Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

December 2013

Europe

Finland

On October 31, the Pension Panel issued *Adjusting the Finnish Pension System to the Increase in Life Expectancy*, a report that finds recent pension reforms insufficient to achieve national fiscal and retirement-age goals. According to the Panel, the rate at which life expectancy is increasing, together with the growing concern for the sustainability of public finances, emphasizes the need for further reforms. (Finland's population is aging faster than any other member country in the Organisation for Economic Co-operation and Development.) The Panel, a working group of pension experts appointed by the central labor market organizations, suggests that a variety of reform measures be considered to address population aging. The central labor market organizations are expected to propose a package of pension reforms by the fall of 2014 in order to meet the goal of passing legislation by 2017. The Panel's findings are largely illustrative rather than specific recommendations for reform, which will be negotiated by the social partners.

The Panel discusses how recent reform measures have addressed the country's demographic challenges. Pension reform since 2005 included provisions to encourage older workers to remain in the labor force and limit the growth of pension expenditure by—

- Changing the normal retirement age for the earnings-related pension from 65 to a flexible range (63 to 68), abolishing the early old-age pension, and restricting access to early retirement (the retirement age for the universal pension remains at age 65);
- Introducing a life expectancy coefficient to the pension calculation, which will reduce pension payments as individuals live longer and promote an increase in the effective retirement age;
- Changing the benefit formula to cover lifetime earnings (instead of the past 10 years);
- Increasing pension contributions by 0.4 percentage points in both 2015 and 2016 (from 23.6 percent in 2014 to 24.4 percent in 2016).

According to the Panel, previous pension reform measures are only a partial success. Recent reforms have led to a slower than expected increase in pension expenditures in the past two decades, a trend which should continue. However, it appears that the targeted effective retirement age of 62.4 years by 2025 will not be reached unless further reform measures are taken. (Finns currently retire at 60.9 years on average.) Achieving that target would help lower incentives to raise pension contributions and reduce the considerable pressures on public finances, which are expected to increase without reform.

The report highlights three measures particularly relevant for examination by the social partners in future pension reform negotiations: (1) pension contributions, (2) benefit amounts, and (3) retirement age. According to the report, a more flexible approach could be adopting some combination of those measures. In addition, the report recommends reviewing the existing early retirement systems, the financial incentives that encourage workers to postpone retirement, and the limits on the flexible retirement age. Another important aspect discussed is social fairness and better adapting the pension system to the needs of the elderly.

Sources: "The Pension System in Finland: Adequacy, Sustainability, and System Design," Finnish Centre for Pensions, 2013; "Finland's Pension Reform and Its Implications," Finnish Centre for Pensions, September 26, 2013; Pension Panel press release, October 31, 2013; "Pension Panel Suggests Raising Retirement Age," *yle*, October 31, 2013; "Finland's Pension Panel Recommends Retirement Age Hike: Life Expectancy Coefficient Rise Confirmed," Mercer, November 15, 2013; "Finnish Premier Expects Retirement Age to Increase by 2015," ipe.com, December 9, 2013.

Asia and the Pacific

Australia

On November 22, the Australian government's Productivity Commission released *An Ageing Australia: Preparing for the Future,* a report that describes the growing financial burden of a rapidly aging population on the national budget. From 2012 through 2060, the proportion of the population aged 65 or older is expected to nearly double (from 14 percent to 25 percent), and the population aged 75 or older is projected to rise from about 6.4 percent to 14.4 percent of the total population. If no changes are made, the Commission expects the cost of public pensions to increase from 2.7 percent to 3.7 percent of gross domestic product (GDP) during the same period.

According to the Commission, even though people are living longer, the time spent in the labor force has not increased proportionately over the past 100 years. For example, since the early 1900s, life expectancy at birth has increased by about 33 years for men, but the time spent in the labor force (for those born in 2012) will only increase by 7 years. Also, although men born before 1925 spent about 75 percent of their lives after age 15 in the labor force, those born from 1946 through 1965 are projected to work about 60 percent of that time, and those born from 1986 through 2060, about half. The Commission warns that the government will not be able to afford to pay for these lengthy retirements.

