Trends in European Pension Reforms

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Introduction

Pension systems are one of the great achievements of the welfare States in Europe in the last century and remain a key element of our social model(s) also in this century. The fact that poverty is no longer the status quo for people who stop working and that many are able to maintain their standard of living after retirement are key achievements of social protection policies. Incidentally – in the EU social protection slang – this is referred to as adequacy of pension systems.

The nature of the pension challenge is not only about demographic trends. It is also about changes in society and in the labour market. Results from the European process of open coordination in the area of pensions enable to characterise the main features of ongoing pension reforms (section 1). Ongoing changes in the labour market and projected impacts of reforms on adequacy and sustainability are essential to monitor (section 2). The reforms now seem to focus on a few outstanding issues (section 3).

1. The pension challenge and the European OMC

Similarities of pension provision and diversity within EU

Public provision plays a central role in national pension systems, which are very diverse among EU27, highlighting that there is no one-size-fits-all solution. While the basic goals of access, adequacy and financial sustainability are universal to all systems, there is considerable degree of variation in design at the national level, notably as a result of historical differences regarding preferences for redistribution or individual choice.

The dominant proportion of total pension provision in almost all EU27 Member States is organised within the general government sector. Pension systems in Europe are generally built on a general statutory social security scheme, functioning on an unfunded basis (pay-as-you-go - payg - where current resources are providing the resources for paying out current benefits).

Benefits provided by those schemes are the major share of pension income for older people. The financing can be based on social security contributions (like for instance in DE, FR, ES or IT) or alternatively on taxes from general budget (like in DK). Those schemes can nevertheless be designed in various ways, depending notably on the earnings – benefit link, for instance including flat-rate universal benefits (like in NL) or notionally defined contributions schemes where benefits are strongly related to former incomes (like in SE).
These schemes include (or are complemented by) minimum benefits for those who did not accrue sufficient pension rights. One can identify three main types of minimum income benefits specifically dedicated to older people: minimum benefits within the earnings related pensions (this can also include minimum accrual rules for those in the labour market), flat rate benefits for older people (generally for people aged 65 or more), and separate social assistance benefits.

These schemes are also often complemented by funded schemes, be they statutory, occupational or voluntary: the first two categories include funded tiers of statutory schemes and all occupational schemes (where membership has a direct link to employment, be they mandatory or voluntary), while the third category includes individual schemes (voluntary where membership does not have a direct link to employment).

In spite of differences, one can depict European general pension provision within four main clusters:

- Earnings related payg pensions, marginally complemented by occupational or voluntary pensions (notably PT, CY, CZ, MT, EL, ES, FR, LU, AT, SI, FI, RO). A number of Member States are also building reserves for their unfunded schemes (notably FI, but also BE, ES, FR or IE);
- Earnings related payg pensions increasingly complemented by statutory funded pensions (PL, HU, EE, LT, LV, SK, BG, and SE);
- Mainly flat rate public payg pensions traditionally complemented (sometimes increasingly) by funded occupational pensions (notably IE, UK, NL, DK);
- Earnings related payg pensions complemented (traditionally and sometimes increasingly) by occupational or voluntary pensions (notably BE, IT, DE, SE).

**The pension challenge is common to all types of pension provisions**

In essence the pension challenge lies in the growing gap between two decisive parameters for any pension system: life expectancy and retirement age. In Europe, the former increases continuously and the latter has declined. While it was normal to retire well after the age of 60 during the 1960's, employment of older workers declined in the 1970s and 1980s in many countries. Despite recent increases, average ages of leaving the labour market remain well below the levels of the late 1960s (Graphs 1 and 2).
Graph 1 – Activity rates by gender in the EU 1970 and 2005

Source: OECD, OECD.Stat database

Graph 2 – Cohort comparisons 1981-1986-1991 by Gender in EU

Source: Eurostat, L73, spring results.

Note: the chart shows the activity rate of three cohorts in the EU15: 1) cohort of those aged 45-64 in 1981, 2) cohort of those aged 50-64 in 1986, and 3) cohort of those aged 55-64 in 1991. The chart illustrates the trend of which activity rate decreased as the cohort gets older. The position of the lines represents the actual level of participation. In the Netherlands, the 55-64 cohorts refer to 1985, 1990, and 1995, respectively.

