



SCENARIOS FOR EUROPE: CHALLENGES FOR PENSION POLICY

Anna Cristina D'ADDIO
Social Policy Division, OECD
<http://www.oecd.org/els/social/pensions>

Convegno di fine anno: « Quali opportunità di
impiego delle risorse alla luce degli scenari dei
prossimi anni »

Roma, 2-3 december 2014



Outline

- The context
- Challenges and risks for pension systems
- Conclusion



Setting the context...

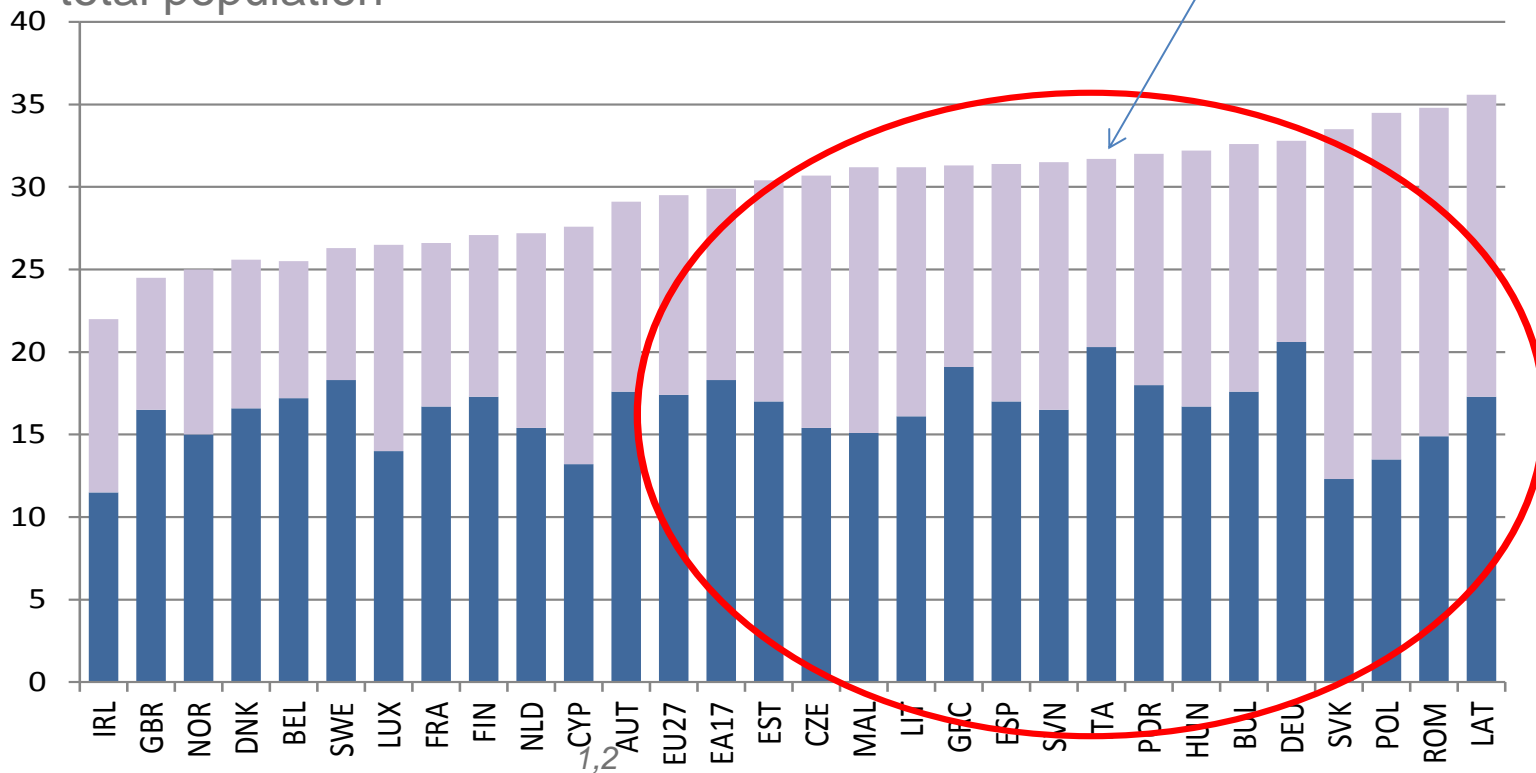
- (Post-)crisis
 - Low growth
 - High unemployment
- Rapid population ageing



Life expectancy increase: (1) The share of the elderly will increase substantially

Share of elderly (65+) in total population

■ 2010 ■ 2060



Note: 1. Footnote by Turkey:

The information in this document with reference to "Cyprus" relates to the southern part of the Island. There is no single authority representing both Turkish and Greek Cypriot people on the Island. Turkey recognises the Turkish Republic of Northern Cyprus (TRNC). Until a lasting and equitable solution is found within the context of United Nations, Turkey shall preserve its position concerning the "Cyprus issue".

2. Footnote by all the European Union Member States of the OECD and the European Union:

The Republic of Cyprus is recognised by all members of the United Nations with the exception of Turkey. The information in this document relates to the area under the effective control of the Government of the Republic of Cyprus.

Source: data from The 2012 Ageing Report, European Union;
see also d'Addio (2014) in Designing Equitable and Sustainable Pensions: Challenges and experiences, IMF publishing

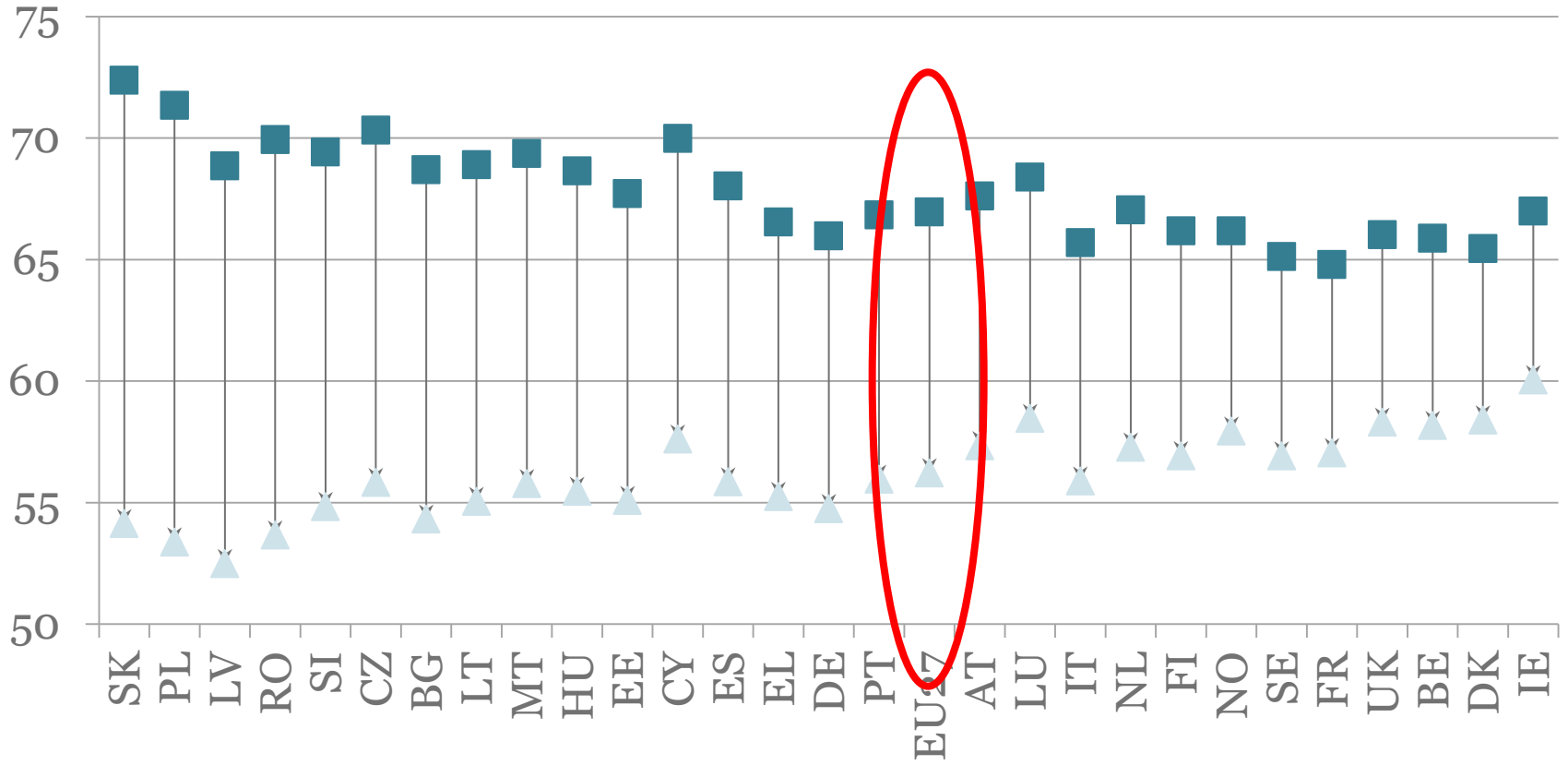


Fertility rates decline: (2)

