people in the 65 or above age group stands at 6% in 2002 (4% for men and 7% for women), lower than the 0–64 age group whose poverty rate stands at 18%. The difference in poverty rates reflects high unemployment rates among the active population, translating in their lower relative income.

In order to save resources, the yearly indexation of all pension benefits was replaced in 2004 by a rule of adjustment of pensions every three years (or earlier if cumulative inflation reaches 5%), which may, however, expose older retirees to the risk of lagging behind the overall standard of living.

(64) There is also a separate sickness and maternity contribution (2.45% of wages) and work injury contribution. Its size varies depending on the risk of a work injury in given branch of industry and company.

In 2003 the unemployment rate reached 19% and it is higher for the young, older workers and women. The low level of employment threatens the future adequacy and sustainability of pensions. While some of those who pay no contributions may be employed informally, they still do not accumulate an employment-related pension and consequently will be more likely to be entitled to minimum guarantee pensions only. Moreover, while the 1999 reform aimed at withdrawing privileges given to certain occupational groups, there seems to be a tendency to continue with the schemes that may have wider consequences on the labour market.

**Financial sustainability:** The number of contributors to the pension system has been decreasing over time due to falling employment levels. The employment rate in the age group 55–64 was only 26% in 2004, far below the Lisbon target. The effective age of withdrawal from the labour market though has increased from 56.6 in 2001 to 57.7 in 2004.

A large number of individuals entered early retirement in the beginning of the 1990s as a side effect of lay-offs. It has added to the steep increase in pension spending from 6.5% of the GDP in 1989 to 15.6% in 1995. In 2003, according to Esspros figures, total pension expenditures were at 14.3% (slightly above the EU average 12.6%). As the early retirement option was limited in 1997, more people entered into pre-retirement schemes. Pre-retirement benefits could be paid to persons who were laid off and fulfilled the criteria for unemployment benefits. From 1997 to 2002, more than 500 000 persons received such benefits.

Around 9% of Polish citizens aged between 20 and 64 (around 2.4 million people) receive disability benefits. Only about 20% of the recipients are above the retirement age (as of January 2005, they will be transferred into the old-age scheme). However, following the introduction of restrictions and thus the reduction in the number of disability pensioners, expenditures on disability pensions and survivors' pensions are falling (from 4.9% of GDP in 2002 to 4.2% of GDP in 2004).

It should be noted that 7.3 p.p. of the 19.52% pension contribution is directed into the mandatory funded pillar, the financing of the current PAYG pensions, which

will be placed under considerable pressure over the coming decades due to transition costs, as well as disability and other early pension cost. According to 2003 projections from ZUS reported in the National Strategy Report that the statutory PAYG pension is projected to show deficits until around the mid-2030s. However, the elimination of early retirement from 2008 and a new form of pensions indexation could ease projected deficits (the change in indexation rules is estimated to save 0.3% of cumulated GDP between 2005 and 2007). Since 1999 ZUS has also drawn commercial bank credits to finance the costs, but servicing these is costly.

Furthermore, the State is subsidising more than 90% of the farmers' pension scheme, which accounts for about 1.8% of GDP. Contributions paid by farmers and benefits received are flat-rate (corresponding to around half of the average PAYG system pension benefits). The system provides very broad coverage for people who claim to work on a farm.

**Modernisation:** Mobility between the three different pension schemes – employees' pension scheme, farmers' scheme and the Security Provision System (for the army, police, etc.) is a concern. Moving from one scheme to another is problematic. Moreover, reliable information on the long-term prospects of the new system, both funded and PAYG, should be developed, to prepare the ground for a broad consensus on further reforms.

Unisex life tables in the NDC contribute to gender equality. Although the statutory retirement age for women, at 60, is below that of men (65). The attempt to phase out these differences by a bill in 2004 was opposed by trade unions and some political parties. Although the system allows flexible retirement, the employment rate among women remains low, in particular for those aged 55–64, which translates into lower accrual of pension rights.

ZUS is working on a backlog of transfers to the private funds as a result of an initial high rate of reporting errors<sup>(65)</sup>. In addition, the conversion of accumulated contributions into benefits has not yet been agreed. This is despite the first benefits under the new system becoming payable in 2009.

(65) The backlog for years 2001 onwards had been processed already. Currently ZUS is working on processing the backlog for 2000 and 1999. All accounts should be cleared by the end of 2006.

## 2.2. Outlook, reform measures and policy debates

According to Eurostat projections Poland's demographic profile will follow the EU average. The elderly dependency ratio will grow from a current level of 19% to 33% by 2025 and to 51% by 2050.

Overall, the ratio of average net pension to average net wage in statutory pension schemes is expected to fall (from 58% in 2004), while the expected time in retirement will increase due to the increases in life expectancy. For a worker retiring at 65 after 40 years at the average wage, ISG theoretical replacement rate calculations show a gradual decline from 2005 to 2050 of the net replacement rate from 78% (gross 63%) to 44% (gross 36%) unless the balance between the years in employment and retirement is maintained (the decrease is lower for people retiring at 67 after 42 years of contributions). These calculations are based on wage growth in line with relatively strong productivity growth and with an interest rate uniform for the EU, departing from these assumptions can translate into a less marked decline in replacement rates<sup>(66)</sup>.

In addition, ISG calculations indicate that the level of replacement rate for a worker retiring in 2005 declines from a current level of 78% (net) to 53% in 2015, in relation to the average wage of the economy in the respective years, reflecting the indexation of benefits, according to the price developments every three years<sup>(67)</sup>. Moreover, low activity rates may threaten adequacy of pensions, especially for women, due to shorter contribution periods and lower average earnings. At the same time the closer link between contributions and benefits resulting from the introduction of the NDC system as well as the funded pension component should help to increase declared work, thus increasing contributions to pension schemes and possibly improving adequacy.

There is a high potential of increasing employment rates among older workers and Poland has already plans to adopt additional measures in that field. Presently, there are two main mechanisms affecting the behaviour of the elderly in the labour market, first try-

ing to reduce early retirement (early pension benefits will be reduced or suspended) and secondly favouring gradual or later retirement (further contributions taken into account in the calculation of pension benefits.) Increasing incentives for working longer could be accompanied by strengthening of vocational rehabilitation. In addition, attention should be made not to offer special favourable pension rights for certain occupational groups.

The AWG projections of 2005 show a considerable drop in public pension expenditure from 13.9% to 8.0% of GDP over the period 2004–50 (pension expenditures decrease to 9.3% of GDP in 2050 when the mandatory funded tier is taken into account). Nevertheless, the calculations indicate that the pay-as-you-go tier is projected to remain in deficit until the mid-2030s due to transition costs. Moreover, a major concern is the high level of government spending despite a partial shift to funded schemes, including substantial spending on disability pensions and high subsidies to the farmers' pension scheme, while minimum guarantee pensions and the deficit of the social security scheme are paid out from general government funds. The funding of all pensions requires, in addition to the total contribution rate of 32.52% of wages, a subsidy from the government which amounts to over 3% of GDP.

Greater transparency and adaptability of pension systems should be promoted to strengthen confidence. Moreover, changes in the system of agricultural social insurance are seen as an option to restrict coverage of farmers' pensions to those who are full-time employed in the agricultural sector. One could also introduce a link between farmer's income and contributions for pensions in order to reduce the need for the State subsidy. In the long run one could think though of unifying the farmers' pension scheme with the statutory pension system.

## 3. Conclusion

Poland has introduced significant reforms in its old-age pension system, the new system being in place since 1999. Further, a Demographic Reserve Fund was cre-

(66) For instance, an increase of 1 percentage point of the real rates of return of individual accounts translates into an increase of 4 percentage points of the net theoretical replacement rate (3% for the gross replacement rate). Moreover, a slower increase in wages of 1.5 p.p. would translate into significant slower levels of final wages and pensions and an increase in the replacement rate of 2 percentage points.

(67) The pension indexation in Poland can be higher, taking into account expected wage developments and the situation of public finance.

ated in 2002 in order to accumulate resources for future financing needs. However, only a part of the old-age pension contribution is transferred to the Reserve Fund, while at the same time old-age contributions are not sufficient to cover the pension liabilities of the Social Insurance Institution.

A major challenge is to increase the currently low level of employment (partly linked to undeclared work and a high level of unemployment). As the 1999 reform did not affect pension provision for people over 49, early retirement is still an issue but this should end in 2008. However, pre-retirement schemes continue to exist and care should be taken that they are not used to replace the early retirement option. A strict implementation of the sharpened disability benefit legislation could help avoid a similar usage of that scheme. To maintain a coherent approach one should avoid granting special pension rights for certain groups of professions.

Following the expected decline in the ratio of average pension to average wage in the statutory pension scheme, adequacy of pensions may translate into an issue in the future, notably when linked with shorter

contribution periods and lower average earnings (due to the high level of unemployment, especially for women). Equalising the legal retirement age for men and women would help to reduce the gender gap in pension entitlements and could contribute to increasing employment rates of older workers.

The national budgetary projections forecast a considerable drop in public old-age pension expenditure from 7.1% to 4.5% of GDP over the period 2009–50. Despite the decrease in spending Poland is facing high transition costs due to a rapid introduction of a relatively large funded scheme, financing of which will require major effort over the next decades. Another challenge to the sustainability of the system is the farmers' pension scheme that, although providing low pensions, is nearly entirely funded from the State budget. The scheme is in need of reforms, both from the aspect of mobility of workers (enabling them to transfer pension rights from one pension scheme to another) and rights in the scheme (restricting benefits payment to those working full-time on farms). One could also consider the integration of the scheme in the general system in the long run.

## 4. Background statistics

	PL			EU-25				
Adequacy								
Current situation								
	Total	Men	Women	Total	Men	Women		
At-risk-of-poverty rate <sup>(1)</sup>	17	17	16	16	15	17		
0–64	18	19	18	16	16	17		
65+	6	4	7	18	15	20		
75+	6	4	7	Nd	Nd	Nd		
Income inequality <sup>(1)</sup>								
0–64	5.2							
65+	3.3							
Income of people aged 65+ as a ratio of income of people aged 0–64 <sup>(1)</sup>	1.13	1.22	1.07					
Median pensions relative to median earnings <sup>(2)</sup>	Nd	Nd	Nd					
Long-term projections								
Theoretical replacement rates <sup>(3)</sup>	2005	2030	2050					
Total net replacement rate	78	64	44					
Total gross replacement rate	63	36	36					
Gross replacement rate 1st pillar	63	52	36					
Gross replacement rate 2nd/3rd pillar	(*)	(*)	(*)					
Financial sustainability								
Current situation								
Esspros Pension expenditure <sup>(4)</sup> , % of GDP	1995	2000	2003	1995	2000	2003		
		13.0	14.3		12.5	12.6		
Employment (2004) <sup>(5)</sup>	Total	Men	Women	Total	Men	Women		
Employment rate (25–54)	68.2	73.9	62.6	76.8	85.2	68.5		
Employment rate (55–64)	26.2	34.1	19.4	41.0	50.7	31.7		
Effective labour market exit age (2004) <sup>(6)</sup>	57.7			60.7p				
Public finances (2003) <sup>(7)</sup>								
Public debt, % of GDP	45.4			63.3				
Budget balance, % of GDP	-3.9			-2.8				
Long-term projections (EPC 2006)								
	2004	Level 2030	2050	Increase 2004–50	2004	Level 2030	2050	Increase 2004–50
Old-age dependency ratio <sup>(8)</sup>	18.6	37.1	51	+174%	25	40	52	+108 %
Public pensions expenditure, % of GDP <sup>(9)</sup>	13.9	9.4	9.3	-4.6	10.6	11.9	12.8	+2.2
Factors determining the evolution of public pensions expenditure (2000–50) <sup>(10)</sup>	Contribution to change in percentage points of GDP				Contribution to change in percentage points of GDP			
Demographic dependency	10.4				8.6			
Employment	-3.2				-1.1			
Eligibility	-4.5				-2.1			
Level of benefits	-7.5				-2.7			
Total (including residual)	-5.7				2.2			

### Notes

<sup>(1)</sup> Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).