The 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 during the same period. Life expectancy at 60 for EU25 has increased by about 4 years from 1960 to 2000. The most recent Eurostat projections see life expectancy in the EU25 at 65 increasing by a little more than another four years from 2004 to 2050.

In most Member States, people are now used to retiring at the average age of 60 after having started to work around 20. In 2004, the related dependency ratio (population over 60, as a percentage of population in the 20-60 age brackets) amounted to a bit less than 40%. According to demographic projections, this ratio would increase in 2025 to almost 60% and in 2050 to 80%. To illustrate this one can notice that in 2025, the ratio of 65+ compared to 15-64...
would be around 40%, but one would need to raise the age ceiling to 70 in 2050 to maintain this ratio.

The ageing challenge is common to all pension systems as all pension systems need to compensate for the decline in employment of older workers and the continuous increase in life expectancy. Pay as you go systems are directly affected by ageing of population as their future contribution base is shrinking while the number of beneficiaries is increasing. Hence, if people retire at the same age, they will benefit from a pension for a longer period. This will need to be financed by future active populations or benefits would necessarily be lower. Funded systems may be safe in terms of contributions base, but the increase in life expectancy also implies some imbalance: if contributions are not increased and/or people do retire later, benefits would be lower. In absence of reform, defined benefit (DB) systems would be unable to maintain their promises, while defined contribution (DC) systems would result in benefit levels well below what was foreseen when people paid in. In general, potential effects of ageing and a shift in the balance between active population and retired people on rates of returns and productivity affect both systems as well. Rates of returns affect future benefits in funded systems, while productivity affects contribution levels in unfunded systems.

In absence of reform, public finances would need to fill – partially – the gap leading to potential pressures on budgets and substantial political splits in societies. Moreover, in a currency area or single market with free movement of people, negative effects in one country could spill over into others – via interest rates and mobility.

An ‘open’ European coordination framework for pension reforms - OMC

Pension reforms have been on the European agenda for more than ten years. The pension debate focuses now not any more on if but on how. From the very beginning, the pension debate started with the question of whether or not we need pension reforms. Recently, the debate has developed further.

The first real push came from the side of Finance Ministers and Central banks worried about both short term burdens on public budgets and about the long-term impacts on the stability of public budgets. About the same time, labour market experts pointed to the high levies on labour resulting from pension and other social insurances as one of the reasons for low employment, most notably among the less skilled work force. Hopes have faded however that only cuts in social contributions would lead to an improvement in the labour markets.
The bridge between challenges and reform trends tells us much about the European pension reform efforts, a cooperative process between the Member States, the European Commission and the Council which is the main source of information for this article.

Challenges are in essence common. Member states actions impact others, and social cohesion has a clear European dimension. But this is not the only reason why there is action on the EU level: we do have common values and understandings such as those expressed in the charter of fundamental rights. These include the right of older people to a decent standard of living. Social cohesion is not just a national issue but also a European one.

The basic structure of this coordination process is as follows: Member States and the European Commission have agreed to work within the open method of coordination on social inclusions and social protection. The open method of coordination works through the common setting of objectives by the European Commission and the Council of Ministers, the reporting by the Member States on the basis of these objectives, and the Commission synthesising the findings in a report which is subsequently endorsed by the Council. Then, at the EU level, overall progress, challenges and arising areas of future concern are reported on, as are the type of action to be taken.

Agreement is that the key objectives of pension reforms, adequacy, financial sustainability and adaptation of systems go together: pension systems should provide adequate retirement incomes in a financially sustainable way while adapting to societal and economic change. Member States presented a first round of National Strategy Reports in 2002 and a second in 2005. These have been synthesised in 2006 by the Commission in the Joint Report on Social Protection and Social Inclusion (see box), endorsed by the European Council and by the Commission Services Paper, "Synthesis Report on Adequate and Sustainable Pensions"\(^1\) and its annexes (country summaries and horizontal analysis).