Working age population will shrink

Share of population aged 15-64
as a % of total population

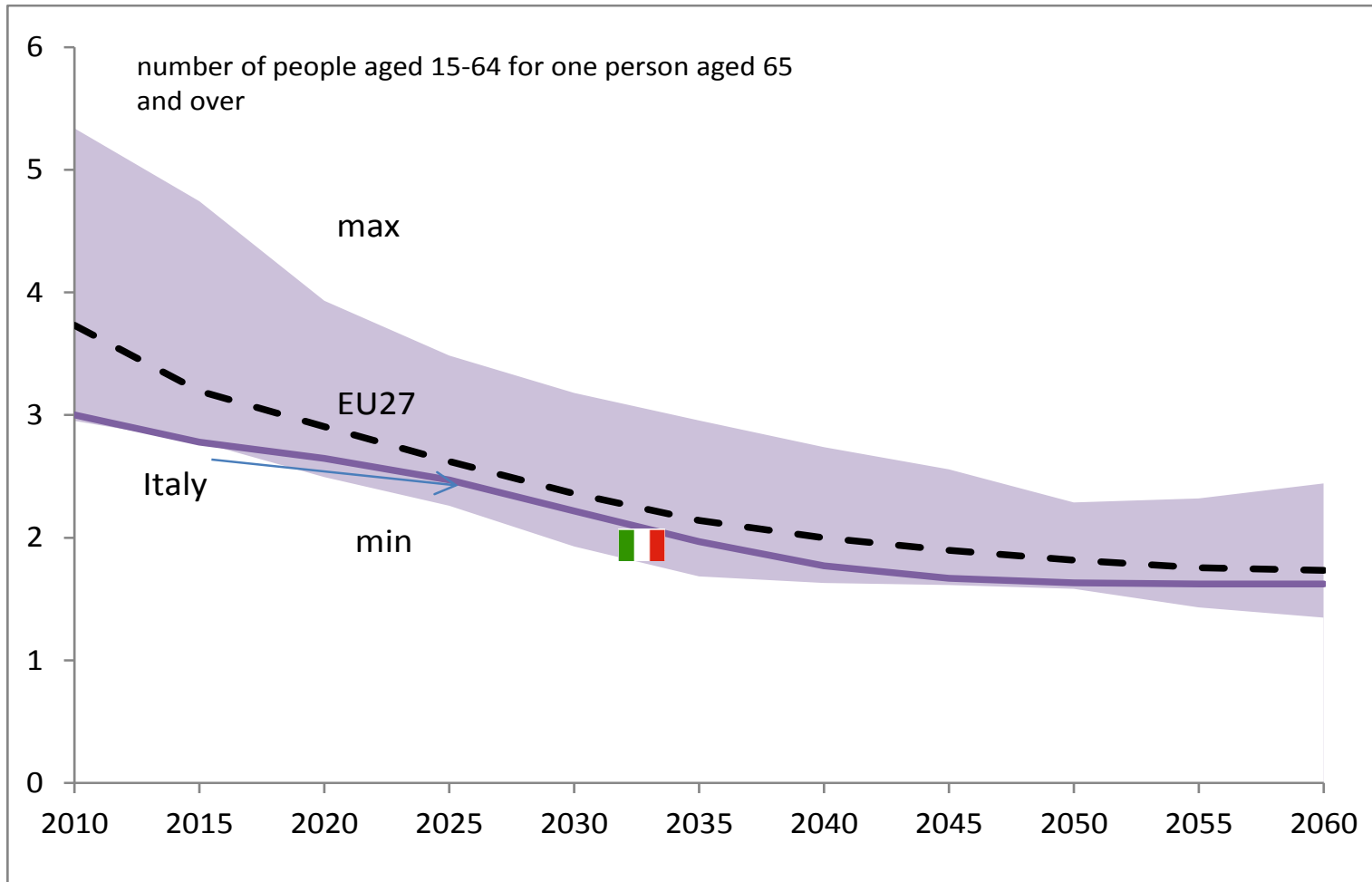
▲ 2060 ■ 2010



Sources: data from The 2012 Ageing Report

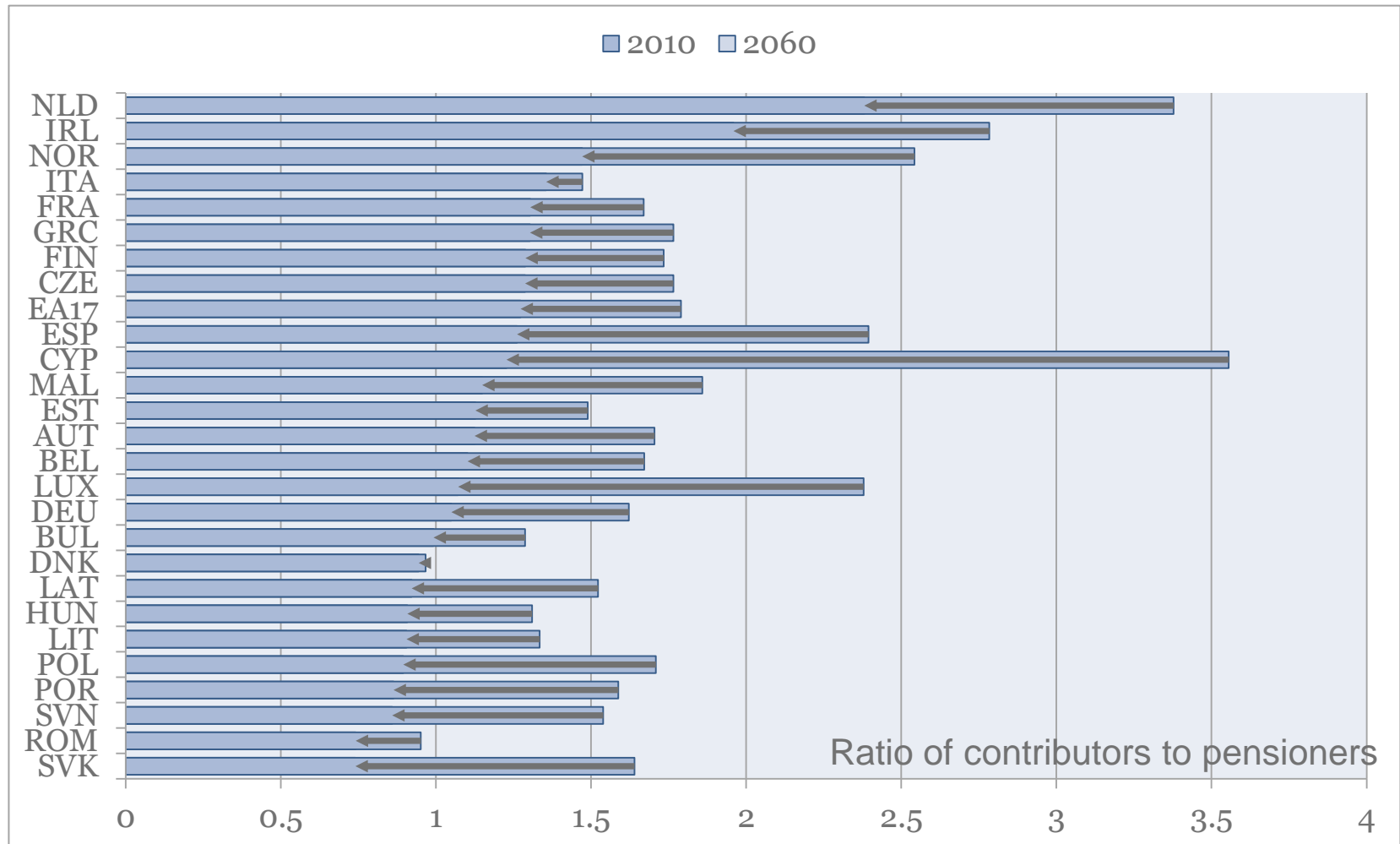


The number of people of working age per retiree will decline





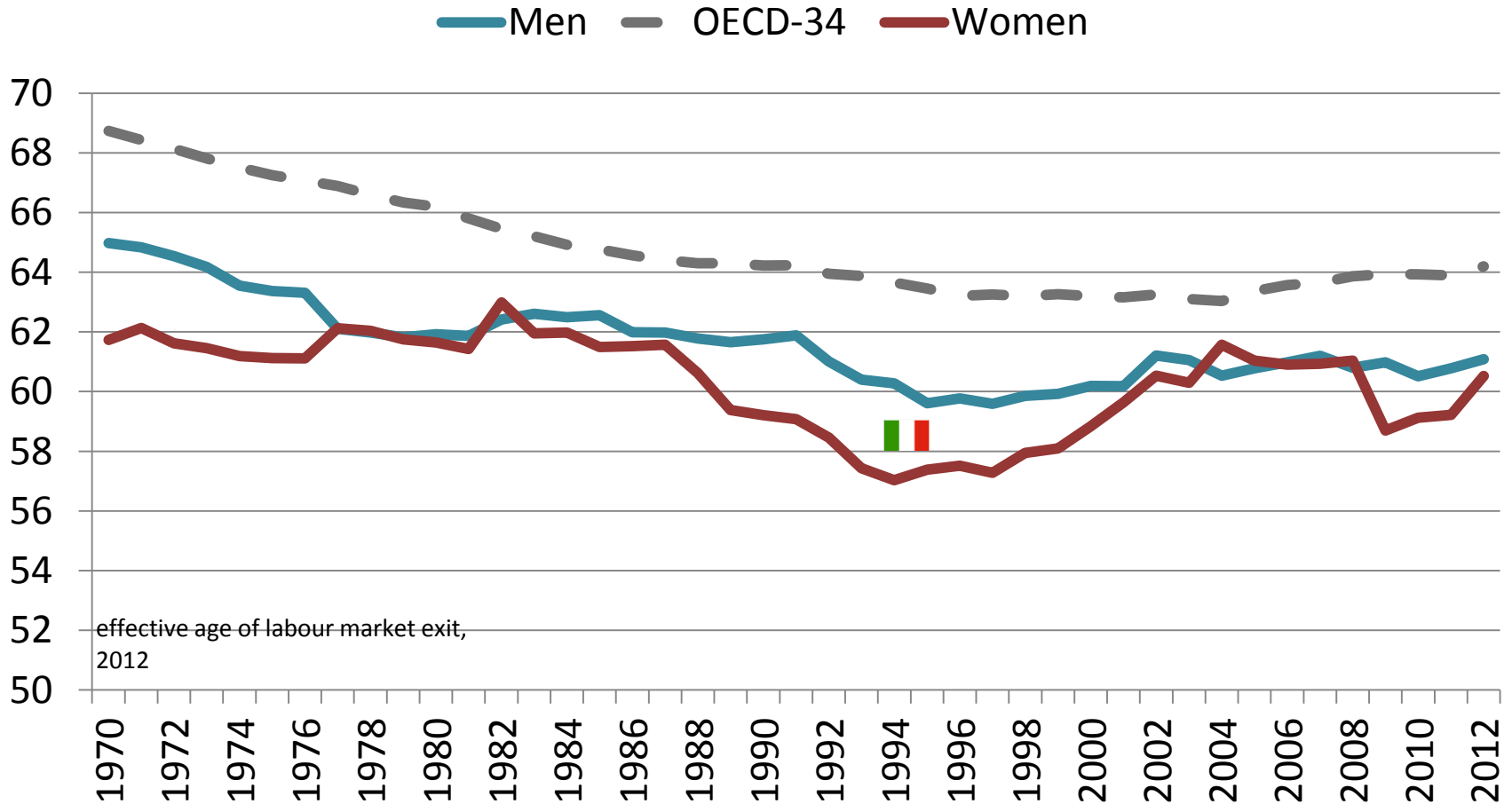
Implying a smaller number of contributors for retiree...