In addition, the Commission states that the current retirement income system discourages older workers from remaining in the labor force. The Age Pension, the asset- and income-tested public pension funded by general revenues, encourages a worker who qualifies for the benefit to leave the work force at the retirement age (currently 65, rising to age 67 from 2017 through 2023); if that person continues working beyond the retirement age, he or she may no longer qualify for the Age Pension based on the income test. A worker who does not meet either the asset or income test relies more on his or her superannuation funds (mandatory employer contributions to an employee's fund or savings account). The preservation age (currently 55, rising to age 60 from 2015 to 2024), the age at which a worker may withdraw his or her superannuation funds, also encourages a relatively early exit from the labor force.

The Commission suggests that the retirement age be linked to life expectancy beginning in 2023. Based on current projections, that age would be gradually increased to 70 by 2035. The savings are estimated at between 0.1 percent and 0.15 percent of GDP per year. Linking the preservation age to life expectancy as well would encourage older workers to remain in the labor force longer.

Source: *An Ageing Australia: Preparing for the Future,* Australian Government Productivity Commission, November 2013.

Reports and Studies

Organisation for Economic Co-operation and Development (OECD)

On November 26, the OECD released *Pensions at a Glance 2013*, a biennial report that examines public and private pension systems in 34 OECD member countries and 8 nonmember G-20 countries. This year's report provides an in-depth analysis of the impact of recent pension reforms and of the role of housing, financial wealth, and public services in providing adequate living standards in retirement. According to the report, many of the countries surveyed have implemented reforms in recent years to improve the financial sustainability of their pension systems in the face of rapid population aging and increasing life expectancy. However, the report argues that by reducing future spending, those reforms may also increase the challenge to governments of ensuring that citizens have adequate income in retirement.

The report highlights trends in pension reforms across the aforementioned 34 OECD member countries: (1) reforms of pay-as-you-go public pension systems aimed at postponing retirement, such as higher retirement ages, automatic adjustment mechanisms, and changes in indexation rules; and (2) reforms of second-pillar defined contribution programs, with some countries (the Czech Republic and the United Kingdom) introducing new programs and others reducing (Poland) or eliminating (Hungary) their second-pillar programs. The report notes that the most common reform during the past 5 years has been increasing the normal retirement age; the majority of OECD countries will have a retirement age of at least 67 years by 2050, with some (Denmark, Greece, Hungary, Italy, Korea, and Turkey) going further by also linking the retirement age to changes in life expectancy. Because of these reforms, the report states that workers who enter the labor force today will have lower benefits at retirement than previous generations.

Pensions at a Glance 2013 also analyzes the adequacy of retirement incomes from a broader perspective, including not only pension benefits but also the role of housing, financial wealth, and the value of publicly provided services. While noting the lack of reliable internationally comparative data, the report finds that—

- Homeownership can contribute substantially to pensioners' living standards by allowing them to live in their own homes and, when necessary, convert their property into cash through sale, rent, or reverse mortgages. Across OECD member countries, approximately 77 percent of workers aged 55 or older are homeowners; the percentages still paying off their mortgages vary considerably from country to country, from around 60 percent in Switzerland to around 10 percent in Hungary and the Slovak Republic.
- Financial wealth of older workers aged 65 older is very unequally distributed, with women faring particularly poorly. While upper income workers can draw on their resources at retirement, most workers are unable to rely on financial wealth to improve their retirement income.
- Publicly provided services—particularly healthcare and long-term care—significantly improve pensioners' household income, especially among the poorest households. The share of in-kind public services in the disposable income of the elderly is around 40 percent across OECD member countries, and it exceeds 70 percent in Sweden and Norway.

The report also provides a variety of comparative indicators—on replacement rates and pension wealth, for example—and detailed country profiles on the public and private pension systems of the countries surveyed.

Sources: *Pensions at a Glance 2013: OECD and G20 Indicators*, Organisation for Economic Co-operation and Development, 2013.

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