Six key issues have been identified. Four issues were already highlighted in the 2003 Joint Pension Report\(^2\) and 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 2006 Synthesis report, especially in the light of recent reforms: securing

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\(^1\) SEC(2006)304

\(^2\) http://ec.europa.eu/employment_social/social_protection/docs/cs7165_03_en.pdf
private pensions that can complement and partially replace public pension provisions and strengthening the governance of pension systems.

**Box – Key reforms of statutory schemes**

Most Member States have introduced reforms of statutory pension schemes providing earnings-related pensions. The contribution period taken into account in the calculation of pensions, the pace of accrual of pension benefits, the pace of revalorisation of past wages (no revalorisation, revalorisation on prices, on wages, or a mix), the pace of indexation of current pensions, but also standard retirement ages vary appreciably among Member States and are generally the target of adjustments during reforms, with various time horizons.

Also, a significant development has been the introduction of a demographic adjustment factor in a number of Member States (in payg systems like in DE, FR, AT, FI in NDC ones like PL, SE and LV and in all DC-funded schemes), which take account of future demographic trends and in particular of increases in life expectancy. They thus provide strong incentives for people to postpone retirement to match rising life expectancy and offer opportunities to achieve adequate pension levels. It can be noted that the same effects can be achieved by more fundamental changes in the organisation of pension systems, but that the expected effects are actually similar.

**2 - Ongoing changes in the labour market and projected impacts of reforms on adequacy and sustainability**

**Labour market and retirement behaviours**

Over the last decade, the employment rate of older workers has increased, reversing a long declining trend. The employment rate of older workers (55-64 age brackets) has increased from 36% in 1995 to 45% in 2006 for EU15, while the increase for EU25 went from 37% in 2000 to 44% in 2006. But in spite of these recent increases, there is still a long way to go in order to reach the European target of 50% employment among older workers. These evolutions actually show significant discrepancies (graph 3): the levels still differ and to a lesser extent so do the size of improvements. In any case compared to the huge declines (10 to 20 percentage points) observed earlier on, the improvements look small but as a signal of a changing trend they are important.

**Graph 3 – Employment rates of older workers in 2005 and evolution since 2000**

Source: Labour Force Survey, annual averages.
Actually, the stabilisation of employment rates took place in the mid 90’s and the reversal in the late 90’s, with the trend accelerating in early 2000’s (graph 4). Earlier, the employment rate also increased in the late 80’s following favourable economic situation at the time, but declined again in the early 90’s with the economic downturn.

**Graph 4 – Employment profiles by Gender in EU15, 1995, 2000, 2005**

Chart : Employment rate profile of older men and women aged 50-69 in the EU15 by sex and individual year of age in 1995, 2000 and 2005

Source: Eurostat, EU LFS, 1995 and 2000 spring data, and 2006 Q2 data

There are composition effects at play (in particular younger baby-boom generation entering the age brackets 55-59 and mechanically increasing employment rates), but these cannot account for the change observed. The forthcoming 2007 issue of Employment in Europe Report provides some decomposition: between 2000 and 2006, while the overall increase of employment rate of 55-64 was of 7.2 percentage points, one fifth (1.3 p.p.) is linked to the change in the older workers’ population structure. Though the contribution of this composition effect is relatively higher for men than for women (Graph 5), the net contribution from the shift in employment rates was clearly more substantial.

**Graph 5 – An increase in employment mainly linked to behaviours (2000-2006)**

Part time work strongly contributes

The increase in employment of older workers over the last decade is partly due to an increase in part-time work, notably among men. The share of part time employment among older workers has been significantly increasing within EU throughout the last decade. It now reaches nearly 25% for EU15 (22.5% EU25 and 22% EU27). It should be noted that this trend is not only accounted for the structural increase in the employment rate of women who are more often working part-time, as the share of part-time work among women increases slightly over the period, while it increases steadily among men (graph 6).

Graph 6 – Share of part-time employment among 55-64 employment

![Graph showing share of part-time employment among 55-64 employment]

Source: Labour Force Survey, quarterly data (2nd quarter). Note: double scale.