<sup>(2)</sup> Source: Eurostat. Median individual pension income of retirees aged 65–74 in relation to median earnings of employed persons aged 50–59 excluding social benefits other than pensions.

<sup>(3)</sup> Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first- and second-pillar pension schemes, retiring at the age of 65 years in 2005.

<sup>(4)</sup> Source: Esspros, Eurostat. Includes expenditure by certain private social protection schemes.

<sup>(5)</sup> Source: European Labour Force Survey, 2004.

<sup>(6)</sup> Source: European Labour Force Survey, 2004.

<sup>(7)</sup> Source: European Commission, DG ECFIN.

<sup>(8)</sup> Source: Eurostat (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15–64.

<sup>(9)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.

<sup>(10)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.

(\*) Negligible proportion



## Portugal

### 1. Main characteristics of the pension system

The statutory regime of the Portuguese pension system consists of a general scheme that is mandatory for all employed and self-employed workers in the private sector. Special schemes exist for civil servants, police and the military, the financial sector and lawyers. There is also a voluntary scheme that is open to residents in Portugal who are not covered by the Portuguese social security system; Portuguese nationals who reside or work abroad can also enrol in this scheme.

Pension contributions to the statutory scheme are not separated from contributions for other benefits provided by the general social security scheme which covers sickness, maternity, occupational diseases, unemployment, disability, old age and survivors (family allowances are residence-based). Without a contributory ceiling, the contribution rate is 34.75% of earnings (11 p.p. paid by the worker and 23.75 by the employer) for employees. On the total 34.75% contributed by the insured person and employer, 16.01% is allocated to old-age benefits, 3.42% to disability benefits and 3.67% to survivors' benefits. For the self-employed, 25.4% of reference incomes are for mandatory coverage (for old age, disability, maternity, occupational diseases and survivors) and 32% for the voluntary scheme (covering sickness). Since 1999, in the general statutory scheme, the legal retirement age is 65 for both men and women, with exceptions at 55 for a limited number of professions. The government has proposed a law to increase the retirement age for civil servants, currently 60 years, gradually by 6 months a year in the next 10 years until it reaches 65, which would become effective from 2006 onwards.

To be entitled to an old-age pension, social security beneficiaries need to have completed a qualifying period of 15 years of insurance, with at least 120 days per year of registered earnings. Since 2002, the earnings over the whole insurance career will be taken into account for the calculation of the pension level, subject to a maximum of 40 years (since 1994 they were calculated on the basis of the average income of the best 10 years over the last 15). There is a tran-

sition period during which the most favourable method of calculation will be used to determine the pension level. The possibility of reducing the transition period is being envisaged.

The 2002 reform foresees that pensions will be calculated for public (new entrants from 1993 onwards) and private employees on the basis of contributions made during the whole career, up to 40 years (with a transition period from 2002 to 2016). Concerning the convergence of pension systems, the government proposed to increase the years of insurance for civil servants, currently 36 years, gradually by 6 months a year until it reaches 40 years.

In the banking and telecommunications sector occupational schemes exist as a substitute for the general scheme (these schemes represent about 4% of the population in employment while about 1.5% of the population in employment is covered by individual provisions).

Although the pension fund market represents 11.2% of GDP, it is almost inactive. The current tax incentives are not considered satisfactory in order to promote the implementation of new occupational schemes. Also, due to the winding-up of several pension funds (particularly in the last two years), and reductions of the number of employees in several sectors, membership has been declining.

Laws and regulations have been adopted in 2001 and 2002 to define general principles for supplementary occupational pension plans, to define requirements for the diversification of pension fund assets and to strengthen the supervisory powers of the Portuguese Insurance Institute over insurance companies and pension funds' managing companies (the only institutions that can administer pension funds). Also with a view to improving the access to supplementary pension provision, the new framework social security law improves the conditions for the acquisition of supplementary pension rights and establishes the principle of portability. Individual provision can take different forms including the subscription to life insurance policies or voluntary membership in a pension fund or in an investment fund.

A tax-financed non-contributory scheme provides means-tested benefits to persons aged 65 and over with-

out adequate benefits from other sources. People with incomes below 30% of the national minimum wage (50% for a couple) are entitled to a social pension under this scheme. Due to the short contributory careers as well as low reference wages, statutory pensions often fall below minimum pensions leading to a significant group of pensioners receiving the minimum pension (in 2004 about 45% of the contributory scheme pensioners were receiving the corresponding minimum pension). In order to reduce the poverty among the elderly a means-tested benefit ('Solidarity Supplement for the Elderly') has been implemented. Other benefits are also available to older people, in particular health and long-term care and housing benefits.

## 2. Situation and perspectives in light of the common objectives

### 2.1. Current situation

Concerning **adequacy**, the current relative income of older persons (aged 65 or older) is on average about 76% of the relative income of the age group 0–64 (77% for men and 75% for women). In the long run, the maturing of the pension system (more pensioners with full careers) and, possibly, the development of supplementary pension schemes should have a positive impact on pensioners' income. According to the calculations carried in the framework of the ISG, current gross replacement rates in the case of a worker retiring at 65 after 40 years of career at the average wage, lie at 75% (91% net).

The level of risk of poverty among the elderly is important (29%), which is related to the significant proportion of the population with short insurance careers or with very low insured earnings. During the last years, a major priority has been to improve the level of the minimum old-age pension. Minimum guaranteed levels for old-age and disability pensions under the contributory scheme were introduced for the first time in 1998<sup>(68)</sup>. The minimum level depends on the number of contribution years and has been increased in recent years. According to the new 2002 legislation, this level is indexed to the minimum wage reduced by 11% of contribution rates and has been increased over the period 2003–06. From 2006, the Solidarity Supple-

ment for the Elderly will be provided to people aged 80 years or more to ensure an income of EUR 300 (and gradually to those aged 65 years or over until 2009).

The 2004 employment rate is 67.8% for the 15–64 population and 50.3% for the population aged 55–64 in line with the Lisbon targets. All workers in the private sector can retire at 65 if they have contributed for at least 15 years. Early retirement conditions have been tightened though. In the private sector the possibility of claiming early retirement at the age of 55 was suspended and the measure allowing the early pension at the age of 58 for the long-term unemployed was eliminated. Currently (beyond those professions mentioned in law), the early pension is only possible for long-term unemployed people aged at least 55 (who have made contributions for 20 calendar years – their pensions are then decreased by 4.5% a year) or 60 (without reduction). In the public service, people having at least 36 years of service can retire before 65, but experience the same decrease of 4.5% a year. Workers in the private sector may postpone their retirement up to the age of 70 and receive a 10% increase in pension per year of deferral (for people having contributed at least 40 years). Moreover, old-age pensions can be freely combined with earned income. The possibility to cumulate part-time work with partial pension is also planned as well as incentives to employ more vulnerable people being strengthened.

Pension expenditure accounts for 11.1% of GDP. Concerning financial **sustainability**, during the 1990s, a number of adjustments were made to reduce the future increase in public pension expenditure. In 1993, the rules for calculating pension entitlements under the special scheme for new civil servants became the same for the new entrants to this scheme as in the general social security scheme. In 1994, the conditions for entitlement to an old-age pension and the coefficient for calculating pension benefits were both tightened (this has been confirmed by the legislation adopted in 2002).

Since the latest social security reform of 2002, earnings over the whole insurance career are taken into account for the calculation of the pension amount (subject to a maximum of 40 years). Annual accrual rates are set in

(68) Previously, a social supplement was paid to people whose statutory pension did not reach the minimum amount of 30% of the average income.

accordance to the level of reference earnings, which results in a maximum pension for workers in the private sector of 92% of the reference earnings (used for calculating the pension) while in the public service it is 90% since 2004. The new benefit formula applies in full to those who started working from 2002 onwards.

A reserve fund for social security was created in 1989. According to the social security reform laws of 2000 and 2002, the aim is to constitute, in the medium term, a reserve that is equivalent to two years of pension expenditure of the general statutory scheme. In addition to receiving the surpluses of the social security scheme, the fund will receive between two and four percentage points of the employees' social security contributions. At the beginning of 2005, the fund held assets that amounted to 4.3% of GDP. The fund is expected to be used when social security deficits start to emerge to cover increased expenditure and to fill the revenue gap. Considering the current macroeconomic situation it will be difficult to increase these reserves in the short term.

In order to promote the development of supplementary pension schemes, a comprehensive legal framework was introduced in 2000 covering management and investment rules, as well as the tax regime for such private provision. In 2002, further tax benefits were introduced and a supervisory framework was defined for supplementary pension schemes. The IORP directive is currently being transposed, while some efforts are projected to improve portability.

Information to beneficiaries has been improved through the availability of a dedicated website providing pension simulations, while dedicated call centres are to be developed. In order to improve transparency the government plans to make public, on a yearly basis, updated long-term projections on adequacy and the financial sustainability of the pension system.

## 2.2. Outlook, reform measures and policy debates

Portugal is projected to face faster ageing than most EU Member States in coming decades. According to latest population forecasts of Eurostat, the elderly

dependency ratio is projected to increase from 25% in 2004 to 39% in 2030 and 58% in 2050.

According to the calculations carried in the framework of the ISG, theoretical replacement rates are projected to remain stable overall. For the case of a worker retiring at 65 after 40 years of career at the average wage, the net replacement rate would be stable at 91% from 2005 to 92% in 2050 (gross replacement rate declines from 75% to 70%).

Portugal is expected to face a significant pressure on its public finance system resulting from ageing populations. According to the AWG projections of 2005, public spending on pensions is projected to rise from 11.1% of GDP to 20.8% between 2004 and 2050 and all age-related expenditure from 23.8% to 33.4% during the same period. The increase in pension spending is one of the highest in the EU, resulting in a serious risk of the long-term sustainability of public finances<sup>(69)</sup>.

The latest pension reform, especially a set of measures in the scope of the convergence of public sector pensions towards the general level of pensions is expected to make some progress in meeting the financial challenge of the pension system and the former national strategy report explained how Portugal will deal with this challenge up to around 2030, but leaves open how the social security deficit is to be financed thereafter. Thus, there is scope for further reform, while taking account of the fact that the balancing of the central government budget remains difficult. In this context, there also seems to be scope for the development of private pension provision. It remains to be seen whether the modernisation of the legal framework for private pensions (including rules on vesting and portability) will be sufficient to allow occupational pension schemes to play a significant role.

In 2006, the Portuguese government will decide on the overall strategy for the pension system. A detailed study on the sustainability of the social security system is being prepared to enable the government to decide which measures are considered more appropriate and necessary in order to ensure the long-term financial sustainability of the pension system.

(69) According to the 2004 national budgetary projections (based on different demographic and macroeconomic assumptions) prepared in the context of the assessment of the long-term sustainability of public finances, the pension expenditure is expected to increase from 11.5% of GDP in 2005 to 15% in 2050.

### 3. Conclusion

In response to the adequacy challenge, a major priority since the last strategy report has been to improve the level of the minimum old-age pension, which should alleviate poverty risks. To reduce further old-age poverty, a new tax financed social benefit – Solidarity Supplement for the Elderly – has been adopted and will be implemented during 2006. Besides, more complete insurance careers in better-paid employment will result in higher pensions for new generations of pensioners.

The most recent reforms will translate into strengthened incentives to work longer and also contribute to a more equitable treatment of members of different schemes. Further harmonisation of the pension system and measures to promote longer working lives should contribute to strengthen adequacy and sustainability.

The government has prepared the harmonisation of the civil service scheme with the general scheme and it is important to pass this quickly through Parliament to ensure that reforms remain credible and equitable.

Progress has been made in meeting the financial challenge of the pension system, while balancing of the central government budget remains difficult.

The government intends to create incentives towards the development of supplementary pension schemes. It remains to be seen whether this modernisation of the legal framework for private pensions will be sufficient to allow meeting expectations that the occupational pension schemes could play a significant role in order to ensure future adequacy.