Sources: data from The 2012 Ageing Report, European Union



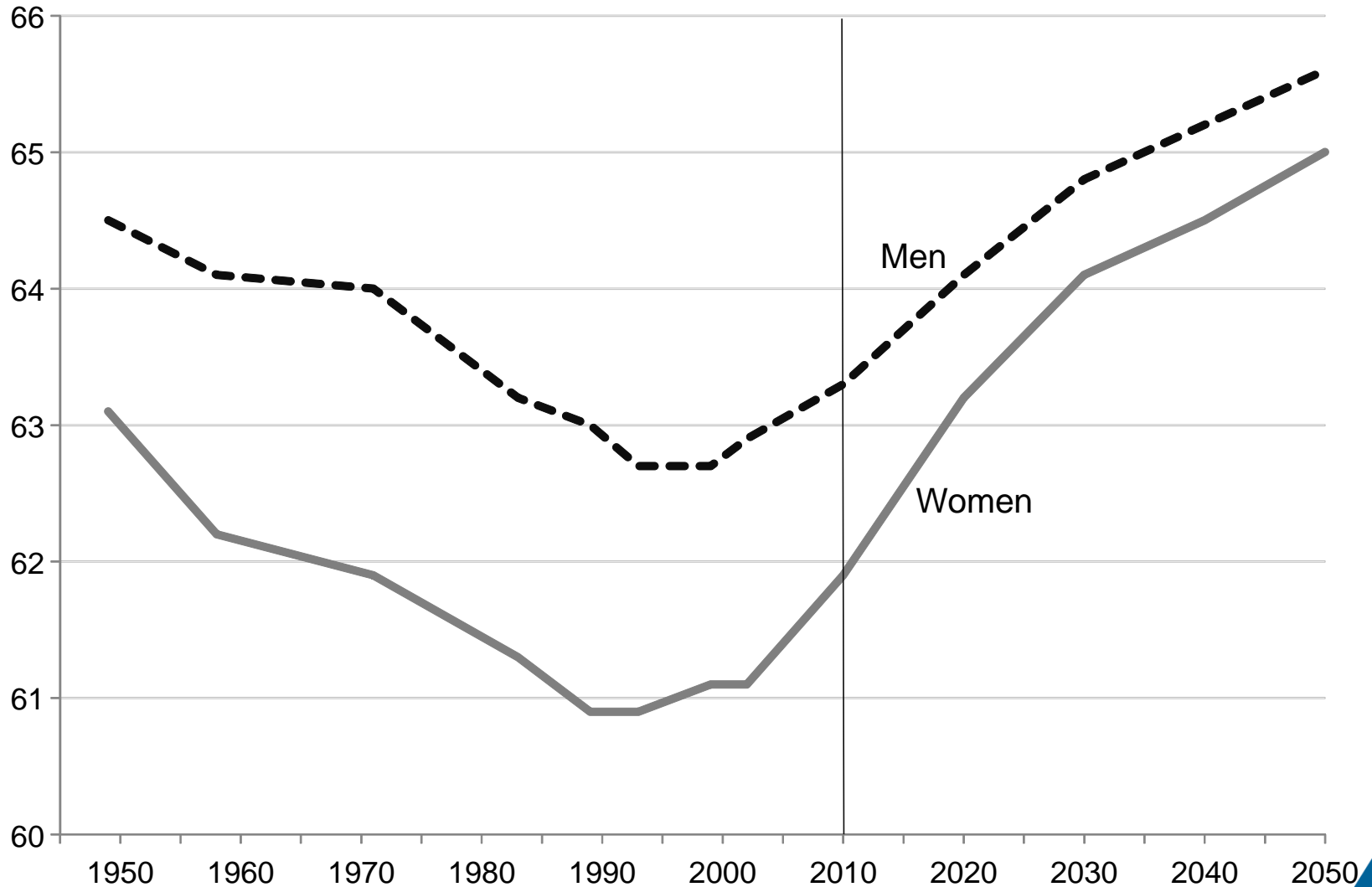
Effective ages of labour market exit have been declining for long





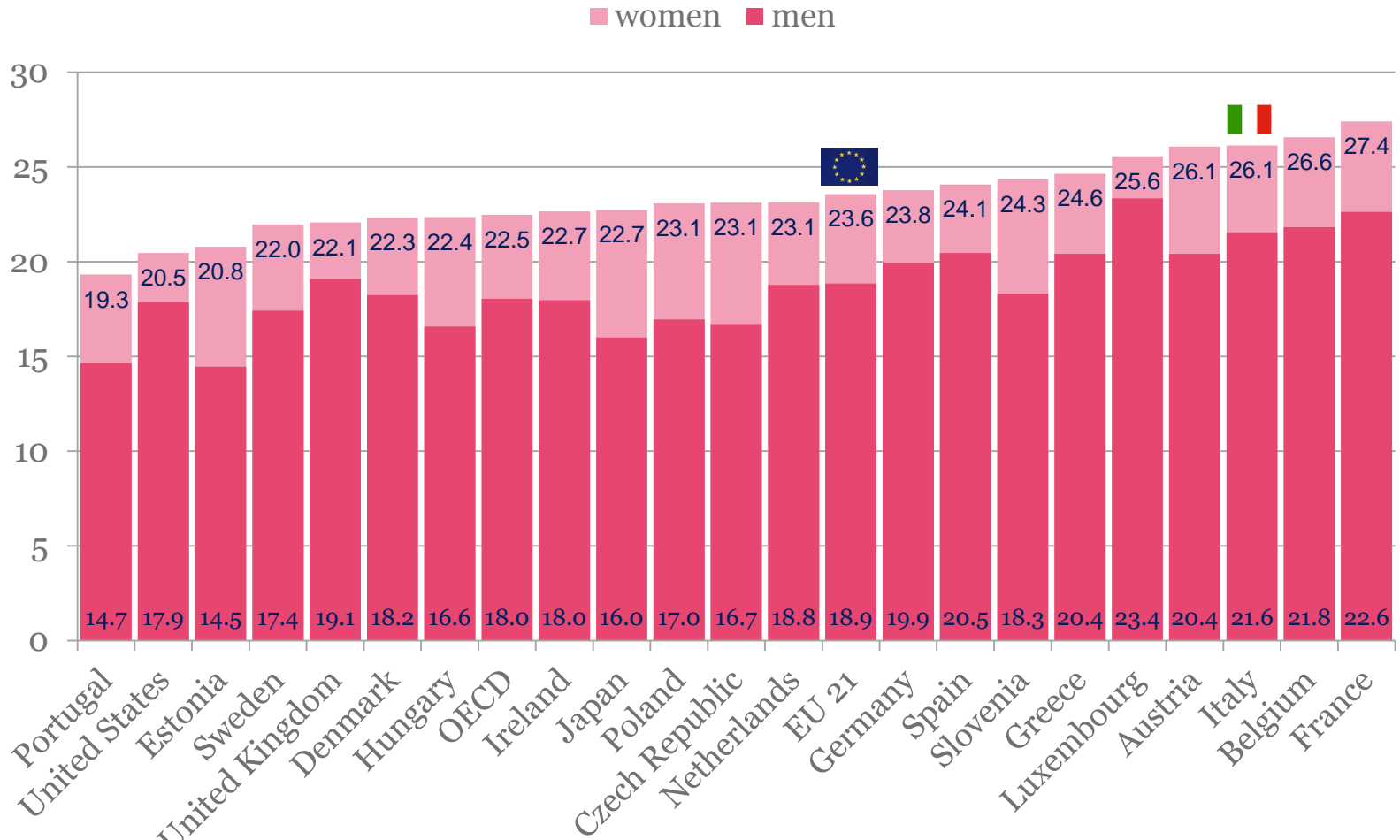
As well as pensionable ages...

Pensionable age, years





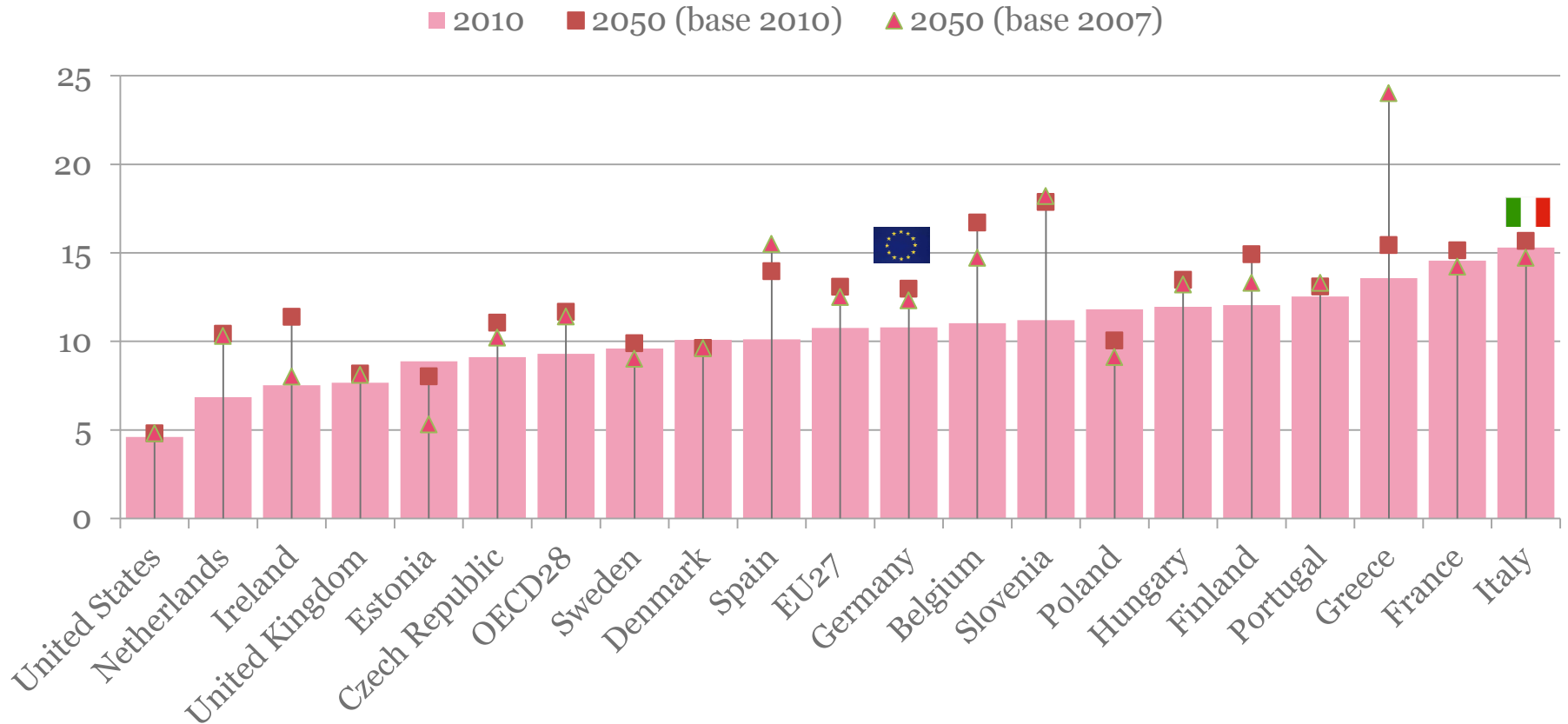
Which results in long periods spent in retirement ...