During 1995-2000, half of the increase in employment of older workers in EU15 was accounted for by increases in part-time employment. The trend slowed down for the period 2000-2006, though about one third of the net increase in employment of older workers is accounted for by part-time work (about 30% of the increase during 2000-2006 for EU25).

Direct transitions from employment to retirement

The most frequent reason for workers to leave their last job or business is specifically for retirement (about 35%). Other reasons include early paths out of the labour market such as early retirement (nearly 20%), illness and disability (about 15%), the job ending through dismissal or redundancy (20%) and other reasons (10%). Direct transitions from employment to retirement among 55-64 old workers represent an increasing share of exits from the labour market in EU15 though a decline can be observed between 2000 and 2006 in EU25 (graph 7). On the other hand, while the frequency of early exits has declined in the last decade in EU15, it remained roughly constant in recent years for EU25. Moreover, the share of exits due to
lack of employment is also increasing in recent years, highlighting the need to develop employment opportunities for older workers.

**Graph 7 – Reasons for leaving last job or business for older workers aged 55-64**

Source: Labour Force Survey, annual averages.

**Some risks of divergence: between Member States, between genders and qualifications**

While labour market outcomes are showing more positive developments than in previous decades with a recovery in recent years, there are also risks that these improvements have not spread. Improvements may occur in some MSs and not in others, they can affect men and women differently and skilled or low skilled labour forces may also see disparate results.

**Graph 8 – Non convergence between Member States?**

Average standard deviation of employment rates for 55-64 and for 25-54 (1983-2006)

Source: Labour Force Survey. Note: Total for all Member States available, EU* for a group of Member States where are available all the period long (BE, DK, DE, IE, EL, FR, IT, LU, NL, UK).

The improvements in older people’s employment differ greatly between countries. It is worth noting that progress can be slower in Member States where employment rates of older
people are already lower. The analysis shows that while there is convergence over the last two decades for the employment rates of the 25-54 population, there is divergence among the 55-64 age bracket (Graph 8), especially since the mid 90's where on average a positive trend is observed.

**Graph 9 – Slow convergence between men and women? Employment rates by gender for 55-64**

![Graph 9](image)

Source: Labour Force Survey.

While the employment rate of 55-64 has increased by 7 points since 2000 in the EU25, the increase is 6 points for men and 8 for women (graph 9). The catch-up is then a slow one, and levels remain very uneven, with 36% for women and 53% for men. In this context, there is a need to pay particular attention to the situation of women when they come closer to the retirement age. More generally, as employment rates among 25-54 remain very unequal (86% for men and 70% for women), it is clear that gender differences in regards to employment can have strong consequences for pension outcomes.

**Graph 10 – Divergence between skill levels? Employment rates of men 55-64 (EU25)**

![Graph 10](image)

Source: Labour Force Survey.

Since 2000 the increase of employment rate among 55-64 year olds has been relatively slower for the less qualified within the EU25: it has been 5 points for the less qualified, compared to 6 or 7 points for medium or highly qualified (graph 10). At the same time the
evolution of employment rates for less qualified was more favourable for the age bracket 25-54, probably reflecting targeted employment measures.

These uneven employment trends are raising some concerns especially in regards to the future adequacy of pensions, as working longer is central to accruing pension rights.

**Future developments: the key channel of working longer**

A key dimension of pension systems is that they relate not only to the current situation of older people but also to future developments, which are influenced by enacted reforms. In view of the potential high costs implied by the ageing of populations, most Member States are engaged in significant reforms of their pension systems, which will clearly impact on future pension benefits. Indeed, reforms are generally aimed at curbing the overall rise in pension expenditures, as expressed as a share of GDP.

For individuals: replacement rates

To look at reform impacts from the perspective of an individual, the Social Protection Committee (SPC) has developed a highly theoretical instrument: theoretical replacement rates, calculated by Member States for 2005 and 2050 (see ISG report 2006\(^3\)). The work carried out highlights that reforms of statutory schemes will often lead to a decrease in replacement rates at given retirement ages, which also reflects the trend towards an increase in life expectancy at 60 or 65 (see 2007 Joint report on Social Protection and Social Inclusion, supporting documents, section 3.3\(^4\)).