## 4. Background statistics

	PT			EU-25				
Adequacy								
Current situation								
	Total	Men	Women	Total	Men	Women		
At-risk-of-poverty rate <sup>(1)</sup>	21	20	22	16	15	17		
0–64	19	18	20	16	16	17		
65+	29	29	30	18	15	20		
75+	35	35	36	Nd	Nd	Nd		
Income inequality <sup>(1)</sup>								
0–64	7.3							
65+	6.5							
Income of people aged 65+ as a ratio of income of people aged 0–64 <sup>(1)</sup>	0.76	0.77	0.75					
Median pensions relative to median earnings <sup>(2)</sup>	0.58	0.57	0.60					
Long-term projections								
Theoretical replacement rates <sup>(3)</sup>	2005	2030	2050					
Total net replacement rate	91	92	92					
Total gross replacement rate	75	71	70					
Gross replacement rate 1st pillar	75	71	70					
Gross replacement rate 2nd/3rd pillar	(*)	(*)	(*)					
Financial sustainability								
Current situation								
Esspros Pension expenditure <sup>(4)</sup> , % of GDP	1995	2000	2003	1995	2000	2003		
	9.8	10.5	11.9		12.5	12.6		
Employment (2004) <sup>(5)</sup>	Total	Men	Women	Total	Men	Women		
Employment rate (25–54)	81.1	87.4	74.9	76.8	85.2	68.5		
Employment rate (55–64)	50.3	59.1	42.5	41.0	50.7	31.7		
Effective labour market exit age (2004) <sup>(6)</sup>	62.2			60.7p				
Public finances (2003) <sup>(7)</sup>								
Public debt, % of GDP	60.3			63.3				
Budget balance, % of GDP	-2.8			-2.8				
Long-term projections (EPC 2006)								
	2004	Level 2030	2050	Increase 2004–50	2004	Level 2030	2050	Increase 2004–50
Old-age dependency ratio <sup>(8)</sup>	24.9	39.2	58.5	+135%	25	40	52	+108 %
Public pensions expenditure, % of GDP <sup>(9)</sup>	11.	16.0	20.8	+9.7	10.6	11.9	12.8	+2.2
Factors determining the evolution of public pensions expenditure (2000–50) <sup>(10)</sup>	Contribution to change in percentage points of GDP				Contribution to change in percentage points of GDP			
Demographic dependency	13.7				8.6			
Employment	-0.2				-1.1			
Eligibility	-0.9				-2.1			
Level of benefits	-3.0				-2.7			
Total (including residual)	9.3				2.2			

### Notes

<sup>(1)</sup> Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).

<sup>(2)</sup> Source: Eurostat. Median individual pension income of retirees aged 65–74 in relation to median earnings of employed persons aged 50–59 excluding social benefits other than pensions.

<sup>(3)</sup> Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first- and second-pillar pension schemes, retiring at the age of 65 years in 2005.

<sup>(4)</sup> Source: Esspros, Eurostat. Includes expenditure by certain private social protection schemes.

<sup>(5)</sup> Source: European Labour Force Survey, 2004.

<sup>(6)</sup> Source: European Labour Force Survey, 2004.

<sup>(7)</sup> Source: European Commission, DG ECFIN.

<sup>(8)</sup> Source: Eurostat (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15–64.

<sup>(9)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.

<sup>(10)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.

(\*) Negligible proportion

## Slovenia

### 1. Main characteristics of the pension system

A dominant **mandatory earnings-related scheme** covers the risks of old age, disability and survivors. All employees and self-employed persons are covered, while specific categories of inactive persons, who are not insured under compulsory insurance, may join the system voluntarily during periods defined by law. The total contribution rate is 24.35%, paid by employees (15.5% of gross wages), employers (8.85% of gross wages), self-employed persons (the total) and through State compensatory contributions. In 2002 31.6% of all pension expenditures were covered by the State budget (21.1% to cover the growing deficit and 10.5% to finance favourable pensions for various groups of insured persons). Contributions have to be paid on all wages without ceiling or floor. To avoid evasion problems in the contribution collection, wages cannot be paid if social security contributions have not been paid. The maximum pension rating base cannot exceed four times the minimum pension rating base, which implies a high degree of redistribution.

The statutory pension scheme has been considerably modified by the 2000 reform. Each full year in the mandatory insurance scheme now counts for a pension accrual of 1.5% per year for men and women equally, while the accrual for the period greater than six months but less than a full year increases by 0.75% (before 2000 the increases amounted to 2% for a full year and 1% for a period above six months, and for women with pensionable service up to 20 years, 3% for each year and 1.5% for every additional 6 months). Minimum percentage for calculating old-age pension benefits differs with the sex of the insured person. For 15 years of pensionable service, which is the minimum possible service eligible to an old-age pension entitlement, men aged 65 and over are granted pensions of 35% of their pensionable earning, while women aged 59 years and 8 months in 2004 (61 years after 2008) are granted 38% of their pensionable earnings (40% before 2000).

Age limits are being gradually increased to the full pensionable age of 61 years for women (by four months each year) and 63 years (by six months each year) for men. During an interim period some groups

of insured people, e.g. long-term unemployed persons, can still retire according to previous rules. The full retirement age of 63 years for men will be implemented by 2009 for women (61) by 2023.

Pensionable age can be lowered to 58 years for men and 56 years for women on account of parenthood (for one parent only, usually the woman), and to 58 also for those with long careers (40 years for men and 38 for women).

Pensions are indexed on wages. Proposals to index pensions only to the costs of living have not been adopted so far because of concerns over future adequacy.

A major pension reform was introduced in 2000 enabling two types of supplementary pension insurance to be created: compulsory (for insured persons performing particularly hard work and work harmful to health, and insured persons performing professional activities which cannot be successfully performed after attaining a certain age) and voluntary. Providers must be approved by the Ministry of Labour, Family and Social Affairs and by the appropriate regulator. Old-age, invalidity and survivors' benefits can be but are not necessarily included. By the end of 2002, one quarter of all insured persons contributed to occupational schemes, while by June 2004 the level of coverage had more than doubled to around 51.10% of the workforce. The coverage level is expected to continue increasing and exceed 70% of the workforce in the future.

A strong incentive for the participation in this voluntary provision is provided by a favourable tax treatment which is shared between the employer and the employee, provided at least 51% (initially set at 66%) of employees are enrolled in a collective voluntary scheme. In that case, employer contributions are in effect tax free. Employees' contributions are deductible for the purpose of personal income taxation, subject to a ceiling. Portability is granted after three years in the firm. Vesting is immediate.

**Individual provision** consists of voluntary individual savings for old age, mostly in the form of life insurance, administered by insurance companies. Premi-



ums paid to this provision are subject to tax relief, but with a fairly low cap (3% of taxable income). Annuities received from this provision are not subject to personal income taxation.

Pensioners who receive low pensions, due to low incomes during their contribution period and/or an incomplete contribution period, can apply for a pension income supplement, provided they fulfil a set of means-tested conditions, which are checked every two years. An insured person entitled to old-age pension is guaranteed the minimum pension in the amount of 35% of the minimum pension rating base (EUR 414) per month. In 1999 the National Pension was introduced, a means-tested benefit that unlike the pension income supplement can be granted to a person who is not receiving any pension.

## 2. Situation and perspectives in light of the common objectives

### 2.1. Current situation

**Adequacy:** The ratio of the average old-age pension to the average net wage gradually decreased since 1995 from 76.2% to 75.3% in 2000 and 70.2% in 2004. Older people experience close to average living standard (the living standard of people aged 65 or more is at 87% of those aged 0–64). The risk of poverty is moderate for people aged 0–64 (9%) but doubles for people aged more than 65 (19%).

The total employment rate was 65.3% in 2004 (70% for men and 60.5% for women). The employment rate of older workers is one of the lowest among EU-25 and far below the Lisbon target: less than a third of older workers (aged 55 to 64) are in employment (29%, 40.9% for men and 17.8% for women).

If a person claims pension prior to reaching the full statutory retirement age and without having acquired full pensionable service of 40 (men) or 38 years (women), the old-age pension is permanently reduced. This reduction depends on the pensioner's age and can exceed 18%. For women, such reduction will be applied after 2015 and will gradually reach a maximum of 10.8%. Moreover, the accrual of pension rights is not capped. With longer working lives, persons can to a certain degree compensate for negative impacts of the changed method of calculation.

Besides, deferral of retirement after becoming eligible for old-age pension is further stimulated in cases where the eligible person reaches 63 (for men) or 61 years (for women) up to maximum 7.2%.

**Financial sustainability:** The expenditure for the statutory scheme was 11.2% of GDP in 2003. Transfers from the State budget to the statutory scheme budget are necessary to cover a deficit and to finance special pensions for different beneficiaries and due to the decrease in contribution rates decided in 1996. According to national data, in 2000, which was the first year of pension reform, the share of total expenditure for pensions remained at 11.4% of GDP, while in the past four years it gradually declined and reached 10.9% in 2004, although the number of pensioners increased by approximately 2.1% per year in the period 2000–04. In addition to pensions, other social benefits for retirees were paid (income support, attendance allowance, alimony, and national pensions), amounting to 0.6% of GDP (roughly stable since 1995). The third category of expenditure from the pension fund is wage compensations (due to disability), which in 1995 represented approximately 0.3% of GDP and then slowly but constantly grew so as to reach 0.5% in 2000 and 0.6% in 2004.

**Modernisation:** Differences in eligibility requirements for widower's pensions for men and women were eliminated with the reform. In particular, the minimum age for the entitlement is 53 years (it was increased by 3 years for women and reduced by 2 years for men). Gender gaps however remain significant; as the poverty risk for people aged more than 65 is twice that for women (23% at the 60% threshold) than for men (11%). Moreover, while the average living standard of men aged more than 65 is 94% of those aged 0–64, the corresponding level is 83% for women.

### 2.2. Outlook, reform measures and policy debates

Slovenia is projected to experience rapid ageing in the coming decades. Demographic trends will result in a significant increase in the old-age dependency ratio, from 21% in 2004 to 56% in 2050.

After 40 years of pensionable service for men and 38 years for women (which will be the necessary service period for pensions subject to achieving the earliest pensionable age), the old-age pension will amount to 72.5% of the pensionable earning (in comparison with



85% before the 2000 reform). This may lead to a worsening of the situation of the most vulnerable, in particular women.

In spite of the last reform, incentives in the pension system for extending active life remain low. The pension system still allows for early retirement under quite generous conditions. The effective retirement age in Slovenia is low (56 for women, 59 for men in 2002). Retiring prior to the full pensionable age entails penalties, but this may not convince workers to stay longer in employment. The number of disabled people increased in the past 10 years. Measures in order to increase incentives, job sharing and a quota system will be introduced from 2006.

The budgetary pressures due to age-related expenditures are significantly stronger in Slovenia than in most other Member States. According to the AWG projections of 2005, public pension expenditure is projected to increase to 18.3% of GDP in 2050, a rise of 7.3 p.p. of GDP from 2004. Such projections risk resulting in a steep rise in the general government debt, currently still at a low level of 30% of GDP, but without policy changes it would rise to about 200% of GDP by 2050.

### 3. Conclusion

The most recent reform constitutes an important step towards ensuring adequate and sustainable pensions. However, budgetary pressures due to age-related expenditures are significantly stronger in Slovenia than in most other Member States, highlighting that further measures will be needed.

Recent reforms improve incentives to work longer which are urgently needed, as the employment rate among older workers is very low. Reducing early exit from the labour market is a major challenge and would contribute to ensuring future adequacy (through further accrual of pension rights which are otherwise planned to decrease) and sustainability. Moreover, the 1999 reform stipulated a long-term difference in retirement ages of women (61) and men (63). A further reduction of the gap in retirement age would contribute to ensuring future adequacy.

Finally, following the introduction of strong incentives for the participation in voluntary provision, about half of all actively insured persons currently take part in voluntary supplementary pension schemes, highlighting the importance of adequate portability as well as risk-sharing rules.