Source: OECD calculation using UN population projections 2010 revision



In many EU countries public pension spending is set to (moderately) increase



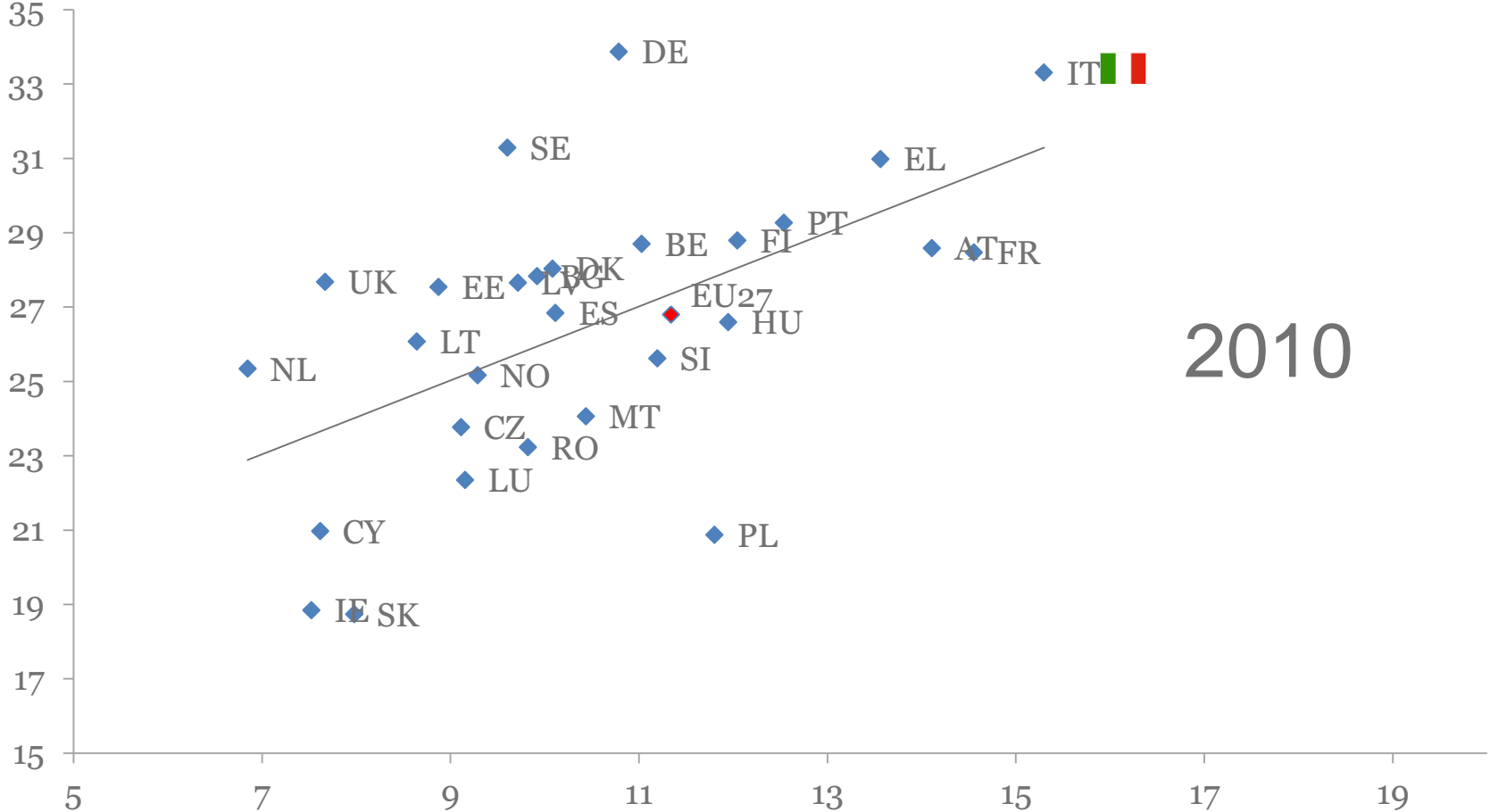
Public expenditure on old-age and survivors' benefits, per cent of GDP

Source: European Commission (2012), *EU Ageing Report 2012*; Canada: Office of the Chief Actuary; United States Social Security Administration (2010)



But only demographics matter?

Dependency ratio: percentage of adult population aged 65+



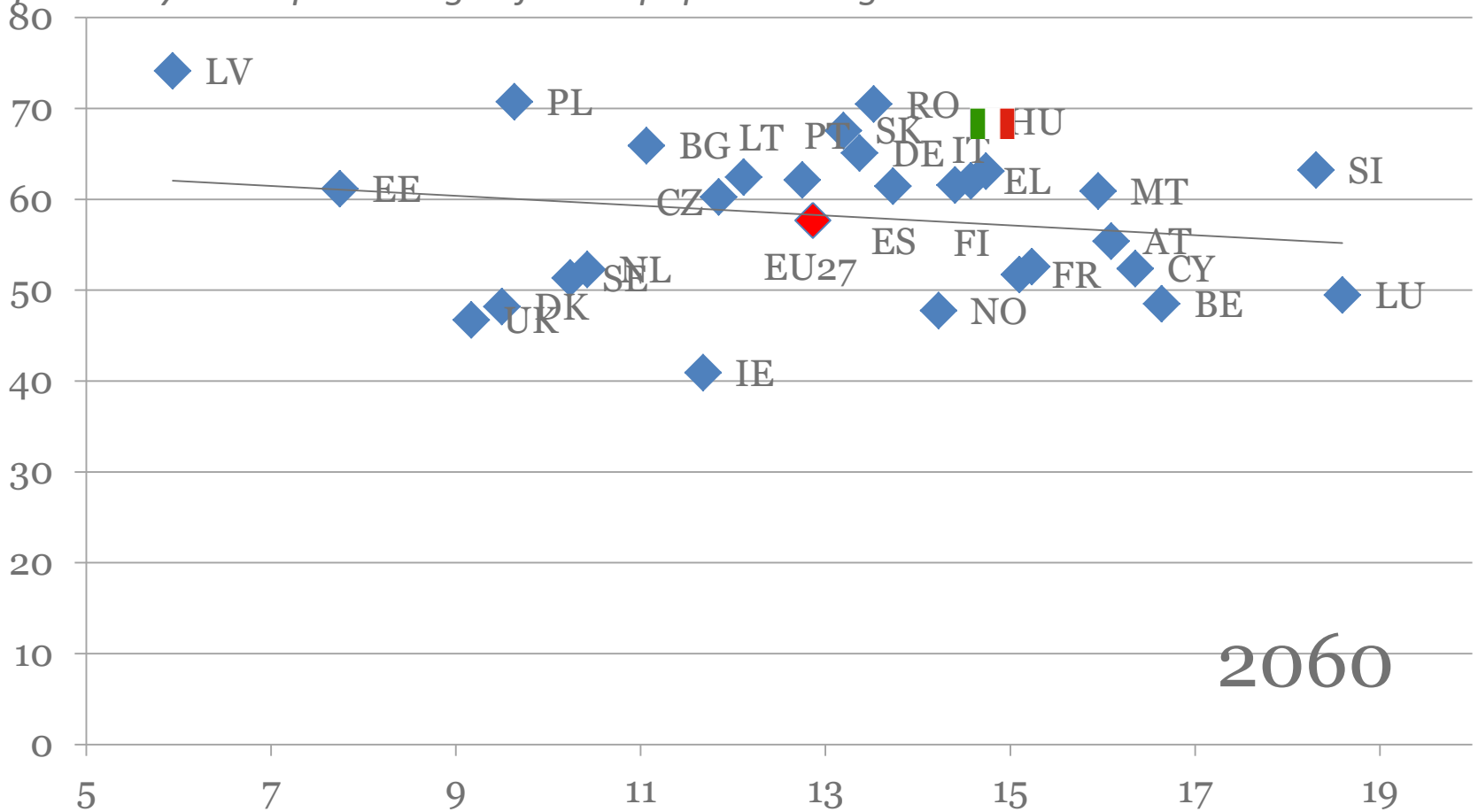
Sources: data from The 2012 Ageing Report, European Union

Public expenditure on pensions, per cent of GDP



Not really...