**Graph 11 – Trends of replacement rates: effect of enacted reforms at a given retirement age (2005-2050)**

Source: Stylised illustration from ISG results on gross replacement rates.

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It should be noted that the evolution of replacement rates is assessed for given retirement ages and given contribution length, while most pension reforms actually plan an increase in at least one or both of these parameters. There are also calculations available - even more hypothetical - on private pension provision and the impact of working longer (graph 11): in an average Member State a combination of private pension savings that amounted to 5 percentage points over the working life and an increase in retirement age of two years would roughly maintain the 2005 replacement rate. This clearly highlights the risks for future adequacy of an insufficient increase of employment rates among 55-64.

These calculations are highly hypothetical and in particular assume that private pension promises are kept. Therefore it may be appropriate to comment on private pensions as a growing part of future incomes of retired people. It should be noted that as it is an average it does not say anything about the likelihood that lower income groups would be able to opt for private pension provisions in the same way as higher income groups. But it shows the extent to which future retirement income will depend on private provision. We know from recent OECD work that lower income groups are less likely to opt for private pension provision (see notably Förster and Mira d'Ercole, 2005).

From a collective point of view: expenditures and public finances

The collective outcome of the pension reforms can be measured by the impact on public pension expenditures – using the results of the projections carried out by each Member State in a coordinated framework (AWG). The latest set of pension expenditures projections produced by the Economic Policy Committee's Working Group on Ageing (AWG) show that changes in employment rates of older workers and drops in the benefit ratio\(^5\) play a major part in decoupling public pension expenditure growth from the increase in the old-age dependency ratio.

The demographic pressure alone would result in an increase of the ratio of pension expenditure to GDP, but actual growth is expected to be much more modest. It is particularly interesting to compare 2005-2015 with 2015-2030 (graph 12). For the first ten years, the overall trend is actually expected to be negative as the increase in overall employment, the reduction in benefit levels and less people actually applying for pension benefits overcompensate. The latter reflects mostly the assumptions on people retiring later.

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\(^5\) This corresponds to a decline of average pensions in relation to average wages, as the former are projected to increase at a slower pace than the latter.
In the second period (2015-2030), the projections do not assume much further progress on employment and less on retiring later, but the reduction in benefit average ratio is more marked. After 2030, almost all the expenditure stabilisation results from reductions in level of public pensions. This corresponds to the results presented earlier on individual replacement rate trends.

Clearly these are projections and they are to be seen more as an invitation to think about policy priorities than as forecasts of what could happen; policy innovation is what they should initiate not feeling depressed over gloomy prospects.

3 - New reform issues

Concerns about equity and poverty

Risks related to inadequate pension provision

As underlined in the 2006 Synthesis report on pensions and in the 2006 EU Sustainability report, adequacy and sustainability of pensions cannot be achieved separately: they are mutually reinforcing in a virtuous or vicious circle. Indeed, achieving sustainability at the cost of a significant decline in the future relative level of pensions would put the reform strategy at risk of unexpected demands for revaluation of pensions. By the same token, promises of pensions without sustainable financing raise questions as to the capacity of pension systems to effectively deliver.
Graph 13 – Projected evolutions of theoretical replacement rates (TRR) and pension expenditures for public pension schemes

Source: ISG and AWG projections (public pension schemes include the funded tier of statutory schemes).

And the evolution of theoretical replacement rates is linked to the evolution of pension expenditures. Member States with more positive developments of theoretical replacement rates appear to face more significant challenges as regards their future pension expenditures (Graph 13 for public statutory pensions) and are generally relatively less advanced in the process of pension reform (it should be noted that reforms up to 2004 are taken into account and that some Member States introduced significant reforms since then).

A revival of Minimum schemes

Besides general earnings related schemes, minimum income provisions for older people have an essential role in alleviating or reducing poverty risk amongst the elderly.6 In a number of Member States the number of beneficiaries of minimum income benefits has been declining in recent decades, reflecting progressive maturation of pension schemes, improvements of benefits levels and an increase in participation rates.