## 4. Background statistics

	SI			EU-25				
Adequacy								
Current situation								
	Total	Men	Women	Total	Men	Women		
At-risk-of-poverty rate <sup>(1)</sup>	10	9	11	16	15	17		
0–64	9	8	9	16	16	17		
65+	19	13	23	18	15	20		
75+	25	17	28	Nd	Nd	Nd		
Income inequality <sup>(1)</sup>								
0–64	3.3							
65+	3.1							
Income of people aged 65+ as a ratio of income of people aged 0–64 <sup>(1)</sup>	0.87	0.94	0.83					
Median pensions relative to median earnings <sup>(2)</sup>	0.68	0.74	0.61					
Long-term projections								
Theoretical replacement rates <sup>(3)</sup>	2005	2030	2050					
Total net replacement rate	82	65	60					
Total gross replacement rate	64	45	39					
Gross replacement rate 1st pillar	64	45	39					
Gross replacement rate 2nd/3rd pillar	(*)	(*)	(*)					
Financial sustainability								
Current situation								
Esspros Pension expenditure <sup>(4)</sup> , % of GDP	1995	2000	2003	1995	2000	2003		
		1.4	11.2		12.5	12.6		
Employment (2004) <sup>(5)</sup>	Total	Men	Women	Total	Men	Women		
Employment rate (25–54)	83.8	86.4	81.2	76.8	85.2	68.5		
Employment rate (55–64)	29.0	40.9	17.8	41.0	50.7	31.7		
Effective labour market exit age (2004) <sup>(6)</sup>				60.7p				
Public finances (2003) <sup>(7)</sup>								
Public debt, % of GDP	29.5			63.3				
Budget balance, % of GDP	-2			-2.8				
Long-term projections (EPC 2006)								
	2004	Level 2030	2050	Increase 2004–50	2004	Level 2030	2050	Increase 2004–50
Old-age dependency ratio <sup>(8)</sup>	21.4	44.5	55.6	+101%	25	40	52	+108 %
Public pensions expenditure, % of GDP <sup>(9)</sup>	11.0	14.4	18.3	+3.7	10.6	11.9	12.8	+2.2
Factors determining the evolution of public pensions expenditure (2000–50) <sup>(10)</sup>	Contribution to change in percentage points of GDP				Contribution to change in percentage points of GDP			
Demographic dependency	13.3				8.6			
Employment	-1.0				-1.1			
Eligibility	-3.6				-2.1			
Level of benefits	-0.9				-2.7			
Total (including residual)	7.3				2.2			
Notes								
<sup>(1)</sup> Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).								
<sup>(2)</sup> Source: Eurostat. Median individual pension income of retirees aged 65–74 in relation to median earnings of employed persons aged 50–59 excluding social benefits other than pensions.								
<sup>(3)</sup> Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first- and second-pillar pension schemes, retiring at the age of 65 years in 2005.								
<sup>(4)</sup> Source: Esspros, Eurostat. Includes expenditure by certain private social protection schemes								
<sup>(5)</sup> Source: European Labour Force Survey, 2004.								
<sup>(6)</sup> Source: European Labour Force Survey, 2004.								
<sup>(7)</sup> Source: European Commission, DG ECFIN.								
<sup>(8)</sup> Source: Eurostat (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15–64.								
<sup>(9)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.								
<sup>(10)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.								
(*) Negligible proportion								

## Slovak Republic

### 1. Main characteristics of the pension system

The Slovak pension system experienced a major reform in 2005 which split the statutory old-age pension scheme (survivor's benefits included) into two tiers, one being **defined-benefit pay-as-you-go financed**, the other a **funded defined-contribution scheme**. The funded tier is managed by private pension funds. All new labour force entrants will be enrolled in this new two-tiered system and current workers will have until June 2006 to choose whether to join the new system or stay in the old one. Each of these tiers receives a contribution rate of 9% of wages; an additional 6% will be collected for disability benefits.

The reform started a gradual rise of pension ages to 62 for both men (from 60 today, to be reached in 2007) and women (from 53–57 depending on the number of children today, to be reached in 2015). There is no right to early old-age pension; the pension equates to 1.2 times the amount of the subsistence minimum. In case of early retirement, pension benefits will decrease by 0.5% for each month of early retirement.

There is also a **voluntary supplementary pension saving scheme**, consisting of pension insurance from employers or trade union organisations and since 2005 other financial tax deductible products of other financial institutions.

### 2. Situation and perspectives in light of the common objectives

#### 2.1. Current situation

**Adequacy:** The risk of poverty of the 65 or above age group is moderate, at 13% in 2002 (12% for men and 13% for women) and is actually much lower than that of the age group 0–64 (22%)<sup>(70)</sup>.

The ratio of average old-age pension provided by the statutory scheme in relation to the average gross wage

remained roughly stable over the last decade: it increased slightly in the second half of the 1990s from 44.3 (in 1995) to 47.3 (2000), and then decreased in 2004 (44.5). This ratio shifted due in part to the new pension formula that provides an insured person 50% of their individual last income after 40 years of insurance. (At present though, there is a debate about whether to lower the target replacement rate in order to reduce transition costs.) ISG theoretical replacement rate calculations show the total net replacement rate in 2005 at 63% and the gross rate at 49%.

One uncertainty regarding the future adequacy of pensions will be the returns from the mandatory funded scheme. The government is not guaranteeing minimum returns making future adequacy more uncertain. As the introduction of the new tier entails a significant loss of contribution revenue to the PAYG scheme, the scope for improving current pensions will remain limited.

**Financial sustainability:** The total unemployment rate declined in 2004 to 18.2%, but long-term unemployment (11%) and unemployment of young people under the age of 25 (34%) remain very high.

In 2004 the employment rate of persons aged 55–64 increased by 0.6 p.p. compared with the year 2003. Although it has increased since 2001, it remains extremely low, at 26.8% in 2004, particularly for older women (12.6%) and far below the Lisbon target. Recently introduced measures, such as the increase of the retirement age to 62 for men and women, cutting of the entitlement by 0.5% for each month of earlier retirement and allowing for pension recipients to work without limiting pension accumulation could contribute to an increase of the average exit age in the future.

Public pension expenditure has shown a slight decreasing trend – from 7.8% of GDP in 1993 down to 7.5% in 2003, clearly below the EU-25 average of 12.6%. A continuing deficit in the total balance of the basic old-age insurance fund and the basic invalidity fund is currently covered by the surpluses out of other funds in the Social Insurance System.

(70) According to more recent figures, referring to income year 2003, the poverty rate of people aged 65 and more is at 11%, while the poverty rate of the general population is 21%.

Long-term financial sustainability of the pension system was one of the declared goals of the government, when introducing the last reform. For those who join the funded tier half of the pension contribution will be transferred to private funds. This will cause a reduction in contribution revenues to the public PAYG scheme, transition costs being estimated at approximately 1% of GDP, when a retirement age of 62 is assumed. Over a period of about 30 years, total transition costs are estimated at 50 to 70 billion SKK (from 15 to 20% of current GDP). These costs are expected to be covered by privatisation revenues and by newly issued debt or further reforms of the public PAYG scheme. The quantification of the additional funds, however, depends primarily on the actual number of persons that join the combined pension system as well as overall economic and employment development. According to estimates of the Ministry of Labour, Social Affairs and Family SKK 70 billion (on 31 December 2004) will be sufficient, if the participation rate in the funded tier amounts to 65% of the economically active population, until mid-2009.

**Modernisation** of the social security system in the Slovak Republic has been a driving force behind the last pension reform that diversifies the longevity risk between the State and the individual. The strengthening of the insurance principle improves incentives to work. The current retirement age will be raised and equalised. However, there are still persisting pay gaps between men and women due to higher rates of long-term female unemployment and unequal distribution of childcare responsibilities, which impact heavily on actual pension entitlements.

Information on the pension system is largely available to the public via Internet sites, toll-free information phone lines and several booklets. An extensive education campaign was conducted at the time of launching the new pension system in order to inform the populace about the effect the combined pension system would have on future benefits. An interactive pension calculator was an important part of this campaign. The Social Insurance Agency gives information on acquired pension entitlements on its website.

## 2.2. Outlook, reform measures and policy debates

The elderly dependency ratio is set to increase quickly from the present 16% to 28% in 2025 and 51% in 2050 (staying just below the EU-25 52%). A low fertility rate combined with increased longevity are the main reasons for the change.

According to replacement rate calculations the net replacement rate from the statutory scheme for a worker retiring at 65 after 40 years of average earnings will remain stable over the next decades, slightly increasing from its present level of 63% to 64% by 2050 and the total gross rate from 49% to 50% by 2050. However, because of a tighter link between contributions and benefits, where 40 years of contributions are taken into account, the individual pension level of under-average earners or shorter careers are projected to decline dramatically, whereas over-average earners gain. During a transition period transition measures for low-income groups have been established.

The Slovak public PAYG pension system has been in deficit and will face gradually worsening financial imbalances due to a relatively radical switch to a funded scheme, which will significantly reduce contribution revenues to the PAYG scheme. Additional transfers from the State budget will be required.

The AWG projections of 2005 show some pressure on public finances due to the ageing of the population. Pension expenditure is projected to increase from 7.2% of GDP in 2004 to 9.0% in 2050, an increase of 1.8 p.p. of GDP (when taking into account the mandatory funded tier of the statutory scheme, pension expenditures increase from 7.2% of GDP in 2004 to 11.2% of GDP in 2050). All age-related expenditure is projected to increase from 15.5% to 17.9% of GDP between 2004 and 2050. The increase in public pension expenditure is mitigated by the 2005 reform, which involved a partial shift to the funded system. The main concern in the context of sustainability of public finance is the high level of current and projected budgetary deficit, largely driven by social security and healthcare costs. The State budget deficit was at its peak in 2000 (-12.3% of GDP) but then reduced to 5.7% in 2002 and 3.3% in 2004.

## 3. Conclusion

The Slovak pension system experienced a major reform introducing a funded tier in 2005, which strengthens adequacy and sustainability of the statutory old-age pension scheme and contributes to the sustainability of public finances as a whole in the long term. However, over the transition period, a large deficit in the financing of the public PAYG scheme will occur. The Slovak Republic plans to earmark additional revenues from privatisation. For how far the privati-

sation revenues will suffice, depends on both the take-up of the funded scheme and overall economic development. Additional measures to reform the public PAYG scheme further might be needed in order to avoid running into heavy debt.

The new pension formula of the PAYG pillar, as well as the introduction of funded elements, established a strong link between personal contributions to the system and benefits. That could lead to adequacy issues in the future for the lower income earners and people with breaks in their careers, notably women. A key challenge for the Slovak Republic is to raise its employ-

ment rates in general and of older workers in particular and to lower unemployment, which would both strengthen the contribution base and allow people to accrue additional pension rights.

An extensive education campaign was conducted at the time of launching the new pension system, providing in particular large access to information on acquired pension entitlements. The provision of adequate information for personal pension planning and thus motivating people to contribute more to increase the adequacy in the system will be of continuing importance.