Dependency ratio: percentage of adult population aged 65+

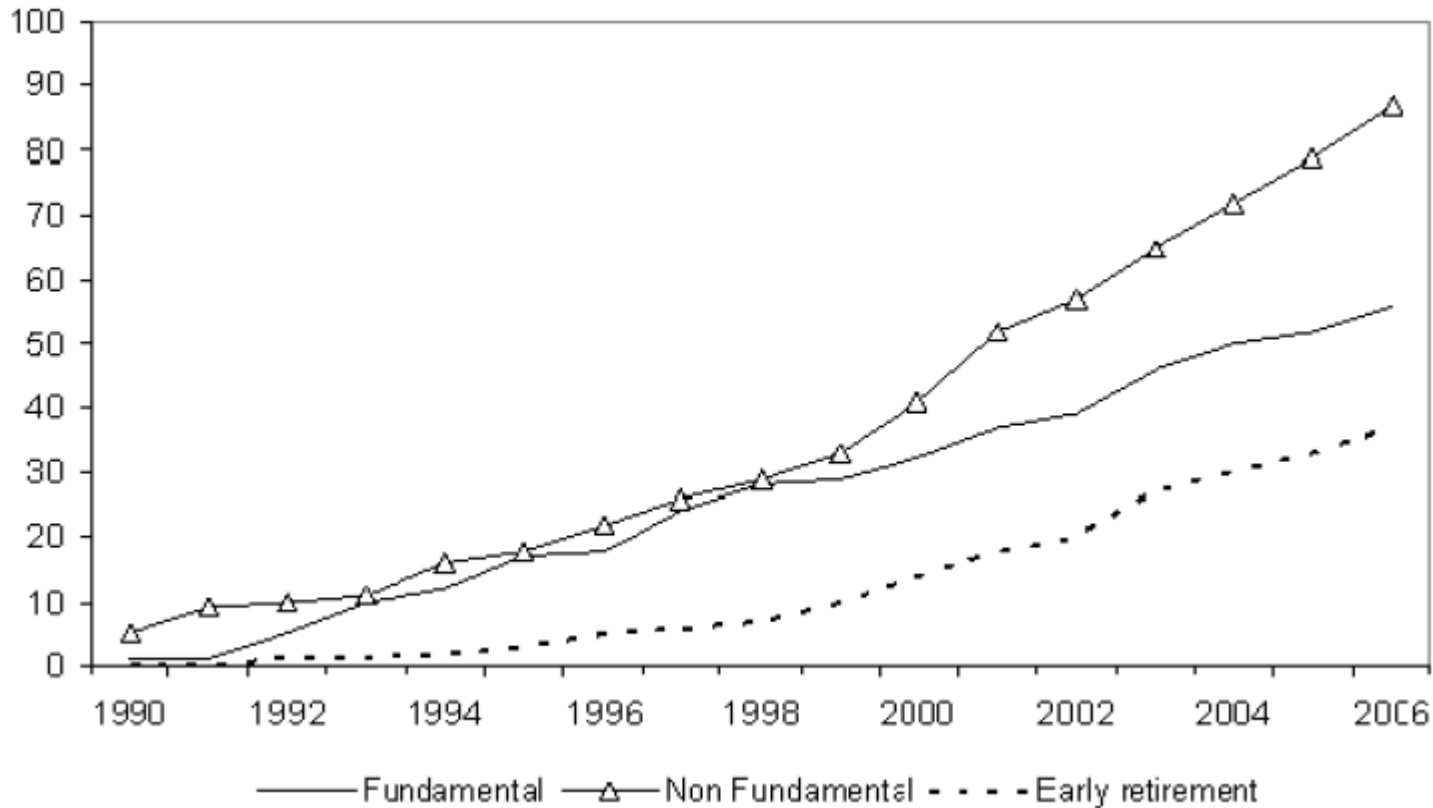


Sources: data from The 2012 Ageing Report, European Union

Public expenditure on pensions, per cent of GDP



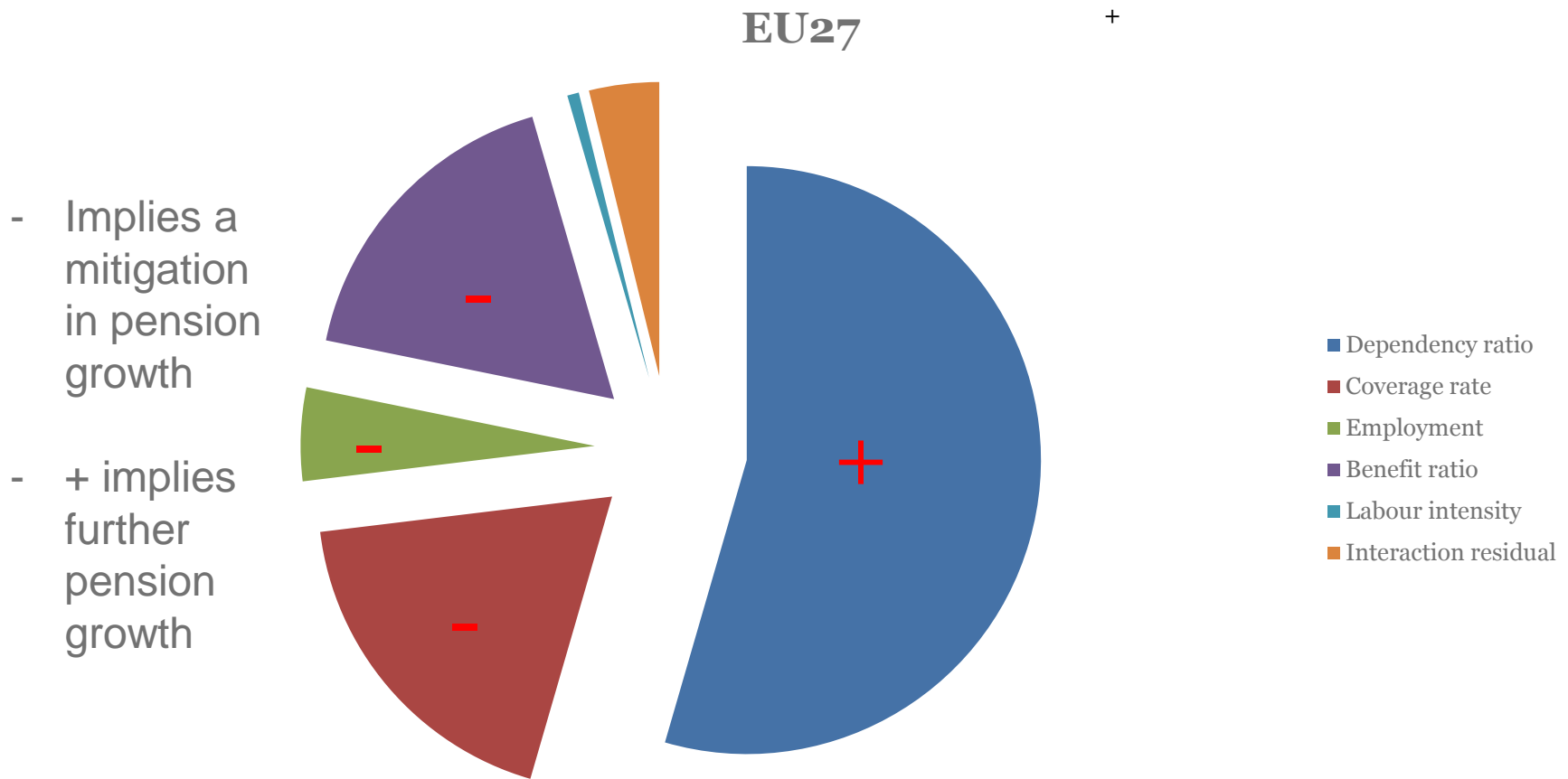
Financial sustainability has driven many pension reforms of recent decades



Source: Arpaia et al. (2009) based on LABREF



Promoting longer working lives is key for both financial sustainability

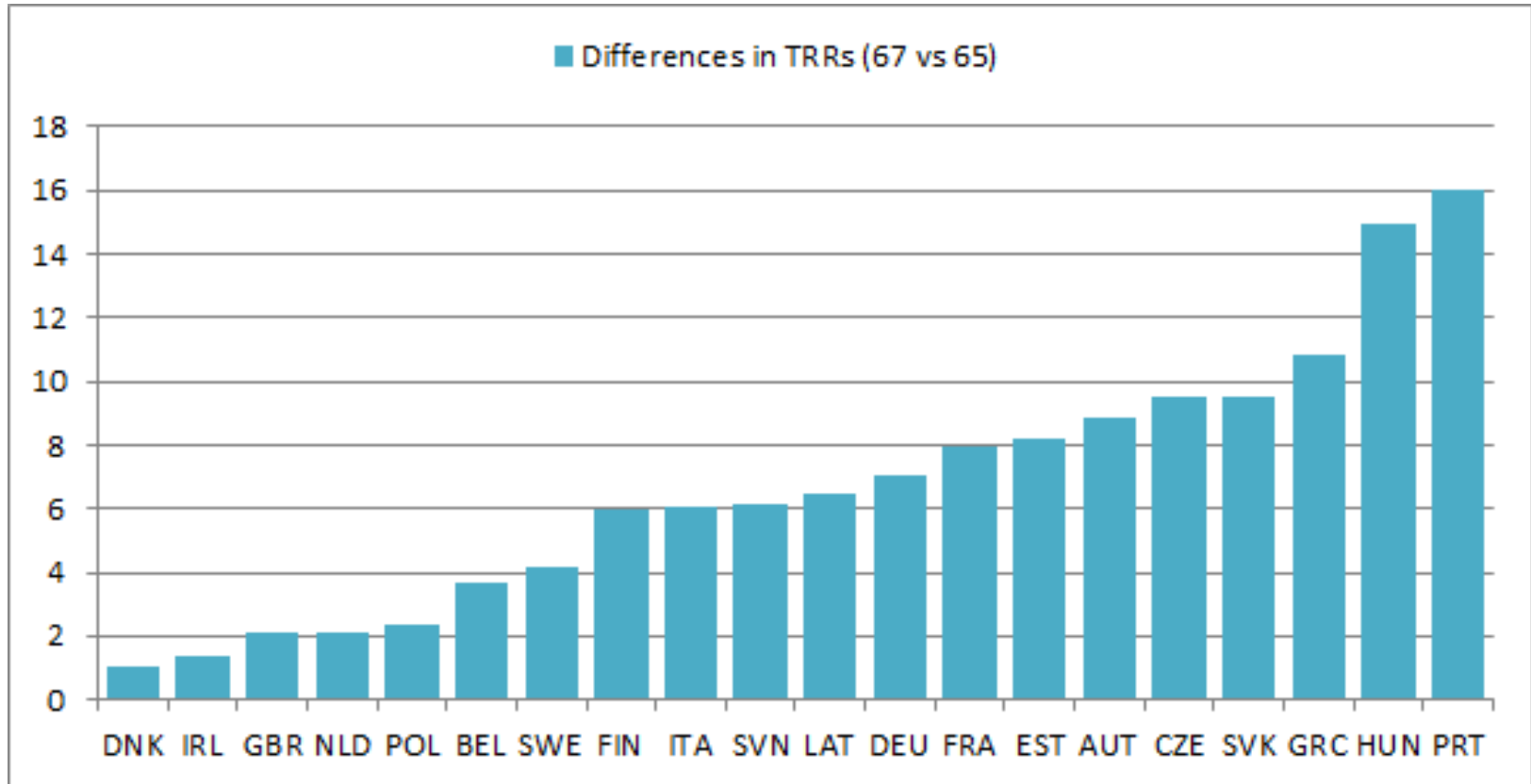


Decomposition of growth in pension spending (as a % of GDP)

Source: Based on data extracted from the The 2012 Ageing report



And retirement-income adequacy



Differences in Net TRR from working until 67 rather than 65, selected OECD countries

