DELIVERING SUSTAINABLE AND ADEQUATE PENSIONS: CHALLENGES FOR PENSION REFORMS IN OECD COUNTRIES

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Agenda

• Overview
• Which challenges for pension systems?
• Ways to address them
• Reforms’ trends and their risks
• Conclusions
Many changes occurred in OECD countries…

• They are:
  – demographic: population ageing
  – Socio-economic: transformations in labour markets, in families, in women’s roles
  – Socio-economic and financial: as a consequence of the crisis

• They carry on some important risks for pension systems
Which priorities in this context?

(1) Financial sustainability ……

Source: OECD (2011a)
(2) Retirement-income adequacy…

% of people age 65+ with income below 50% of the equivalised household income, late 2000s

Source: OECD Income distribution database; OECD (2013a,b)
Which challenges for reforms of pension systems?

• To maintain/restore financial sustainability being affordable to tax payers
• To enhance risk diversification
• 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
How to cope with these challenges?

- Extending working lives
- Targeting more the safety-nets on the most vulnerable
- Encouraging people to save more
  – Role of wealth in old-age?
What countries have done?

• Systemic reforms:
  – Examples: NDC system (ITA, POL, SWE, LAT, NOR); private pension provision replaced part of the public provision or was added on top of it; shift from DB to DC;

• Parametric reforms:
  – Retirement age; reference period for pensionable earnings; adjustments for early/late exit from the labour market; indexation/valorisation.
Normal pension age: long-term rules

Number of OECD-34 countries

Source: OECD Pensions Outlook, OECD (2012); OECD (2011b)
Some main trends of pension reforms…

1. Retrenchment of public pension provision and higher role for private pensions
   – Shift from DB to DC
2. A stronger contributory principle
3. An increasing role for automatic adjustments

→ These trends imply that much of the risk is shifted onto individuals

• Pension reforms may modify, and often do so, risk allocation across stakeholders:
  – It is therefore important to minimise the negative impact deriving from this risk re-allocation
An increasing role for private pensions ...

- Decline in generosity of public pensions allow for a greater role of private pensions,
- But also because diversification of risks may be beneficial
- In some countries, private pensions are mandatory
  - they replace part of the public pension (e.g. Mexico, Chile)
  - They are added on top of public pensions such as in Australia and Norway
- In others they are quasi mandatory (such as in the Netherlands, Switzerland, Denmark, Iceland)
- In others they are voluntary: e.g. Germany, Japan, UK, Italy, Belgium
Moving from DB to DC

• Transfer of investment risk
  – link with the performance of financial markets
  – how investment performance affects the "wealth" accumulated for retirement?

• Transfer of demographic risk
  – how much of the cost of increasing life expectancy will be borne by retirees either as lower benefits or higher retirement ages?

• Stronger link with paid employment
  – Link with the performance of the labour market

→ Risk of getting inadequate pension benefits
But coverage gap of private pensions exist!

Source: OECD (2012, 2013a,b)

But also across ages and genders! Coverage is lower for younger workers and women.

Myopia? Lack of information? Which design?
Stronger contributory principle: labour market risks?

Career length is different for men and women

Source: OECD Women and Pensions, forthcoming

Increasing unemployment

Source: OECD Economic Outlook, n. 93, May 2013.
Need to work save more …there is a pension savings gap...

Gross replacement rate for an average earner from mandatory pension schemes and difference from OECD average replacement rate

Source: OECD Pension Models and OECD (2013a)
An increasing role for automatic adjustments…

• Most OECD pension system have automatic adjustment mechanism being related to changes in economic or demographic factors (see D’Addio and Whitehouse, 2012; OECD, 2012)

• Trade off between sustainability and certainty over retirement

• Reduce unexpected burden from sudden changes
  – Reduce the political risk
  – But not address behavioural challenges
Conclusion

• There is no magic bullet;
  – Strike a balance objectives: adequacy and sustainability

• Retirement-incomes may be considered as a portfolio with different degrees of risk
  – reforms may affect the risk allocation between stakeholders;
  – process of reform accelerated during the crisis;

• Minimum and means-tested pensions allow to counteract some of these risks

• To raise effective retirement ages is crucial...but labour supply is only one side of the coin... labour demand is the other;

• Finally, retrenchment of public pensions leave a pension savings gap. To fill it people will have to save/work more to ensure retirement-income adequacy is maintained....
Thank you for your attention!

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Pensions at a Glance 2013 is forthcoming
November 2013
For further information see also:

- OECD (2013a), OECD Review of the Irish Pension system;
- OECD (2013b), Women and Pensions, forthcoming
- OECD (2012), OECD Pensions Outlook;
- OECD (2011a), Paying for the past, providing for the future: Intergenerational solidarity, Issue paper for the OECD Ministerial Meeting on Social Policy, Paris
- OECD (2011b), OECD Pensions at a Glance