In a number of Member States, the risk of poverty for people in retirement ages is currently higher than for the active population, though poverty gaps are lower, most probably reflecting the effect of minimum benefits. Older women and oldest people are particularly at risk of poverty, mainly reflecting past accruals and ongoing indexation of pensions. Nevertheless, one should note that needs may be different and these numbers do not take good account of in kind benefits and housing costs (imputed rents).

Member States are trying to maintain or even improve basic income protection, while pension reforms also tend to reduce the level of replacement rates for a given career length

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6 See SPC study on minimum income provision for older people (2006).
and profile. Future developments in the role of minimum income provision for older people are difficult to assess as in coming decades contradicting trends will be at play: maturation of pension schemes and increase in female workforce participation will continue, while effects of past unemployment levels and an increase in partial employment as well as the effect of recent reforms (that often translate in a decrease in benefit levels) will begin to develop. In this respect, it seems essential to develop tools to monitor these possible future developments, through further prospective analysis on trends at play, for instance through theoretical replacement rates or dynamic (panel) micro-simulation models.

Partially as a result of the indexation rules, including those influenced by automatic adjustment mechanisms, replacement rates of people will lag behind the general evolution of incomes to various extents and sometimes substantially. Of course those with good pensions at the moment of retirement will still have good pensions even 20 years after retirement. But what about others, notably women and the oldest pensioners?

While many reforms can reduce the average level of pensions, Members States pay attention to guaranteeing a decent minimum to all. In that respect, it should be noted that incentives and indexation rules can be designed to benefit or at least not disadvantage those pensioners with modest incomes. Some indexation rules can translate into a worsening of the relative situation of the poorest pensioners, in particular when they grow older. Though from the few evaluations available it does not seem that minimum income provisions generally provide adverse incentives to work longer or save, some provisions tend to make easier the prolongation of active life (notably design of means test).

**Compulsion vs. incentives: working longer and private pensions**

**Working longer**

Choice and options can help, but we should also think about leaving the labour market as a process rather than as one off decision. People may wish to work longer but less intensively and with shorter hours, days or weeks. Incentives do matter – these areas are notably developed by the OECD – and we need to get the incentives right (Graph 14), but we can see that while there is a link, countries with fairly comparable retirement incentives have different labour withdrawal rates.

Most Member States are currently reviewing or reforming the conditions of taking-up of pensions, notably by adapting statutory retirement ages (like for instance DE, DK or UK),
by introducing more flexibility in the choice of the path from work to retirement⁷, and also by reviewing conditions of early exits from the labour market.

**Graph 14 – Drop in employment rates between 55-59 and 60-64 and annual increase of theoretical replacement rates (TRR) from 60 to 65 in selected MSs**

More flexibility in retirement age can be achieved through appropriate incentives to prolong working lives, but also through partial pension and possibilities to combine pensions with earnings. The strength of incentives to work longer appears as a key issue for the design of flexibility in retirement age. If incentives are too weak, this is a encouragement to retire earlier, and if incentives are too high, costs for public finances can be significant in the event of significant increase in average retirement age (notably as at higher ages, there is a risk to subsidise those who would have in any case postponed retirement). Besides, incentives should be strong enough for lower wages, both for efficiency (sustainability) and adequacy grounds. For the latter, reviewing the incentive structure should take place in respect of minimum income provision.⁸ But for lower ages (in particular before 60), the emphasis should be less on incentive structures than on restricting possibilities to exit the labour market before standard retirement age (except perhaps for special conditions, such as hazardous jobs).

Introducing more flexible retirement provision not only requires a careful design of the structure of incentives but also that appropriate information is provided to beneficiaries. This is a difficult question that requires long term efforts, as experience suggests that even when individuals are provided with the information on their pension entitlements, they do not

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⁷ The SPC has adopted a study on flexibility in retirement provision in April 2007, that will shortly be available on the following web address: http://ec.europa.eu/employment_social/social_protection/pensions_en.htm  
⁸ See also SPC study on minimum income provision for older people, available on the following web address: http://ec.europa.eu/employment_social/social_protection/docs/SPC%20Study%20minimum%20income%20final.pdf
necessarily understand the consequences of different retirement choices in a context of changing rules. This also highlights the importance to define minimum provision (for instance ceilings on pension benefits and/or on eligible age) which ensure adequate retirement incomes by restricting the scope for choice.