Source: OECD calculation for the European Commission



Main challenges for reforms of pension systems in recent years

- To maintain/restore financial sustainability being affordable to tax payers
- To enhance retirement-income adequacy and coverage
- To improve/restore equity
 - Between men and women
 - Within the same generation between individuals in different jobs, occupations and sectors
 - across generations



Trends of recent reforms

- Moving towards a tighter link between contribution and pension benefits
 - DC, NDC (SWE, ITA, POL, LAT, NOR) ; NDC have some nice properties but need to be well designed .
 - The transition is important
- Retrenchment of public pensions
- Moving towards longer working lives
- Putting pensions on auto pilot

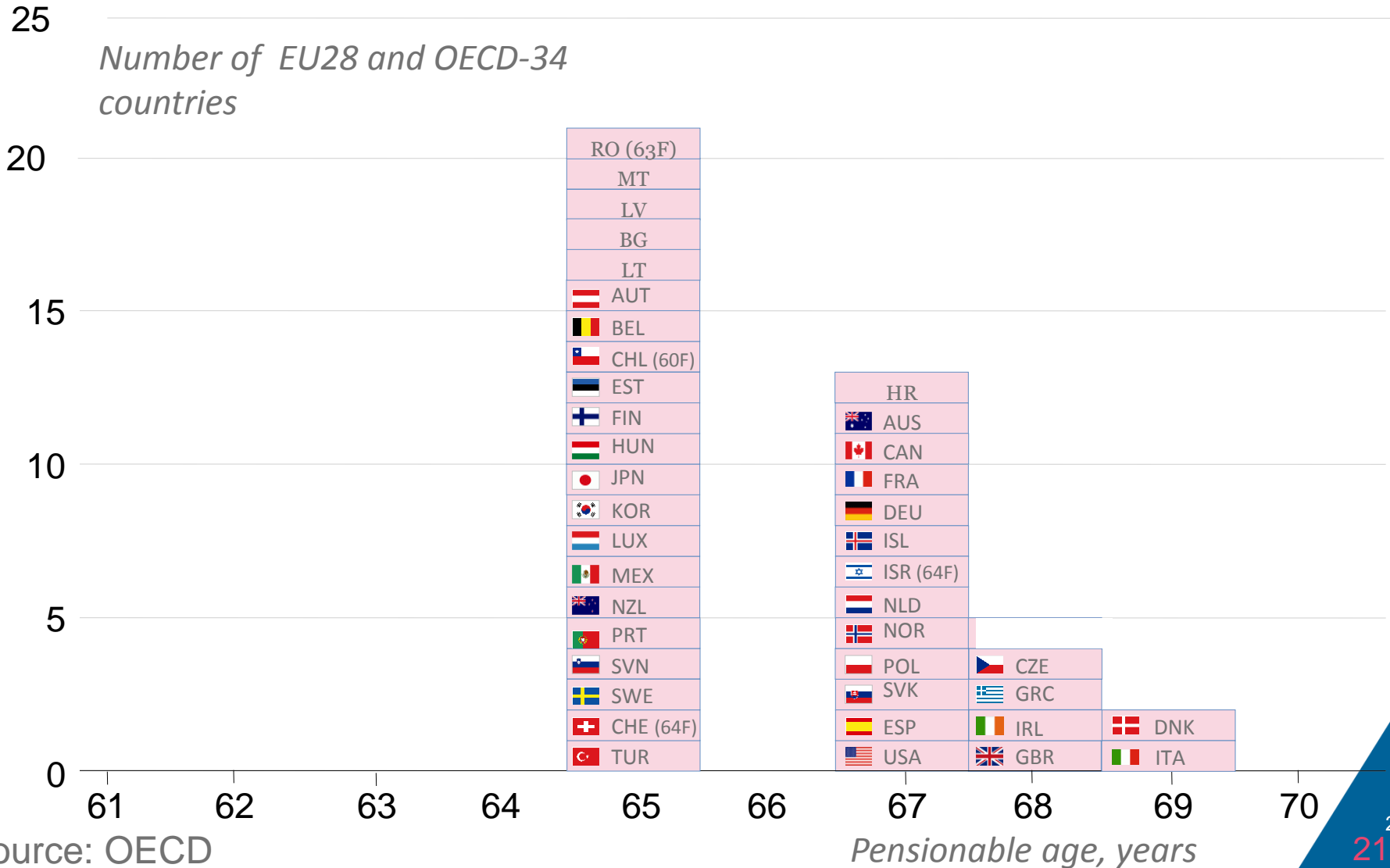


Trends of pension reforms (2)

- Expansion of private pensions ...but also reversal of previous reforms because of the crisis and the need for fiscal consolidation
- Enhancing administrative efficiency and transparency of pension systems
 - Design of policies for funded schemes is important (see the OECD roadmap on DC)

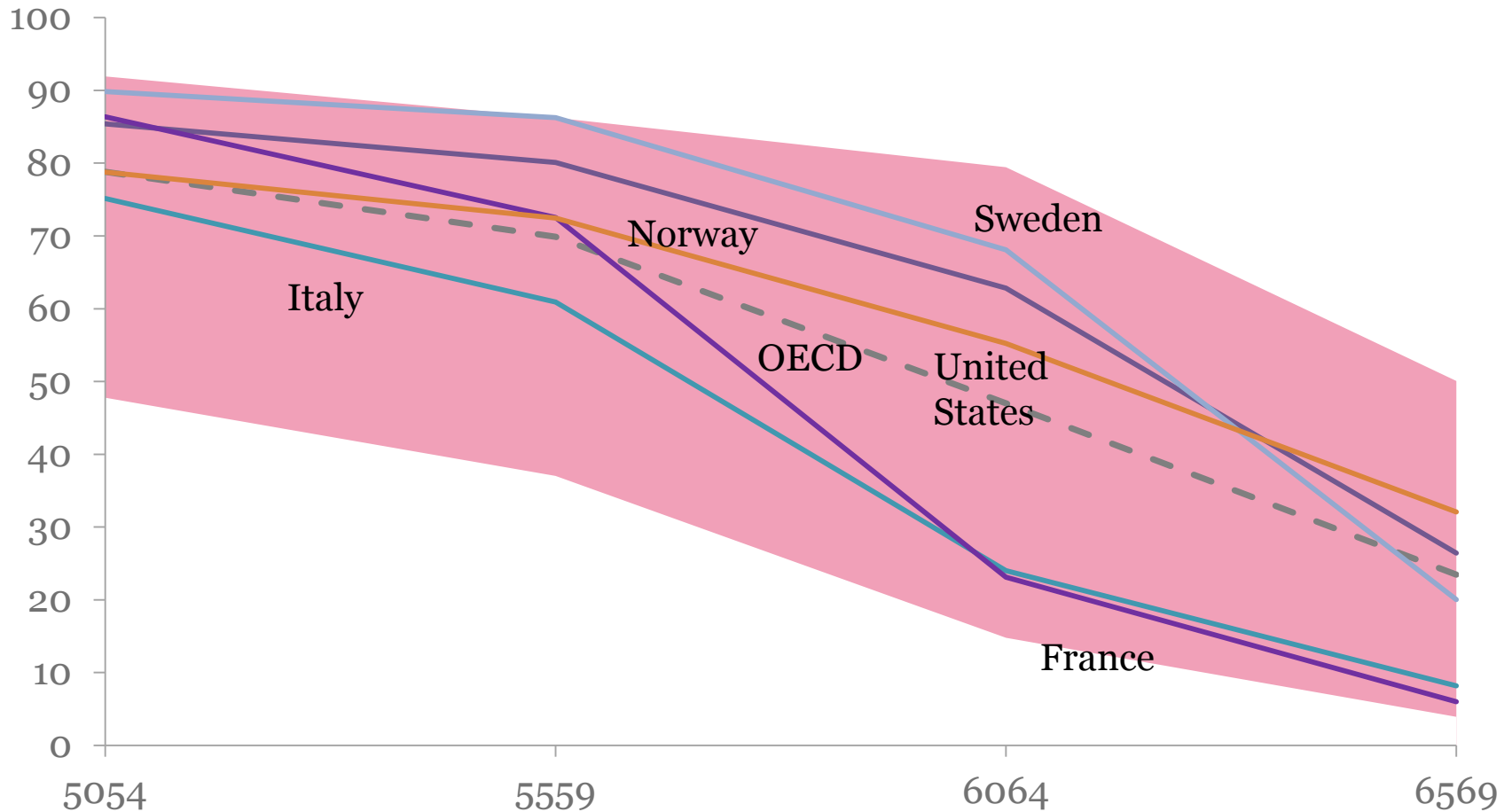


Age in the long-term





Countries are very heterogeneous ...participation rates of older workers vary also across age-groups



Source: OECD Labour market indicators

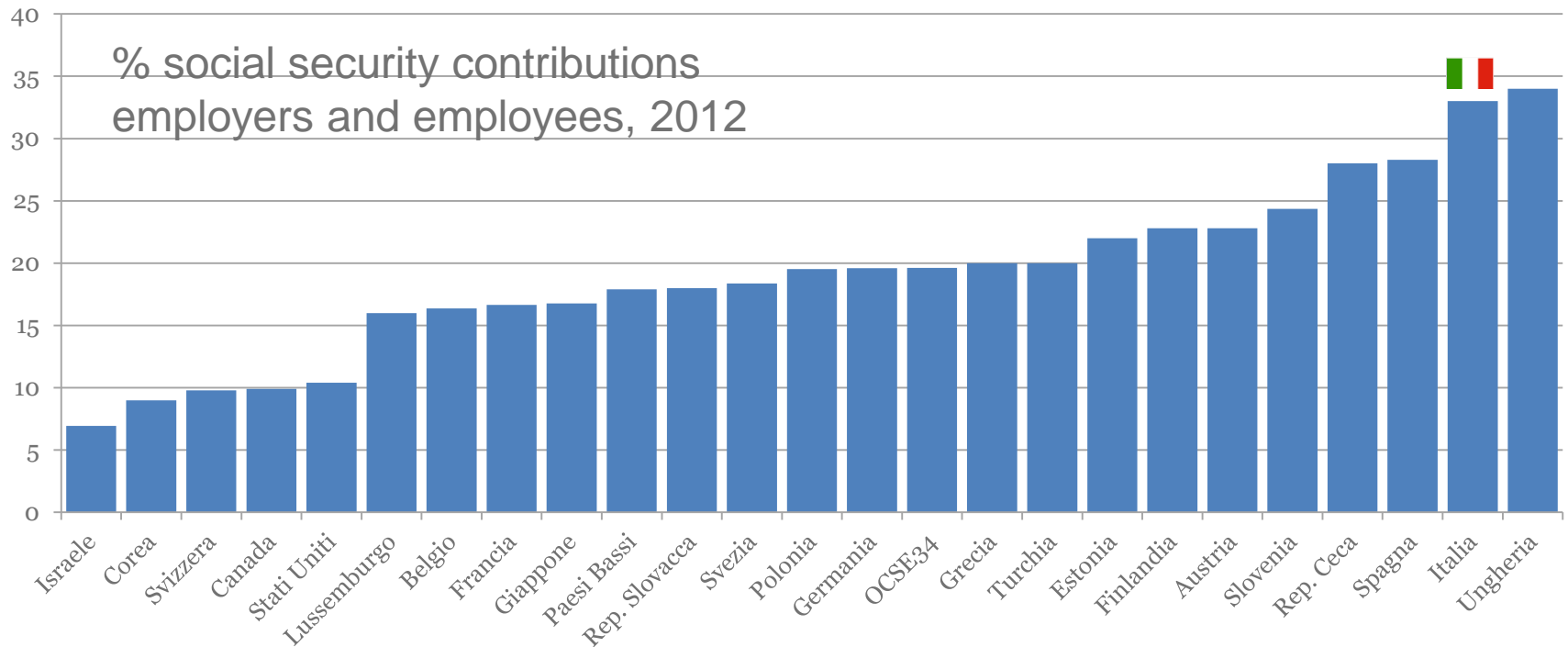


Financial sustainability of the system rests also on people with effective longer working lives