## 4. Background statistics

	SK			EU-25				
Adequacy								
Current situation								
	Total	Men	Women	Total	Men	Women		
At-risk-of-poverty rate <sup>(1)</sup>	21	21	21	16	15	17		
0–64	22	22	22	16	16	17		
65+	12	12	13	18	15	20		
75+	20	20	20	Nd	Nd	Nd		
Income inequality <sup>(1)</sup>								
0–64	5.8							
65+	3.2							
Income of people aged 65+ as a ratio of income of people aged 0–64 <sup>(1)</sup>	0.89	0.89	0.89					
Median pensions relative to median earnings <sup>(2)</sup>	Nd	Nd	Nd					
Long-term projections								
Theoretical replacement rates <sup>(3)</sup>	2005	2030	2050					
Total net replacement rate	63	62	64					
Total gross replacement rate	49	49	50					
Gross replacement rate 1st pillar	49	49	50					
Gross replacement rate 2nd/3rd pillar	(*)	(*)	(*)					
Financial sustainability								
Current situation								
Esspros Pension expenditure <sup>(4)</sup> , % of GDP	1995	2000	2003	1995	2000	2003		
	7.4	7.5	7.5		12.5	12.6		
Employment (2004) <sup>(5)</sup>	Total	Men	Women	Total	Men	Women		
Employment rate (25–54)	74.7	80.0	69.3	76.8	85.2	68.5		
Employment rate (55–64)	26.8	43.8	12.6	41.0	50.7	31.7		
Effective labour market exit age (2004) <sup>(6)</sup>	58.5			60.7p				
Public finances (2003) <sup>(7)</sup>								
Public debt, % of GDP	42.6			63.3				
Budget balance, % of GDP	-3.7			-2.8				
Long-term projections (EPC 2006)								
	2004	Level 2030	2050	Increase 2004–50	2004	Level 2030	2050	Increase 2004–50
Old-age dependency ratio <sup>(8)</sup>	16.3	31.7	50.6	+210%	25	40	52	+108 %
Public pensions expenditure, % of GDP <sup>(9)</sup>	7.2	8.3	11.2	+4.1	10.6	11.9	12.8	+2.2
Factors determining the evolution of public pensions expenditure (2000–50) <sup>(10)</sup>	Contribution to change in percentage points of GDP				Contribution to change in percentage points of GDP			
Demographic dependency	9.0				8.6			
Employment	-1.3				-1.1			
Eligibility	-2.5				-2.1			
Level of benefits	-3.1				-2.7			
Total (including residual)	1.5				2.2			

### Notes

<sup>(1)</sup> Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).

<sup>(2)</sup> Source: Eurostat. Median individual pension income of retirees aged 65–74 in relation to median earnings of employed persons aged 50–59 excluding social benefits other than pensions.

<sup>(3)</sup> Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first- and second-pillar pension schemes, retiring at the age of 65 years in 2005.

<sup>(4)</sup> Source: Esspros, Eurostat. Includes expenditure by certain private social protection schemes.

<sup>(5)</sup> Source: European Labour Force Survey, 2004.

<sup>(6)</sup> Source: European Labour Force Survey, 2004.

<sup>(7)</sup> Source: European Commission, DG ECFIN.

<sup>(8)</sup> Source: Eurostat (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15–64.

<sup>(9)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.

<sup>(10)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.

(\*) Negligible proportion

## Finland

### 1. Main characteristics of the pension system

The statutory pension provision comprises a basic national pension scheme that aims to guarantee a minimum income for all pensioners and a complementary earnings-related scheme. The latest major pension reform was introduced in the earnings-related scheme from the beginning of 2005, complementing the range of earlier reforms during the two previous decades.

The national pension provides a minimum pension based on the length of residence and can, after 40 years of residence, reach a monthly amount of approximately EUR 495 for a single person (about 21% of average wage-earners' income), depending on the place of residence. The amount decreases as the person's earnings-related pension increases with a phasing-out rate of 50% (only the earnings-related pension affects the means testing.). Above a defined level of earnings-related pension, the national pension is not paid. For low-income workers, especially those with short employment records, continuing to work will increase the total pension only partially, as the earnings-related pension reduces the amount of national pension (from 2005, this is not the case for any rights accrued beyond 63 years). The pensionable age for the national basic pension is 65.

The share of pensioners receiving only national basic pension is declining. In 2004, only 8% of pensioners received a complete national pension, while the national pension supplemented the earnings-related pension of a further 52%.

The earnings-related scheme provides insurance-based pensions and covers all employees (without income ceiling) and the self-employed. Old-age pensions for private sector employees currently start to accrue from the age of 18. Retirement is flexible between 62 and 68 years, accompanied by higher accrual rates for the last years of work: 1.9% a year between 53 and 62 years and 4.5% between 63 and 68 years instead of the standard accrual rate of 1.5%.

From 2005, the pension has been calculated on the basis of the wages received during the whole professional career, revalorised on the whole, in line with earnings growth<sup>(71)</sup>. National pensions are indexed with the consumer price index, while earnings-related pensions are indexed with weighted index comprised of wages at 20% and of prices at 80%.

In the statutory earnings-related pension scheme, mandatory partial funding was introduced in the 1960s. Currently, it contributes to about a quarter of the financing. For employees of the private sector, these funds are managed by private pension funds, which compete on the basis of customer service and return on investments and must comply with a detailed regulatory framework. A guarantee scheme ensures the payment of benefits in the event of insolvency of a pension institution. Also, for local government and State pensions, reserve funds have been established with the aim of increasing funding to the same level as for the private sector pension schemes. Altogether, the reserves of all mandatory schemes amounted to 59% of GDP in 2004 and are projected to rise to almost 80% of GDP by 2020.

Access to early retirement schemes and unemployment pensions has been significantly reformed. At present, it is possible to retire at 60 by receiving an unemployment pension<sup>(72)</sup>, or by receiving a partial pension from the age of 58 (in 2001, the share of persons employed part-time among the 55–64 years was 5% of all and around 11% of persons employed in this age bracket).

Due to comprehensive coverage of the statutory schemes, the relatively high replacement rate and the absence of a pension contribution ceiling, the supplementary pension coverage is modest. In 2002, occupational pensions covered approximately 5% of the working-age population (15–64 years) and the share of the benefits from occupational pension schemes in the total of the pension payments was 3.3% whilst that of individual pensions was 1.3%. The number of individual plans increased significantly in recent years. At the end of 2003, approximately 12% of the population between 15 and 64 were covered by private pension plans managed by Finnish insurance companies.

(71) When calculating the pension at the time of retirement past earnings are adjusted to present levels. This wage coefficient puts a weighting of 80% on changes in wages and 20% on changes in prices.

(72) Disability is the most frequent cause of early retirement.



Pension benefits are supplemented by pensioners' housing allowance (which benefited 22% of pensioners in 2004), pensioners' care allowance for supporting independent living at home (24% of pensioners in 2004), special tax treatment of pensions allowing a tax-free income up to the level of the national basic pension and public social welfare and healthcare services. In recent years the proportion of people aged 65 and over receiving social assistance due to special needs has been less than 4% while the national basic pension provides a higher minimum income than the standard social assistance.

## 2. Situation and perspectives in light of the common objectives

### 2.1. Current situation

**Adequacy:** The level of pensioners' incomes is around 75% of that of the rest of the population (it is closer if one takes into account imputed rents on owner-occupied dwellings which are more frequent amongst pensioners than the working-age population). According to ISG calculations, the gross replacement rate for a theoretical worker at the average wage retiring at 65 after 40 years currently lies at 57% (63% net). At the end of 2003, the average total pension of people entitled to an old-age pension (and survivors' pension) amounted to EUR 1 137 per month, which corresponded to 49% of average employees' wages.

The statutory pension schemes ensures poverty risk of the elderly population is moderate (17% at the 60% threshold) higher than that of the 0–64 years (10%)<sup>(73)</sup>. Moreover, certain risks seem to persist particularly for women aged 65 or more (poverty rate of 20%) and older pensioners (the poverty risk for people aged 75 or more lies at 25%), which can be connected to the non-employment of the oldest women during their active life and, thus a higher proportion of them receiving only national basic pensions.

**Financial sustainability:** In 2003, pension expenditure accounted for 11.4% of GDP (below the EU-25 average of 12.6%, according to Esspros data). A number of reforms, with the aim of limiting the increase of retirement expenditure, had already taken place in the 1990s. In 2001 and 2002 important reforms were agreed which came into force in 2005. In particular, Finland made great efforts with regard to early retirement, notably through a tightening of the access to the unemployment pension scheme.

After a significant fall at the beginning of the 1990s, employment rates went up during the second half of the decade and are now above the European average, due to a large part with employment policies for older workers and of a progressive adaptation of pension schemes. The employment rate of the 55–64 population has increased by approximately 15 percentage points during the last decade and the last reforms of the retirement system, which were introduced at the beginning of 2005, further strengthen incentives to extend working lives.

In 2004, the employment rate of 55–64 year olds was 51%, in line with the Lisbon target. The previous National Strategy Report identified the employment rate of 55–64 year old men as a particular challenge. In 2004 this had risen from 42% to 51%, while women's employment rate was similar at 50% and increased from 2003 to 2004 by around 2 p.p. In 2004, 83% of Finns retiring on a pension were under 65 years old – a slight improvement from the previous reporting round, when it was 86%. Two out of three persons aged 60–64 are currently pensioners. The most common reason given is reduced work ability. Improvements in older worker employment rates have mainly occurred in the 55–60 age group in part due to the 2005 reforms.

**Modernisation:** Gender differences in living standards and the risks of low income amongst older people remain significant. In particular, among people aged 65 and more, poverty rates are 11% for men and 21% for

(73) The outline of pensioners' income is particularly sensitive to the at-risk-of-poverty threshold applied. In recent years, the relative risk of poverty for the elderly has been very close to that for the entire population, with the at-risk-of-poverty threshold set at 50 or 40% of the median income. If the poverty threshold is set at 60%, however, the risk of poverty for the elderly clearly increases. Thus, a relatively large percentage of the elderly has an income between the 50 and 60% thresholds. Moreover, according to national statistics for 2001, when imputed housing income is taken into account, the poverty risk of people aged more than 65 was at 10.5%, while the risk of poverty for people aged below 65 was 10.8%.

women. This is mainly linked to their lower participation in the labour market in the past and average lower wages. Since 2005, pensions accrue during periods without earnings due to childcare, unemployment, training, sickness and rehabilitation.

## 2.2. Outlook, reform measures and policy debates

According to the latest Eurostat demographic projections, Finland will face an atypical demographic ageing until 2025: the increase of the dependency ratio will be faster than that for the EU-25 until 2025 and then become slower. Indeed, it is expected to rise from current levels of 23% (25% for EU-25) in 2004 to 45% in 2030 (40% for the EU-25), and then increase slowly to 47% by 2050 (while the EU average will be 52%).

The overall strategy to cope with significant pressures in pension expenditure is built upon the elements of increasing the pre-funding of the earnings-related pension scheme more than the legal requirements and reducing public debt, as well as conducting sound macroeconomic policies conducive to higher labour productivity, economic growth and employment rates (notably among older workers, thereby increasing the effective retirement age). The government aims at raising the overall employment rate to 75% by 2011. The objective of recent reforms is also to increase the rate of employment of older workers to 55% by 2010 (from 51% in 2004). Recent projections suggest that further reforms should involve a raising of the age of retirement by about two or three years between now and 2050.

The 2005 reform of the earnings-related scheme aims at discouraging early retirement. One element of the reforms introduced flexible retirement between the ages of 62 and 68, accompanied by higher accrual rates for later years of work, and an increase in the age of partial retirement. Moreover, for people born in 1944 or later, early retirement pensions will no longer be available before 62, with stronger incentives to postpone retirement until 63<sup>(74)</sup>. The reform also introduced a reduction of the lower-age threshold for the accrual of pension rights (from 23 to 18 years), a gradual abolition of the unemployment pension scheme and, finally, the abolition of the individual early (disability) pension scheme.

From 1 January 2005, benefits are calculated on the basis of incomes received during the whole profession-

al career and the integration of pensions (the previous 60% ceiling) is abolished, making work increase the amount of pension at all times. In addition, one of the innovations of the last reform consists of a mechanism for taking into account the future rises in life expectancy by the introduction of a life expectancy coefficient. It will begin to affect the level of pensions from 2010 (it should be about 95% in 2020 and 90% in 2040), while the effects of strengthened incentives to retire later are expected to emerge more quickly.

According to the ISG 2005 projections, net replacement rate levels are projected to remain roughly stable for a worker retiring at 65 after 40 years at the average wage, at a level of 63% in 2005 (gross 57%) to 62% in 2050 (gross 52%). As a result of reforms adopted, the replacement rate is projected to decline for a career with high wage progression, due to the extension of the calculation on pensions on a whole career (from 61% to 53% for progressively high earners). The level of the replacement rate is also projected to decline for a worker retiring at 65 after 40 years at two thirds of the average wage (from 74% in 2005 to 67% in 2050).