The impact of pension reforms on effective retirement age and on employment on older workers also depends to a great extent on other factors, most notably opportunities on the labour market for older workers, which depend both on employees abilities to continue working above 55 (health status, training opportunities) and employers attitudes towards older workers.

Private pensions

The trend towards a decline in prospective replacement rates at a given age results in various adjustments not only in statutory schemes (pay-as-you-go also possibly including a funded tier) but also in private pension schemes in some Member States. The contribution of private pensions will benefit people who are actually covered and thus a significant share of pensioners will rely only on the contribution provided by statutory schemes.9

Hence there is whole set of measures in Member States to encourage them to do so. One obvious option is to go through employers and social partner agreements – occupational pensions. One other option is fiscal incentives – but costs to public budgets can be substantial and concerns have been articulated on distributional impacts. There is also a key debate about making such savings compulsory – some countries have done so notably in the North of Europe and in Eastern Europe. Recently, IT and the UK have moved for a so called Opt Out solution. Compulsory and opt out schemes have specific characteristics which distinguish them from traditional private funded systems in terms of freedom and choice on the one hand and risks and security on the other.

**How to fully restore social and financial sustainability?**

Pension reforms, employment and growth are interdependent. Working longer refers not only to pension reform, but also to a number of aspects including various paths out of the labour market (early exits), training, discriminations and more generally labour market opportunities for older workers. Increasing employment opportunities for older people is vital for both achieving employment goals and supporting sustainable growth, thereby allowing the maintenance of a high level of social protection in an ageing society.

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9 See Joint report on Social Protection and Social Inclusion, 2007, supporting documents, section 3.3 for a presentation of issues linked to representativeness.
Pensions constitute a major part of public expenditure in almost all countries and a financially sound public pension system is essential to the sustainability of public finances as a whole, which in turn supports overall growth and economic performance. On the other hand, a successful improvement of competitiveness and productivity can create room to manoeuvre for pension reform.

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. These issues should be distinguished from moving to funded pillars and diversification of systems as these can take place and do within the all systems, which is a somewhat different trend.

Furthermore, we know that today’s assumptions on life expectancy, growth, employment (policies could be more successful than assumed in the projections), demography (think about migration) may be more or less accurate tomorrow or in five years. Some member countries have therefore built in automatic adjustment mechanisms – the benefit calculation adjusts for each individual to expected life expectancy at this very moment. Employment and growth trends are systematically considered when indexation of benefits is fixed or if the income base for benefit calculation is determined. This leads to automatic adjustments and should reduce the gaps between assumed expenditure trends and real trends. Other member countries have opted for (often in addition to) compulsory regular reviews of the accuracy of the assumed trends. Hopefully independent experts submit a review pointing to any discrepancies which have emerged and governments will then be obliged to consider appropriate policy responses.

4- Conclusion

It is widely accepted that working longer is a key method to balancing the adequacy and sustainability of pension systems. Therefore we need a lot more action on working longer, including making sure that retirement systems do not give the wrong but the right messages, and that labour market reforms are made to improve employment opportunities for older workers.
There also seems to be an agreement that it is crucial to strengthen individual responsibility and flexibility of retirement provisions. Societies need to be confronted with the collective outcome of their decisions and in particular as regards equity and adequacy. This should not be done when it is almost too late and reforms require huge efforts, but rather it should be done at such a time when adaptations can be carried out smoothly.

This requires good governance and transparency of pension systems, notably in regards to ensuring that decided reforms are implemented without significant delays. There is a real need to invest in governance of systems, notably in transparency which will allow society to pursue policy priorities and to avoid unintended effects which create significant difficulties. Regular reviews and continuous reform paths are preferable to late and large reforms which often prove difficult to implement.

**Selected references**

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http://ec.europa.eu/employment_social/employment_analysis/employ_en.htm


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http://ec.europa.eu/employment_social/social_protection/pensions_en.htm

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SPC Special Study on Privately Managed pension provision (2005)


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