- Working longer also by giving more incentives to larger choice
 - Flexible retirement age with neutral/actuarial benefit formula
 - Possibility to combine old-age pension and work without reduction
 - More flexibility in late career
 - Increase penalties for early retirement
 - Increase bonus to defer retirement
- Abolition of mandatory retirement



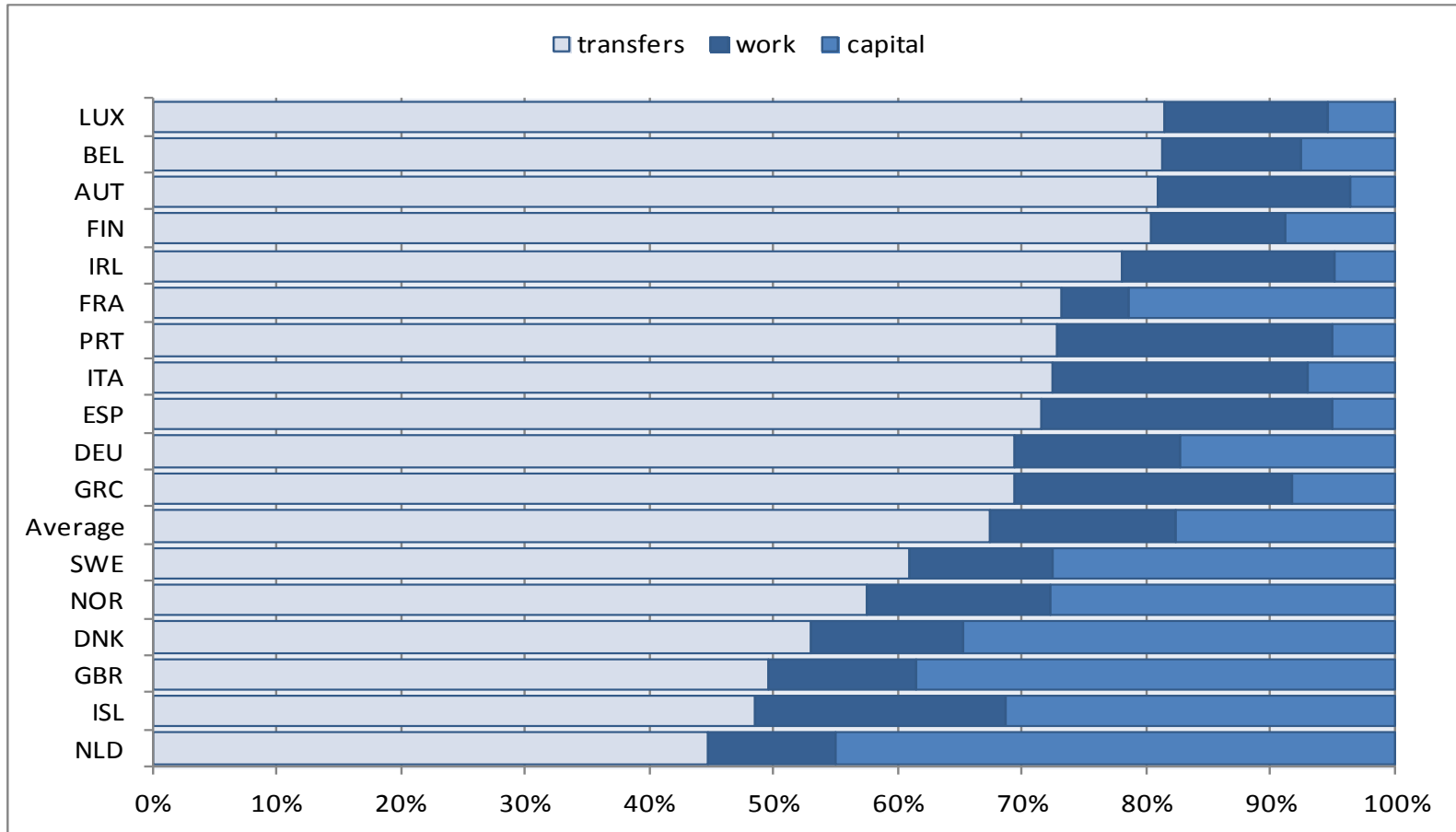
The entire design of the pension system (public and private) is important



Source: OECD (2013) Pensions at a Glance 2013, OECD publishing



Retirement-incomes do not derive only from pensions...



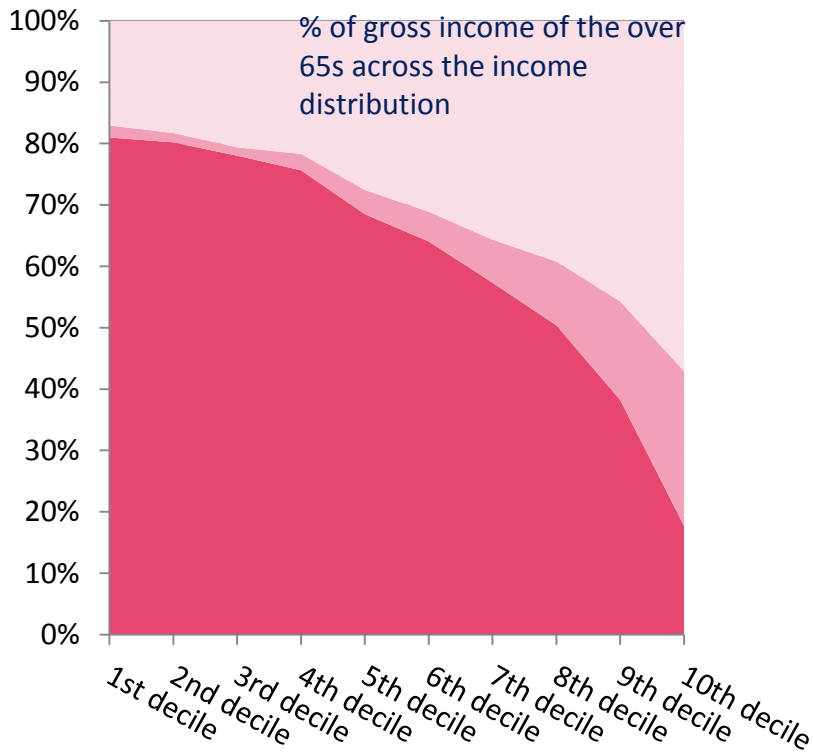
The design of the pension systems clearly matter

Source: based on the OECD income distribution database)



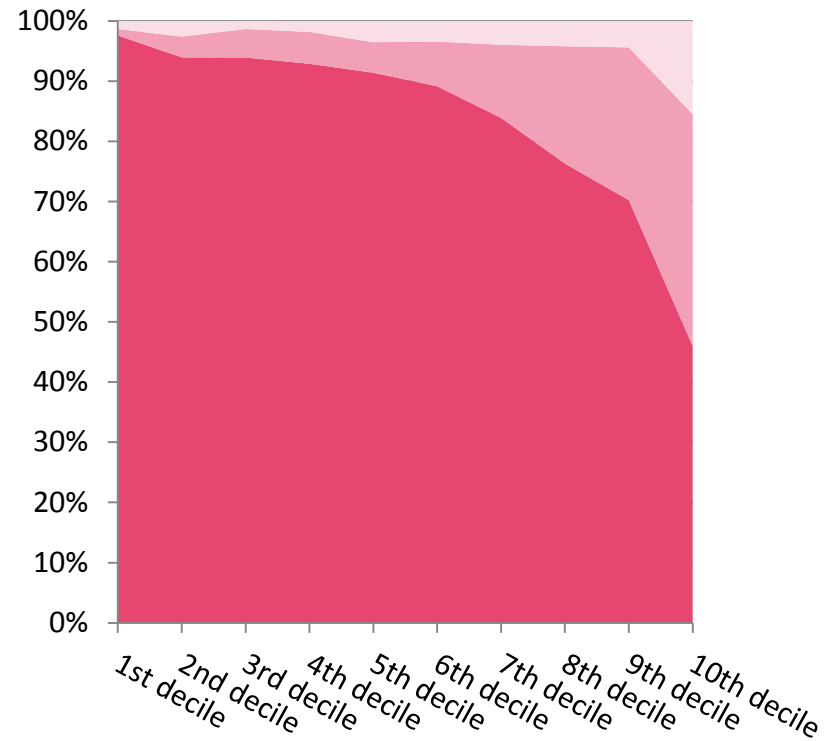
Public transfers represent a large share of the income of the elderly....