The recent reforms of the pension system should significantly reduce the pressure of an increase in pension expenditure in relation to GDP. Finland is expected to face relatively strong pressure in its public finances due to an ageing population and the resulting growing age-related public expenditure. According to projections made by the AWG in 2005, public spending on pensions is expected to increase by a further 30 p.p. of GDP by 2050. All increases in pension expenditure will occur between 2004 and 2030, peaking at 14% of GDP in 2033 and thereafter slightly decreasing. Total age-related expenditure is projected to increase from 23.7% to 27.0% over the period of 2004–50, being dominated by the pension spending.

Contributions to private sector pension schemes are projected to rise by about 6 p.p. by the 2030s from today's 21.6% and then remain stable (this corresponds to about half what was projected before the pension reform which will significantly reduce pressure to raise pension contributions in the private sector). Moreover, the partial funding of all earnings-related pensions will reduce future pressure to increase contributions as half of the projected rise in the pension expenditure is expected to be financed through the return from the funds.

(74) A 0.6% reduction for early retirement will be made in the pension for each month before the age of 63.

Finland has so far succeeded in adapting its system to the development of its society. The succession of reforms has, on the one hand, made the legislation more complex, but, on the other it has provided an opportunity to streamline the system and bring various schemes closer to each other. One issue under discussion is the consolidation (planned for 2007) of pension schemes which should contribute to a gradual harmonisation of the principles of internal operation of the various arrangements.

### 3. Conclusion

With the 2005 reforms Finland has made significant progress in meeting the challenge of creating financial sustainability in its pension system, whilst ensuring adequate levels of pensions and simultaneously adjust-

ing its system to changing societal circumstances, in particular through an adjustment mechanism of pensions to increases in life expectancy. In the long run the last reforms imply a raising of the retirement age by about two or three years between now and 2050.

Finland has developed a strategy of accumulation of surpluses both in the private and public sector (in total, the assets of social security pension schemes account to 59% of GDP in 2004). However, it is expected that a further increase in the contribution rate will be needed in the statutory scheme for the private sector. This strategy hinges critically on economic and productivity growth as well as on rising employment rates which will have to contribute to maintaining surpluses in general government finances and to accumulating pension reserves.

## 4. Background statistics

	FI			EU-25				
Adequacy								
Current situation								
	Total	Men	Women	Total	Men	Women		
At-risk-of-poverty rate <sup>(1)</sup>	11	11	11	16	15	17		
0–64	10	10	10	16	16	17		
65+	17	11	20	18	15	20		
75+	25	15	30	Nd	Nd	Nd		
Income inequality <sup>(1)</sup>								
0–64	3.6							
65+	2.8							
Income of people aged 65+ as a ratio of income of people aged 0–64 <sup>(1)</sup>	0.75	0.81	0.72					
Median pensions relative to median earnings <sup>(2)</sup>	0.53	0.52	0.54					
Long-term projections								
Theoretical replacement rates <sup>(3)</sup>	2005	2030	2050					
Total net replacement rate	63	66	62					
Total gross replacement rate	57	57	52					
Gross replacement rate 1st pillar	57	57	52					
Gross replacement rate 2nd/3rd pillar	(*)	(*)	(*)					
Financial sustainability								
Current situation								
Esspros Pension expenditure <sup>(4)</sup> , % of GDP	1995	2000	2003	1995	2000	2003		
	12.7	10.7	11.4		12.5	12.6		
Employment (2004) <sup>(5)</sup>	Total	Men	Women	Total	Men	Women		
Employment rate (25–54)	81.0	83.8	78.2	76.8	85.2	68.5		
Employment rate (55–64)	50.9	51.4	50.4	41.0	50.7	31.7		
Effective labour market exit age (2004) <sup>(6)</sup>	60.5			60.7p				
Public finances (2003) <sup>(7)</sup>								
Public debt, % of GDP	45.4			63.3				
Budget balance, % of GDP	2.3			-2.8				
Long-term projections (EPC 2006)								
	2004	Level 2030	2050	Increase 2004–50	2004	Level 2030	2050	Increase 2004–50
Old-age dependency ratio <sup>(8)</sup>	23.3	46.9	46.7	+100%	25	40	52	+108 %
Public pensions expenditure, % of GDP <sup>(9)</sup>	10.7	14.0	13.7	+3.1	10.6	11.9	12.8	+2.2
Factors determining the evolution of public pensions expenditure (2000–50) <sup>(10)</sup>	Contribution to change in percentage points of GDP				Contribution to change in percentage points of GDP			
Demographic dependency	8.8				8.6			
Employment	-0.9				-1.1			
Eligibility	-3.1				-2.1			
Level of benefits	-0.9				-2.7			
Total (including residual)	3.3				2.2			
Notes								
<sup>(1)</sup> Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, Income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).								
<sup>(2)</sup> Source: Eurostat. Median individual pension income of retirees aged 65–74 in relation to median earnings of employed persons aged 50–59 excluding social benefits other than pensions.								
<sup>(3)</sup> Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first- and second-pillar pension schemes, retiring at the age of 65 years in 2005.								
<sup>(4)</sup> Source: Esspros, Eurostat. Includes expenditure by certain private social protection schemes.								
<sup>(5)</sup> Source: European Labour Force Survey, 2004.								
<sup>(6)</sup> Source: European Labour Force Survey, 2004.								
<sup>(7)</sup> Source: European Commission, DG ECFIN.								
<sup>(8)</sup> Source: Eurostat (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15–64.								
<sup>(9)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.								
<sup>(10)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.								
(*) Negligible proportion								

## Sweden

### 1. Main characteristics of the pension system

The **statutory pension scheme** is earnings-related and draws all its financing from social security contributions (separated from the budget of the State), which are planned to be kept constant at 18.5% of pensionable earnings. The guarantee pension and survivors' pensions are covered by general taxes and disability pensions by the sickness insurance scheme.

Out of the 18.5% contribution rate up to a social insurance ceiling, 16 p.p. are financing pensions on a pay-as-you-go basis through the mechanism of notional accounts: contributions are capitalised at a given interest rate into a hypothetical retirement capital (this capitalisation path follows income growth, while the indexation of pensions in payment more or less follows income growth, i.e. income growth minus 1.6%). The remaining 2.5 p.p. are invested in one or more funds selected by the member (so-called *premium pension*). At the time of retirement, the hypothetical retirement capital is converted into a pension, the amount of which depends primarily on the current level of remaining life expectancy. The capital accumulated under the *premium pension* can be either paid out from the pension fund or transferred into an annuity.

The earliest income-based pensions and premium pensions can be drawn is 61. The size of the annual pension will increase the later a person chooses to retire due to further-earned pension rights during the additional working years and decreasing remaining life expectancy. Pension rights may be earned for an unlimited time, and no definite retirement age exists. Under the Employment Protection Act, an employee is entitled to stay on in employment until their 67th birthday. 25, 50, 75 or 100% of the pension may be drawn. If the individual continues to work after beginning to draw the pension, additional pension rights are accrued irrespective of age.

**Occupational schemes** are primarily based on four large collective agreements, concluded by social partners. These agreements cover more than 90% of employees. Contributions are paid by employers and range between 2% and 5% of wages in the defined contribution schemes, while in the defined benefit

schemes they can be higher. There is a strong shift of the occupational schemes towards defined-contribution arrangements. Occupational pension schemes usually provide an extra income amounting to approximately 10–15% of a person's final salary. These contracts may also contain survivors' protection and sickness insurance in case of long-term illness.

Approximately 40% of the employed population are covered by **individual provisions**, which corresponded to approximately 5% of total pension expenditure in 2002. These individual pension insurance schemes are contracted on a voluntary basis and are fiscally deductible. The average amount contributed in 2003 corresponds to around 2.3% of the average annual gross wage. The importance of these private pensions has been rising continuously within the last 10 years. Typical products generally take the form of traditional life insurance or unit-link insurance.

The **old-age guarantee pension** provides a minimum pension for persons from the age of 65 years as a supplement to the statutory pension earnings-related scheme (maximum amount after 40 years of residence in Sweden). It is financed by taxes, price-indexed and not reduced by wage income, capital income, occupational or private pension benefits. A new form of means-tested support for the elderly people not entitled to the guarantee pension (especially immigrants) – maintenance support for the elderly – was introduced in 2003. Means-tested housing allowances also supplement the incomes of numerous pensioners.

### 2. Situation and perspectives in light of the common objectives

#### 2.1. Current situation

Concerning **adequacy**, the earnings-related scheme is based on the principle of actuarial neutrality: the accumulated assets from contributions paid during the whole professional life are transposed into an annuity at the time of retirement, taking into account life expectancy at retirement. In addition to this, the contribution account is also credited for some breaks in the professional life such as unemployment and parental leave. The employers' part of the pension contribution

is financed by the State budget for such benefits. Furthermore, certain groups are credited with supplementary pension rights based on hypothetical incomes called pensionable amounts in order to benefit the insured for periods that can lead to a loss of income but should not do so. Pensionable amounts are given to parents of small children aged 0 to 4, for periods when sickness or activity compensation is received or studying (as well as time completing national military service). The entire contribution of 18.5%, in these cases, is paid out of the State budget.

In 2005 replacement rates were around 70% (68% gross and 71% net) for a 40-year career at the average wage, retiring at 65 (including both statutory pensions and occupational pensions). Occupational pensions are well-developed and also expected to contribute to the maintenance of the standard of living after retirement. The Swedish pension system ensures adequate standards of living for men and women (the relative income of those aged 65 or more represents about 80% of the relative income of those aged 0–64), even if differences persist according to the gender dimension (83% for men and 73% for women). The risk of poverty of elderly people is maintained at a moderate level, close to for the overall population. Poverty rates among aged persons 65 or above are 14% in 2003 at the 60% ceiling (9% for men and 18% for women).

Regarding **financial sustainability**, the defined-contribution principle of the new pension scheme limits the future increase in pension expenditure to the increase in the accumulation of pension contributions. Pension expenditure was at 12.7% of GDP in 2003, almost at the EU average. Moreover, the financial viability of the NDC pension system is guaranteed by the mechanism of automatic adjustment in case of imbalances and helped through the intermediate (buffer) fund created at the beginning of the 1960s. This fund is supposed to contribute to the long-term financing of the pension system. Its capital amounted to almost 30% of GDP in 2005. Other pension scheme assets, including occupational and individual schemes, represent around 67% of GDP for 2003.

The pension system allows a high degree of flexibility, both for the choice of the retirement age and also concerning the possibility of combining earned income and a total or partial pension. The rate of employment of older workers in Sweden is the highest in the EU-25.

While there is no fixed retirement age, early retirement is possible, however, on a pension which is actuarially neutral. While the pension system provides incentives to remain in work, the number of older workers on sick leave and on the receipt of disability benefits experienced a rapid growth; however, trends changed in 2003 and the number of people on sick leave has since decreased, albeit from a high level.

As for **modernisation**, the universal Swedish pension system ensures a great degree of flexibility, for instance, as regards different work patterns and flexible retirement possibilities, while providing effective incentives to work and equality between genders.

The Swedish reform builds on a broad political consensus and is accompanied by a will to improve the information for future recipients, who receive a statement of their pension capital and several forecasts of their future pension on the basis of certain assumptions (on the growth rate, the yield, the retirement age, etc.) each year. Within this framework, a broad pension Internet portal was set up in 2004, with the objective of making it possible for individuals to make a forecast of their future pensions (not only statutory, but also occupational and in the future also individual).

## 2.2. Outlook, reform measures and policy debates

The increase in the old-age dependency ratio is projected to be very slow, growing from a moderate 26% in 2003 by just 14 p.p. to 41% in 2050, in particular due to a fertility rate being among the highest in the EU.

