

## Editorial

### *Pensions under stress*

In OECD countries, the pension landscape has been changing at an astonishing pace over the past few years. After decades of debate and, in some cases, political standstill, many countries have launched significant pension reforms, including higher retirement ages, changes in the way entitlements are calculated and other measures to introduce savings in their pension systems.

OECD countries have very different pension schemes, but this new wave of reforms faces remarkably similar challenges: how to ensure that pension systems are financially sustainable and how to give citizens an adequate income in retirement. Tension between these two objectives is not new, but the economic crisis with its impact on public deficits and debts and thus the need for fiscal consolidation has added urgency. In large pay-as-you-go systems, especially in continental Europe, *financial sustainability* is the primary concern: how can the large success of past decades in reducing old-age poverty be maintained while ensuring that the costs of pension provision do not become too high for the next generations in the context of population ageing? Other countries with smaller public pension systems, such as the English-speaking countries, are more concerned with ensuring *adequate retirement incomes* by expanding the coverage of private pension schemes and raising contribution rates.

While many reforms had been in the making even before the crisis, a major accelerator of pension reform was the economic crisis and the resulting need for fiscal consolidation. In the 2009 edition of *Pensions at a Glance*, the OECD noted that, although private pension assets had taken a hit, pensioners had been largely spared from benefit cuts and sometimes even saw their public pension benefits increased as part of economic stimulus programmes. By 2013, this is no longer the case. Given their large incidence in overall public spending – about 17% on average across OECD countries (ranging from 3% in Iceland to 30% in Italy) – pensions are now also being targeted in fiscal consolidation programmes.

Reforms have addressed a number of key elements of pension systems. One of the most visible and politically contested measures has been raising the retirement age. Pension ages have increased in most OECD countries. A retirement age of 67 is now becoming more common, rather than the exception as was still the case a few years ago. Some countries have gone even further, moving to 68 or 69 years, though no other country has gone as far as the Czech Republic which decided on an open-ended increase of the pension age by two months per year.

More and more countries are also introducing automatic adjustment mechanisms or sustainability factors; these aim to rebalance pension systems in line with the evolution of demographic, economic and financial parameters. In order to address shorter-term budget constraints, several countries are adopting, or considering, freezes of benefit levels, in

particular of higher-level pensions. In most cases, exceptions are made for low-income retirees by maintaining or increasing old-age safety net benefits. More recently, special pension schemes are also coming into focus, such as those for civil servants or for other groups of the population which may still be enjoying more favourable conditions for retirement. Decisions are particularly complicated as they raise broader issues, such as employment and pay conditions in the public versus the private sector.

Looking forward, the challenge of balancing sustainability and adequacy will become more pronounced in most countries. Governments will be forced to answer tough questions of both intra- and intergenerational fairness. As the baby boomer generation retires and pension systems continue to be reformed, the focus on preventing old-age poverty will become sharper and sources of income in old-age other than those from pension systems would have to be considered. This edition of *Pensions at a Glance* shows that homeownership and the financial wealth of older people, as well as services such as health and long-term care, are important factors influencing people's living standards in old age. Homeownership, in particular, can make a big difference for many pensioners, both reducing the need for cash and providing a way to generate income later in life. Accounting for these assets is likely to play a role in the policy debate on adequacy of incomes and inequalities in retirement.

Taking a broader view on living standards in retirement, however, raises other difficult questions. In countries where youth unemployment is high, for example, the pension benefit may be the only income households have to support a whole family, including jobless young people who live with their parents. The solution, however, cannot be to pay pensions to support a large family or for pensions to solve all problems, but to provide social and labour market policies that address the needs of every group of the population.

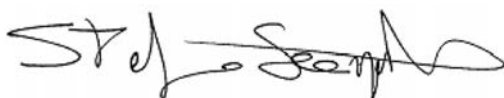
Private pension systems also need to be strengthened to ensure that they contribute effectively to retirement income adequacy. Retirement savings took a hit in the initial phase of the global financial crisis but now pension funds' asset and solvency levels have largely recovered. Nevertheless, private pensions have come under strong pressure in a climate of distrust in the financial sector and in a prolonged low interest-rate environment. For example, enthusiasm for funded private pillars has waned in some of the Central European countries: Hungary and Poland have abolished or significantly scaled down their mandatory private pension systems. Partly, this was a consequence of underestimating the fiscal costs associated with the introduction of mixed public-private, partially funded systems. But another reason was growing public discontent with the results of private pension funds due to high administrative fees and disappointing returns of pension funds. Even in Germany where individual private retirement savings are strongly promoted and subsidised, questions are being asked as to whether public support for private pensions is the right way to go. Sometimes, it is suggested that public money should rather be used to bolster public pay-as-you-go systems.

At the same time, other countries have been moving in the opposite direction, promoting low-cost, well-managed pension organisations that are better oriented to the needs of low income households. A good example is the recently launched National Employment Savings Trust (NEST) in the United Kingdom, which acts as the default in the new national automatic enrolment programme. The UK government expects this new system to address the major benefit adequacy gap that lower and middle income households are exposed to, because of the relatively low public pension benefits and the

voluntary nature of private pension provision. This follows an earlier reform in New Zealand which also introduced auto-enrolment for new employees. Other countries with smaller public systems, such as Ireland, are also recognizing that private pension saving on a purely voluntary basis will not result in high coverage rates and sufficient contributions. They are therefore considering either soft compulsion, such as auto-enrolment in private pensions, or even mandatory participation in private pensions. Other countries that stand out for their prudent and effective management of private pension systems include Denmark and the Netherlands, where, despite the crisis, investment returns have remained positive over the last five-year period in real terms.

While unhappiness with private pensions is understandable in the current economic context, it is important to recall the reasons why countries started to diversify the sources of retirement income in the first place. Private pensions were intended to limit the burden on younger generations by pre-funding at least part of the future pension obligations in a context of often rapid population ageing. This latter demographic challenge persists and moving back to pay-as-you-go systems will not help address the looming pension crisis. Middle-earners will be the group of people who are at highest risk of not having sufficient retirement income; indeed most countries protect low earners through minimum pensions and old-age safety nets, while most high-income people complement their public pension benefit with income from other sources, including personal savings and investments. Encouraging private provision for retirement, both through occupational and personal pension plans, thus remains important. But the current debate does highlight the urgency of dealing with the cost issue of running private schemes. It is indeed hard to justify obliging workers to put money into retirement income arrangements in which in the end only the provider makes a profit.

Addressing population ageing will require a much broader view than most governments currently seem to be taking. Retirement incomes are the reflection of employment and social conditions over the life course of each individual. Pension systems alone will not be able to correct inequalities and breaks during working lives. Ageing societies will therefore need much more policy action than just pension reform, and much more strategic thinking: what should our societies of the future look like? How will we deal with the old-age care challenge? What will be the fiscal impact of ageing and what will this mean for social protection systems and the sharing of responsibilities between the individual and the state, between public and private service providers? And how can we maintain solidarity in a context of rising inequalities between and within generations? Answering these questions will require comprehensive discussions and the design of holistic plans to which the OECD will continue to contribute through its work on public and private pensions and on a range of social and economic policies more broadly.



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