United Kingdom



Italy

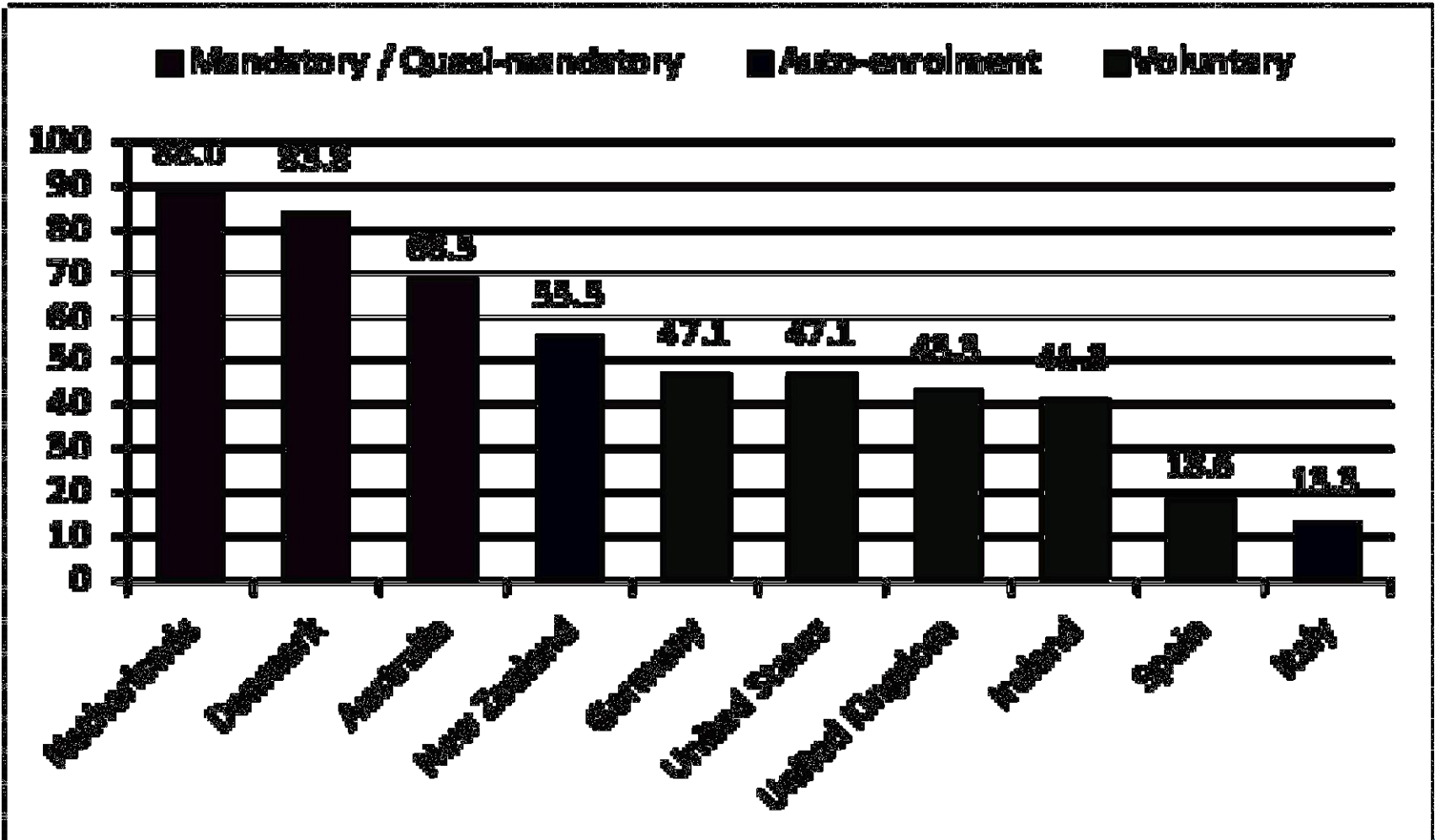
Public transfers work capital



Source: based on the OECD income distribution database



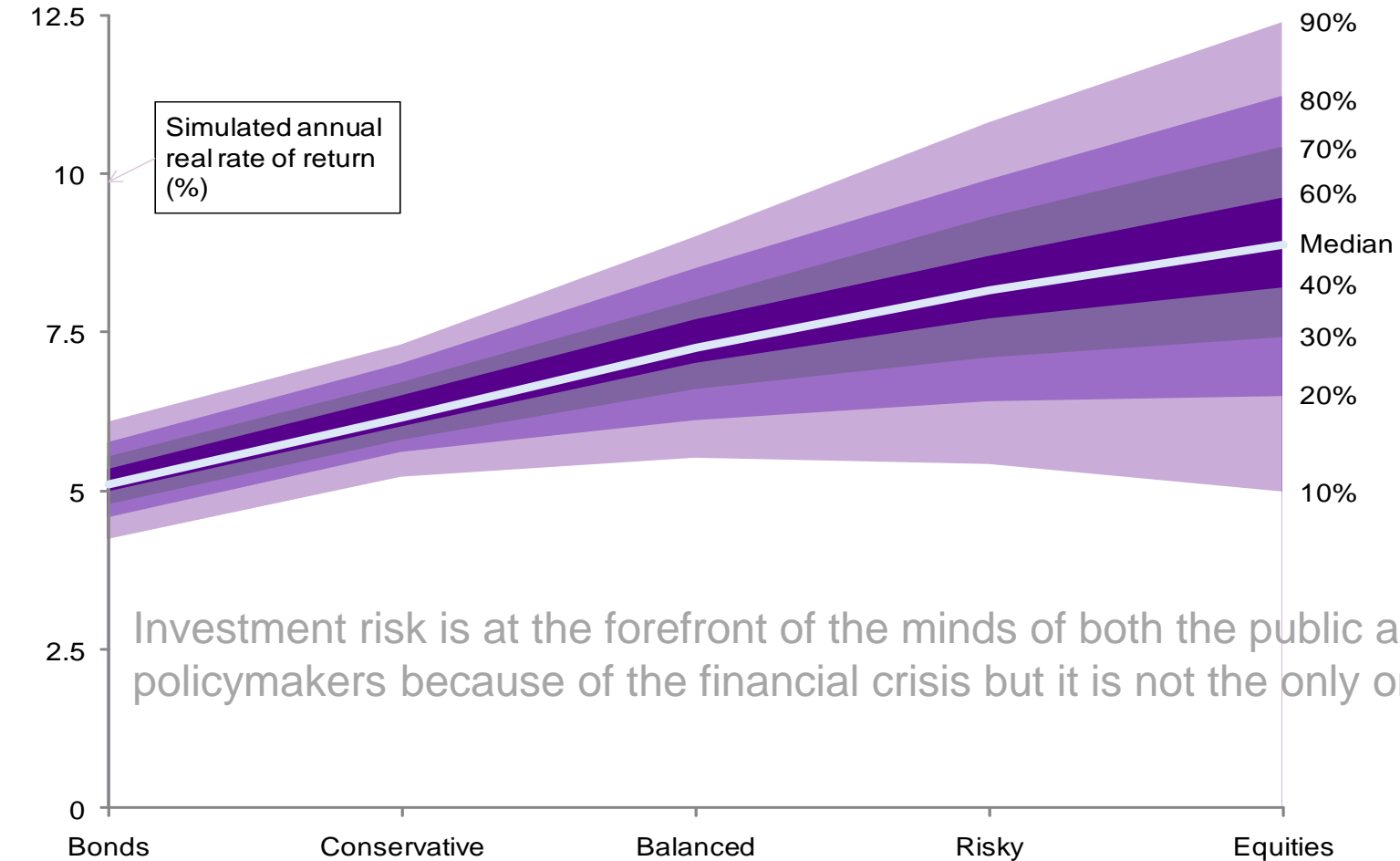
Private pensions may fill part of the gap but in Italy coverage is still very low



Source: OECD (2012) OECD Pensions Outlook



Pensions are a long-term issue: risks matter



Investment risk is at the forefront of the minds of both the public and policymakers because of the financial crisis but it is not the only one!

Source: D'Addio, Whitehouse and Reilly (2009)



What are the risks?

- Intergenerational gaps are increasing:
 - Poverty is higher among young and prime-age people
 - Unemployment is very high and careers are more precarious
 - Employment rates of older workers have increased, while they have decline for young people
 - Pensions are a long term issue: financial risks also matter



Pension reforms: which challenges for the future?

- NDC is based on a strong link between contributions and pension benefits
 - What will be the impact of precarious careers and earnings profiles on future pension entitlements?
 - What will be the impact of unemployment?
- How to best protect the most vulnerable?
- How to develop private pensions?



Conclusion (1): Many challenges ahead...

- Pension spending is still set to increase in many OECD countries.
- Future entitlements will generally be lower and depend more closely on labour and financial market performances.
- Retirement-income adequacy may become a major challenge for those who have not contributed enough.



Conclusion (2)

- There is no magic solution for a more sustainable, adequate and equitable pension system;
- Process of reforms has accelerated but there may be the need to do more
- In Italy the previous reforms have contributed to stabilise pension spending in the LT



Conclusion (3)

- Trade-off sustainability/adequacy will stay
- Need to increase coverage in the self-employed and the informal sector
- Need to develop labour market policies to effectively deliver longer working lives:
 - increasing retirement ages alone will not suffice
 - Does living longer mean working longer?
 - Does working longer also means working better?



Conclusion (4)

- Risk diversification is still important despite the financial and socio-economic context
 - However additional voluntary savings may be unaffordable
 - Need to think of «pensions» in a broader context
- Communication and information are crucial
 - Pension reforms have social and economics implications that matter



Conclusion (5)

- More important safety nets for the most vulnerable are needed too
- Achieve different objectives at the same time (equity, security and adequacy of benefits, solidarity) ;
- Broad and comprehensive approach to ageing is essential
- A strong and competitive labour market is essential too

Pensions
at a Glance

Pensions at a Glance

Pensions at a Glance
2009

Pensions at a Glance
2011

RETIREMENT-INCOME SYSTEMS IN OECD
AND G20 COUNTRIES

Pensions at a Glance
2013

OECD AND G20 INDICATORS

anna.daddio@oecd.org

New OECD Pensions Outlook
forthcoming November 2014

<http://www.oecd.org/pensions/pensionsataglance.htm>



The OECD Roadmap for the good design of DC pension plans

1. Design DC pension plans coherently with structure of the pension system
2. Encourage people to contribute and contribute for long periods
3. Improve the design of incentives to Δ contributions and coverage
4. Promote low-cost retirement savings instruments
5. Establish appropriate default inv. strategies while providing choice
6. Favour life-cycle (LC) investment strategies as defaults
7. Encourage annuitization as a protection against LR
8. Promote the supply of annuities
9. Make it easier to deal with Longevity Risk
10. Ensure effective communication and address financial literacy

This Roadmap was approved by the OECD Working party on Private pensions in June 2012. For a full copy see

<http://www.oecd.org/daf/fin/private-pensions/50582753.pdf>