Replacement rates at a given age are projected to decrease significantly in the coming decades. According to ISG calculations of theoretical replacement rates, for a worker retiring at 65 after 40 years of work, the net replacement rate would markedly decrease from 71% in 2005 to 57% in 2050 and the gross rate would go down from 68% in 2005 to 56% in 2050 (while the contributions from funded pillars remains the same). This will follow from the increase in life expectancy (i.e. increase in the time being spent in retirement) and the same assumption of 40 years in employment when the defined-contribution principle is pursued. Accordingly, cohorts who retire in 2050 would need to work for 44 years, up to the age of 69, in order to achieve the same replacement rate as those who retire in 2005.



Minimum social security pensions are indexed to prices; earnings-related pensions (both PAYG and funded part) are indexed to average wage growth. However, the indexation is front-loaded so that 1.6% increase is given at the time of retirement, while later index adjustments are equal to the average wage growth minus 1.6 percentage points. This allows having a higher pension level at the beginning of the retirement period, which is considered to correspond better to the consumption pattern of pensioners during their whole retirement period. However, over time, this situation might cause an increase in the relative risk of poverty for older pensioners with a low earnings-related pension.

The contributions are notionally recorded on individual accounts and credited annually by a notional rate of return, which is equal to the increase of total wages. An automatic balancing mechanism has been introduced (slowing the indexation of the pension capital in case of imbalances), while the conversion of the notional retirement capital into a pension takes into account the life expectancy at the time of retirement, which neutralises an important factor of the increase in pension expenditure.

Sweden's public pension system, independent from the State budget, is expected to face only low pressure due to the ageing populations. According to the budgetary projections made by the AWG in 2005, its current public spending on pensions (10.6% of GDP), is projected to increase up until 2050 very slowly – only 0.6 p.p. (compared to 2.2 p.p. in EU-15). The overall spending on age-related expenditures is projected to increase from 25.7% to 26.3% of GDP over the same period.

Nevertheless, the maintenance of the employability and of the work capacity is a key element of future adequacy and financial sustainability. At the present time, the government is trying to reabsorb the increase in sick leave by the implementation of a broad programme aiming at promoting health at work. The action plan comprises, in particular, measures to improve the work environment and to set out more clearly an employer's responsibilities. It also includes measures for a rapid return to work after recovery, commitments for greater accessibility to healthcare and medical treatment, as well as a review of a patients' situation at least once every three years. In addition, the system of disability pensions has been re-examined and has been incorporated into the health insurance system. This reform aims at making the sys-

tem more equitable, by facilitating the access to employment by distinguishing between activity compensation (for workers between 19 and 29 years) and sickness compensation (for those between 30 and 64 years). It provides, in particular, the possibility of access to rehabilitation measures and the possibility of combining employment and partial benefits.

Finally, under the new earnings-related pension scheme, financial risks related to longevity or the contribution base are borne by the pension recipients, while holding the contribution rate constant. A financial risk for the general budget could arise in respect of financing the guaranteed minimum pension if a large number of people were unable to accrue sufficient earnings-related pension rights.

### 3. Conclusion

Sweden has managed to create a public pension system which is adequate and financially stable in the future, as long as people compensate the significant decrease of replacement rates by a later exit from the labour market. Sweden ensured its financial sustainability by the development of a reserve fund at the beginning of the 1960s (amounting to almost 30% of GDP in 2005) and through a mechanism of automatic adjustment in case of imbalances.

The employment rate of older workers in Sweden is the highest in the EU-25. The pension system allows a high degree of flexibility, both for the choice of the retirement age and also concerning the possibility of combining earned income and a total or partial pension. The transparency of the pension system and the pension information given to individuals should enable them to plan their professional life in order to ensure an appropriate pension and thus gives important incentives for a greater participation of older workers in the labour market. Nevertheless, general financial literacy in the field of pensions is not satisfactory, despite the information provision efforts.

Although actuarial neutrality in the system and possibilities for flexible retirement would keep people from retiring early, some channels of early exit from the labour market have tended to develop, in particular through sick leave and disability benefits. The government is addressing these developments and should monitor the outcome of the implemented measures.



## 4. Background statistics

	SE			EU-25				
Adequacy								
Current situation								
	Total	Men	Women	Total	Men	Women		
At-risk-of-poverty rate <sup>(1)</sup>	11	10	12	16	15	17		
0–64	11	11	11	16	16	17		
65+	14	9	18	18	15	20		
75+	20	14	24	Nd	Nd	Nd		
Income inequality <sup>(1)</sup>								
0–64	3.3							
65+	2.7							
Income of people aged 65+ as a ratio of income of people aged 0–64 <sup>(1)</sup>	0.77	0.83	0.73					
Median pensions relative to median earnings <sup>(2)</sup>	0.67	0.66	0.69					
Long-term projections								
Theoretical replacement rates <sup>(3)</sup>	2005	2030	2050					
Total net replacement rate	71	60	57					
Total gross replacement rate	68	58	56					
Gross replacement rate 1st pillar	53	43	40					
Gross replacement rate 2nd/3rd pillar	15	16	15					
Financial sustainability								
Current situation								
Esspros Pension expenditure <sup>(4)</sup> , % of GDP	1995	2000	2003	1995	2000	2003		
	12.8	11.7	12.7		12.5	12.6		
Employment (2004) <sup>(5)</sup>	Total	Men	Women	Total	Men	Women		
Employment rate (25–54)	82.9	85.0	80.9	76.8	85.2	68.5		
Employment rate (55–64)	69.1	71.2	67.0	41.0	50.7	31.7		
Effective labour market exit age (2004) <sup>(6)</sup>	62.8			60.7p				
Public finances (2003) <sup>(7)</sup>								
Public debt, % of GDP	52.0			63.3				
Budget balance, % of GDP	0.3			-2.8				
Long-term projections (EPC 2006)								
	2004	Level 2030	2050	Increase 2004–50	2004	Level 2030	2050	Increase 2004–50
Old-age dependency ratio <sup>(8)</sup>	26.4	38.4	40.9	+55%	25	40	52	+108 %
Public pensions expenditure, % of GDP <sup>(9)</sup>	10.6	11.1	11.2	+0.6	10.6	11.9	12.8	+2.2
Factors determining the evolution of public pensions expenditure (2000–50) <sup>(10)</sup>	Contribution to change in percentage points of GDP				Contribution to change in percentage points of GDP			
Demographic dependency	4.8				8.6			
Employment	-0.6				-1.1			
Eligibility	-0.2				-2.1			
Level of benefits	-2.8				-2.7			
Total (including residual)	0.9				2.2			
Notes								
<sup>(1)</sup> Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, Income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).								
<sup>(2)</sup> Source: Eurostat. Median individual pension income of retirees aged 65–74 in relation to median earnings of employed persons aged 50–59 excluding social benefits other than pensions.								
<sup>(3)</sup> Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first- and second-pillar pension schemes, retiring at the age of 65 years in 2005.								
<sup>(4)</sup> Source: Esspros, Eurostat. Includes expenditure by certain private social protection schemes.								
<sup>(5)</sup> Source: European Labour Force Survey, 2004.								
<sup>(6)</sup> Source: European Labour Force Survey, 2004.								
<sup>(7)</sup> Source: European Commission, DG ECFIN.								
<sup>(8)</sup> Source: Eurostat (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15–64.								
<sup>(9)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.								
<sup>(10)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.								
(*) Negligible proportion								

## The United Kingdom

### 1. Main characteristics of the pension system

In the UK, the **statutory State Pension** system consists of a flat-rate basic pension and an earnings-related additional pension, the State Second Pension that reformed the previous State Earnings-Related Pension Scheme (SERPS) (survivors' and disability pensions are also statutory). These two tiers of the first pillar are financed through earnings-related National Insurance contributions. In addition, earnings-related pensions of government sector employees are covered in part by State budgets. State pension age is 65 for men and 60 for women but legislation is in place to equalise State pension age at 65 by April 2020. A full flat-rate basic State pension normally requires 44 qualifying years of National Insurance Contributions (which may include some National Insurance credits) for men and 39 qualifying years for women. State pensions cannot be taken up before State pension age, but may be deferred in return for a higher State pension (10.4% increase per year of deferral) or a one-off lump sum with interest instead (annually at least 2% above the Bank of England base rate).

A unique feature of the UK pension system is the possibility to contract out of the additional State pension. This requires coverage by an occupational or personal pension scheme providing equivalent or better benefits than the earnings-related component of the statutory scheme. 60% of the employed are in such contracted-out schemes and are entitled to a National Insurance contribution rebate.

The introduction of the **State Second Pension** (in 2002) enables people on lower earnings to build up their pension entitlements. People earning between the lower earnings limit (about GBP 4 264 for 2005-06) and GBP 12 100 (for 2005-06) will accrue pension rights as if they had earned GBP 12 100. In addition, individuals are credited second pension rights for periods when they cannot work due to caring responsibilities or disability.

**Pension Credit** introduced in 2003 is an income-related benefit for people aged 60 or over. It is targeted at the least well-off pensioners and the income test is more generous than for previous income-related benefits. Pension Credit provides, or contributes to, a minimum level of income of GBP 109.45 for a single person or GBP 167.05 for a couple. These amounts may be more for people who have caring responsibilities, are severely disabled or have certain housing costs.

**Occupational pension schemes** tend to be established by a single employer and were generally of the defined-benefit type, providing pensions based on years of service and final pay. However, the coverage of defined-benefit schemes is declining and most new schemes have taken the form of DC schemes<sup>(75)</sup>.

**Personal pensions** were introduced in 1988 to offer a private second pension to people without access to an occupational scheme or who change jobs frequently (although Retirement Annuity Contracts, similar to personal provisions, were available prior to 1988). About 14% of the working-age population have personal pensions (44% for self employed). To make private second pensions more attractive, **Stakeholder Pensions** were introduced in April 2001. This form of personal pension account was designed to provide an option for people with moderate incomes who do not have access to a company pension scheme. Stakeholder pensions must meet a number of minimum standards and in particular have low charges (maximum 1.5% of fund value per annum, reducing to 1% after 10 year's membership), and have the flexibility for participants to vary contributions or move between schemes without any financial penalty. About 1.37 million people contributed to stakeholder pensions in 2003-04<sup>(76)</sup>.

Around 40% of the working age population is contributing to an occupational or personal pension – about 60% of employees of working age – and over two thirds of pensioner households had income from a private pension scheme (72% had investment income from non-pension sources).

(75) 'Occupational Pension Schemes 2004: The twelfth survey by the Government Actuary', published June 2005.

(76) HMRC data 2003-04.

## 2. Situation and perspectives in light of common objectives

### 2.1. Current situation

Concerning **adequacy**, the median income of people aged 65 or more stands at about 74% of the income of those aged 0–64. The gross replacement rates for a worker at the average wage retiring at 65 after 40 years of contributions currently lies at 66% (82% net), 17% from the statutory scheme and 50% from the occupational scheme. This is based on the assumption that the person remains in the scheme for three quarters of their career and is contracted out of the State Second Pension for that time. For people with no private pension at all (only with a public State Second Pension) the gross replacement rate is 35% (47% net).

The poverty rate among elderly people in the UK has declined in recent years, but remains above EU average. According to latest national figures, in 2003 the relative poverty rate (at the 60% of median income threshold) for people aged 65 and more was lying at 24% (30% for oldest people, aged 75 or more), at a higher level than the poverty risk for the 0–64 population of 17%. According to national figures, the poverty risk among persons aged 65 and more declined by about 5 percentage points from 1996-97 to 2002-03<sup>(77)</sup>. However, these figures do not show the full effect of Pension Credit, introduced in October 2003, and which is expected to lead to a further fall in pension poverty in 2004–05 at a time when earnings of the working age population have increased rapidly.

Concerning **sustainability**, the employment rate of people aged 55–64 was 56% in 2004, which is significantly above the Lisbon targets, while the average age of effective labour market withdrawal is 62.9 for men and 61.4 for women in 2004. Among persons 50 to 69 years old who retire before State pension age, 49% gave ill-health as a reason, 18% were offered financial terms to retire early or take voluntary redundancy and a further 18% were made redundant, dismissed or had no choice<sup>(78)</sup>. Moreover, those in receipt

of private pension income were more likely to retire early.

Some measures were introduced to encourage the participation of older workers both before and after State pension age, (in particular by providing back-to-work help through the New Deal 50 Plus) and tackling age discrimination. Incentives for continued or more flexible working have been strengthened and people may delay claiming their pension or even 'de-retire' when they have claimed, and earn an increase pension later, or a generous lump-sum payment. In parallel, the simplification of tax incentives for pensions will introduce a single universal regime for tax-privileged pension savings<sup>(79)</sup>.

In view of the importance of private provision, the current diversity and complexity of private pension schemes poses particular challenges. Individuals are faced with a range of choices when they start or change employment. The large number of schemes raises issues of the feasibility of close supervision. A further notable development over the last decade has been the closure of employer sponsored DB provision (the Pensions Commission estimates 60% of DB schemes are closed to new members) which have been replaced with DC schemes. While the trend in total scheme membership is uncertain, average contributions to occupational DC schemes are lower than for DB schemes (according to the National Strategy Report, total contributions to DB schemes are broadly in the 17–20% range, whereas DC schemes are usually in the 7–9% range). The difference in contribution levels would suggest less generous occupational pensions for workers in the future.

The challenges posed for private pension provision by longer life expectancy, economic uncertainties and risk of inadequate management are currently being put on the political agenda. The establishment of a Pension Protection Fund (PPF) will provide increased security for the members of occupational pension schemes. The PPF started operating in April 2005 and will pay compensation (up to certain limits) to members of defined-benefit schemes and the defined benefit part of hybrid

(77) This decline is higher if one refers to the absolute poverty ceiling of 1996-97: the decline from 1996-97 to 2002-03 amounts then to about 15 percentage points, corresponding to a reduction of the poverty risk of two thirds. According to other national sources, with incomes measured 'After Housing Costs', the relative poverty risk among elderly people above State pension age declined by about 8% from 1996-97 to 2003-04.

(78) Factors affecting the labour market participation of older workers, Department of Work and Pensions Research Report 200.

(79) There will be two key thresholds in the new regime – the lifetime allowance, set initially at GBP 1.5 million, rising to GBP 1.8 million by 2009-10; and the annual allowance, set initially at GBP 215 000, rising to GBP 255 000 by 2009-10.

schemes, where the employer becomes insolvent and the scheme is underfunded. For those scheme members who lost part of their defined-benefit occupational pension prior to April 2005, who are within three years or above of their scheme pension age, the government has introduced the Financial Assistance Scheme (FAS) with funding of GBP 400 million, which will top up to a level broadly equivalent to 80% of the core pension benefits (to a maximum of GBP 12 000 per year). Additionally, the new Pensions Regulator, established in April 2005, will take a pro-active approach to pension scheme management focusing on fraud, poor administration and underfunding. It can impose civil penalties and, where appropriate, prosecute those responsible through the criminal courts and contributes to providing information and assistance to some operators.

Concerning **modernisation**, the legislation is in place to equalise State pension age at 65 by 2020. Relative living standards are on average slightly higher for men (76% for those 65 or above relative to 0–64) than for women (73%), and poverty risk remains higher for women (28% at the 60% threshold for those 65 or more) than for men (23%).

The portability of pension rights will also be improved from April 2006 onwards by giving early leavers a right to a cash transfer to a new scheme after three months.

Adults (up to State pension age) are being provided with individual State pension forecasts, and employers are being encouraged to provide information to their workers on pension options and entitlements. The UK Government is developing a web-based retirement planner and an interactive website, covering work, savings and retirement planning and is working with financial services to improve the range of information and guidance materials available, to the entire population, including those of school age.

## 2.2. Outlook, reform measures and policy debates

The United Kingdom is expected to face similar demographic trends to most EU Member States, but the currently favourable situation protects it from the most urgent risks. The old-age-dependency ratio, even if growing from 24% in 2003 to 45% in 2050, is still projected to be among the lowest in the EU.

Recent reforms should translate into improvements of **adequacy** of pensions, and in particular of the situation of the poorest pensioners. Continued increases in the take-up rate of the Pension Credit should translate into further decreases of poverty rates among people aged 60 or more. Replacement rates at a given age are expected to remain constant for the coming decades for people contracting out, under the assumption of a contribution rate of 23.7% (18.7% employer and 5% employee), which is significantly higher than the current average contribution rates to occupational schemes. Currently, around 60% of employees contract out into occupational/private schemes. For people who don't contract out of the State Second Pension the gross replacement rate is projected to decline from the current levels of 35% (47% net) to 25% in 2050 (41% net). A major challenge will then be to ensure that more people have access to, and make use of, opportunities to provide for a higher living standard after retirement.

Although the UK already meets the Lisbon and Stockholm employment targets (the employment rate of people aged 55–64 was 56% in 2004), there is still room for improvement. The UK government has announced that it will make compulsory retirement ages in companies below age 65 unlawful, except where an employer can justify a lower age. Employers will also give due consideration to individuals who request the right to stay in employment beyond any State retirement age. The need for a 65 default retirement age in legislation will be reviewed in 2011.

The Incapacity Benefit (IB) Green Paper *Pathways to Work* (2002) set out a long-term strategy for encouraging and assisting people with health problems and disabilities to return to work. This strategy is critical to support older people, as 1.3 million of the 2.7 million people claiming IB in the UK are over 50. The UK government recently announced proposals for reforming incapacity benefits. Pathways to work pilots have been introduced, bringing together employment and health support for the first time and by October 2006 a third of all claimants will be able to receive the help available through Pathways.

Whereas adequacy of the basic State pension had developed into a major challenge over the 1980s and 1990s, future financial sustainability of the public pension system appears less challenging. The strategy for

ensuring the financial **sustainability** of the whole pension system is to focus public pension expenditure on lower income groups and to encourage more pension provision to be funded by private savings.

UK State pension spending is around 5% of GDP – and according to national sources is projected to remain broadly stable over the next 50 years<sup>(80)</sup>. Expenditure on State pensions is expected to increase from GBP 47 billion in 2001-02 to GBP 54 billion in 2007/08 (real terms, 2005-06 prices). According to the AWG projections of 2005, spending on public pensions, including public employees' pensions, will increase by 2 p.p. of GDP from 6.6% of GDP in 2004 to reach 8.6% in 2050. On the basis of the current budgetary situation, the budgetary projections imply an increase in gross debt from current 41% to 90% of GDP in 2050. Finally, financial sustainability of public pensions appears to be well under control, but depends to a larger extent than in other countries on the performance of private pension providers. If private pensions decline from their current and anticipated levels, future governments may face increased claims of income-tested benefits.

In October 2004, a government-commissioned report on the future adequacy of pensions was released. The 'Independent Pensions Commission' chaired by Adair Turner indicated that "unless new government initiatives can make a major difference to behaviour, it is unlikely that the present voluntary private system combined with the present State system will solve the problem of inadequate pension saving." (Pension's Commission Press release on 12 October 2004). According to this report total spending amounts to 9.9% of GDP, out of which 6.1% is public and 0.8% of GDP corresponds to public sector pensions. Spending for the later group seems to be dynamic and a reform process has been put in place, including a rise of the normal retirement age to 65. The UK government is seeking to address the issue of under-saving through its Informed Choice programme, which aims to maximise the take-up of work-based pensions and support people through education and information in making decisions about saving for their future.

### 3. Conclusion

Through recent reforms of the State Second Pension and 'Pension Credit', the UK has improved State pension adequacy. Poverty rates have been declining in recent years and are expected to decline further once the full effect of Pension Credit appears.

While financial sustainability of State pensions appears to be under control and the employment rate among older workers is already high, employment opportunities – full-time, part-time and flexible working hours – to help older people to stay in work as long as they wish can contribute to increase old-age income.

A unique feature of the UK pension system is the possibility to contract out of the State Second Pension. Subsequently, the adequacy, as well as the sustainability of pensions, depends to a larger extent than in other countries on the coverage and performance of private pensions. In this respect, the UK should continue to address the major challenge of ensuring that people have access to, and make use of the provisions for a higher living standard after retirement. Extending the coverage and depth of pension savings will be important to ensure adequate income replacement in the future.

The precise form of reform will be based on the Pensions Commission's recommendations out of its second report at the end of 2005, advising in particular on whether there is a need for "moving beyond a voluntary approach". In this respect at least three issues arise concerning future adequacy. The first is the impact of the shift to DC pension plans on the level of contributions to occupational schemes, secondly, how to ensure that people accommodate the rate of the basic State pension through increases in other sources of retirement income, and thirdly, how to continue to improve incentives to work later and save adequately.

(80) Source: Annex A, HM Treasury's Budget Report published alongside the Pre-Budget Report 2005.

## 4. Background statistics

	UK			EU-25				
Adequacy								
Current situation								
	Total	Men	Women	Total	Men	Women		
At-risk-of-poverty rate <sup>(1)</sup>	18	17	19	16	15	17		
0–64	17	16	17	16	16	17		
65+	24	21	27	18	15	20		
75+	30	28	32	Nd	Nd	Nd		
Income inequality <sup>(1)</sup>								
0–64	5.9							
65+	4.0							
Income of people aged 65+ as a ratio of income of people aged 0–64 <sup>(1)</sup>	0.74	0.76	0.73					
Median pensions relative to median earnings <sup>(2)</sup>	Nd	Nd	Nd					
Long-term projections								
Theoretical replacement rates <sup>(3)</sup>	2005	2030	2050					
Total net replacement rate	82	84	85					
Total gross replacement rate	66	68	69					
Gross replacement rate 1st pillar	17	18	19					
Gross replacement rate 2nd/3rd pillar	50	50	50					
Financial sustainability								
Current situation								
Esspros Pension expenditure <sup>(4)</sup> , % of GDP	1995	2000	2003	1995	2000	2003		
	11.9	12.2	11.0		12.5	12.6		
Employment (2004) <sup>(5)</sup>	Total	Men	Women	Total	Men	Women		
Employment rate (25–54)	80.8	87.7	74.2	76.8	85.2	68.5		
Employment rate (55–64)	56.2	65.7	47.0	41.0	50.7	31.7		
Effective labour market exit age (2004) <sup>(6)</sup>	62.1			60.7p				
Public finances (2003) <sup>(7)</sup>								
Public debt, % of GDP	39.8			63.3				
Budget balance, % of GDP	-3.3			-2.8				
Long-term projections (EPC 2006)								
	2004	Level 2030	2050	Increase 2004–50	2004	Level 2030	2050	Increase 2004–50
Old-age dependency ratio <sup>(8)</sup>	24.3	741.3	45	+85%	25	40	52	+108 %
Public pensions expenditure, % of GDP <sup>(9)</sup>	6.6	7.9	8.6	+2.0	10.6	11.9	12.8	+2.2
Factors determining the evolution of public pensions expenditure (2000–50) <sup>(10)</sup>	Contribution to change in percentage points of GDP				Contribution to change in percentage points of GDP			
Demographic dependency	4.7				8.6			
Employment	-0.1				-1.1			
Eligibility	Nd				-2.1			
Level of benefits	Nd				-2.7			
Total (including residual)	1.9				2.2			
Notes								
<sup>(1)</sup> Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, Income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).								
<sup>(2)</sup> Source: Eurostat. Median individual pension income of retirees aged 65–74 in relation to median earnings of employed persons aged 50–59 excluding social benefits other than pensions.								
<sup>(3)</sup> Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first- and second-pillar pension schemes, retiring at the age of 65 years in 2005.								
<sup>(4)</sup> Source: Esspros, Eurostat. Includes expenditure by certain private social protection schemes.								
<sup>(5)</sup> Source: European Labour Force Survey, 2004.								
<sup>(6)</sup> Source: European Labour Force Survey, 2004.								
<sup>(7)</sup> Source: European Commission, DG ECFIN.								
<sup>(8)</sup> Source: Eurostat (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15–64.								
<sup>(9)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.								
<sup>(10)</sup> Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.								
(*) Negligible proportion								





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