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Pensions at a Glance 2009
Retirement-Income Systems in OECD Countries
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Executive Summary

The financial crisis and the deep economic crisis that it spawned have dominated the news for over a year. The first of the special chapters in Part I of this third edition of *Pensions at a Glance* looks at the implications of the crisis for retirement-income systems. The *financial* crisis has hit pension funds in OECD countries hard, with their investments losing on average 23% of their value during 2008, worth a heady USD 5.4 trillion. Looking at individual countries, the impact depends on the importance of private pensions in the overall retirement-income package, which is especially large in Australia, Denmark, the Netherlands, the United Kingdom and the United States.

The *economic* and *social* crisis is already apparent in the form of declining output, rising unemployment and slower growth (or even declines) in wages. This means that public pension plans will also be hit, with lower revenues from contributions and greater pressure from benefit expenditure.

The individuals most affected by the financial and economic crisis are older workers, who have little time before retirement to wait for their pension savings to recover and encounter greater problems finding a new job if they become unemployed. The special chapter on the crisis and pensions includes new calculations of the impact of being long-term unemployed late-in-life on people's incomes in retirement. Younger workers feel much less of an impact as they typically save less at this stage in their career and have a much longer expected working life over which to recoup any losses in retirement savings and pension entitlements. People who are already retired and drawing their pension also tend to suffer less.

Using the OECD pension models, the chapter shows how the negative effect of the crisis on retirement incomes is muted in many countries by public safety-net benefits and the tax system. More than 75% of older people in Australia and around 65% in Denmark, for example, receive at least some benefit from resource-tested schemes. The value of these entitlements increases as private pensions deliver lower returns, protecting much of the incomes of low- and middle-earners. In Australia, each extra dollar of private pensions results in a 40 cent reduction in public pension. Conversely, a dollar less in private pensions results in 60 cents more in public pension benefit. But in some countries, the old-age safety nets are or will be insufficient during times when private savings cannot supplement low retirement incomes.

The actions that governments have already taken to mitigate the impact of the crisis are discussed and evaluated. The chapter shows that pension systems have been affected in two main ways by the economic-stimulus packages that many governments have introduced: increased payments to older people and the use of public pension reserves to finance crisis mitigation. Further responses for pension policy are also assessed, covering the labour market, public safety-nets, regulation of private pension funds and investment

choice. Despite huge short-term political pressures, it is imperative that governments resist expedient reactions threatening the stability and sustainability of retirement-income provision. The long-term challenges of demographic change and population ageing have not gone away and will still have to be faced once the crisis is passed and economies start to recover.

The incomes and poverty of today's older people are examined in the second special chapter of Part I. In the mid-2000s, net incomes of people aged over 65 were worth 82% of those of the population as a whole on average in OECD countries (taking account of differences in household size). But there is a large difference between countries. Old-age poverty is practically non-existent in some countries, but over 40% of the old live in income poverty in Korea, for example. Poverty rates average 13.2% for older people in the OECD, compared with 10.6% for the population. The chapter also discusses how incomes and poverty of older people are likely to evolve in the future as a result of pension reform, and social and economic change.

Recent pension reforms are the topic of the third special chapter of Part I. Updating the analysis in the second edition of *Pensions at a Glance*, this chapter shows that OECD countries have continued to reform their pension systems in the period since 2004; indeed, in only five of them was there little or no change. These recent reforms are grouped around key objectives for the pension system: coverage of workers, adequacy of retirement benefits, financial sustainability, economic efficiency (minimising distortions to labour-supply and savings incentives), administrative efficiency and security of retirement incomes in the face of different risks and uncertainties.

The assessment of reforms shows that the period from 2004 to May 2009 has been one of evolution rather than revolution. There was none of the wide-ranging, systemic reforms that took place in the decade up to 2004. In some countries, such as the United States, Norway, Austria and Ireland, the reform process has now stalled. In other countries, the reform process has slowed or even gone into reverse. Legislated changes to the pension system in Italy, for example, were postponed. In the Slovak Republic, workers covered by the new defined-contribution plans have been allowed to switch back to the public system and similar roll-backs of reform are being discussed elsewhere. The crisis may lead to further changes that are not consistent with the long-term strategy needed for a sustainable pension policy.

The final special chapter of Part I, again updating and extending work from the previous edition of *Pensions at a Glance*, looks at the coverage of private pensions. It focuses on countries where public pensions are low and so individuals bear a greater responsibility for providing for their own old age. Yet again, the financial crisis is a real concern, particularly if it undermines people's confidence in private pensions. Nevertheless, fiscal constraints mean that private pensions must remain part of the equation in providing for old age. Policies to ensure that people do save for retirement, including automatic enrolment and tax incentives, are evaluated.

A range of pension indicators is presented in Part II of this report. The first nine indicators look at individual pension entitlements, calculated with the OECD pension models. The values of the parameters reflect the situation in 2006. The calculations are designed to show future entitlements for workers who entered the labour market in 2006 and spend their entire working lives under the same set of rules. For workers on average earnings, the *gross replacement rate* – pension benefits relative to earnings when

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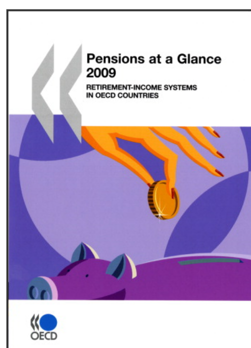
working – averaged 59% in the 30 OECD countries. However, many countries offer concessions in their incomes taxes to older people and most pensioners do not pay any social security contributions. Thus, for average earners, the *net replacement rate* (taking taxes and contributions into account) is 70% on average. Replacement rates are shown separately for men and women and at different levels of earnings. A new indicator showing replacement rates including typical voluntary private pension schemes has been added in this edition.

What matters for governments is not just the replacement rate but the overall pension promise. This is measured by the indicators of *pension wealth*, which show the lifetime value of benefits taking account of differences between countries in pension age, life expectancy and indexation of pensions in payment. On average, men in Luxembourg will receive around USD 825 000 in pensions over their lifetimes and women, around USD 1 million. Luxembourg may be an extreme example, but lifetime pensions from mandatory schemes are worth USD 400 000 for men and USD 475 000 for women on average in OECD countries.

A second set of four indicators, again new to this edition of *Pensions at a Glance*, explores broader elements of retirement-income systems. It presents information on contributions, and how pension contribution rates have changed over time. In fact, contribution rates have been remarkably stable given the demographic pressures on pension systems, increasing from an average of 20% in 1994 to 21% in 2007. However, these pressures are apparent when looking at public pension spending, the second of these indicators, which increased 17% faster than national income between 1990 and 2005, from 6.2% to 7.2% of gross domestic product. The indicator of pension spending also includes information for mandatory private pensions and in-kind benefits, such as housing benefits and subsidies. Two further indicators of retirement-income systems concern private pensions, with data on coverage of voluntary private pensions and the value of assets in pension funds.

The final set of four indicators looks at the background and context in which pension systems operate. Three are demographic: life expectancy, fertility and the dependency ratio (the number of pensioners per person of working age). Data on average earnings, which underlie much of the other indicators, can also be found here.

Finally, the country profiles in Part III give key indicators for national pension systems, set out the parameters and rules in a consistent way and give the main results for individual pension entitlements: replacement rates and pension wealth. At the beginning of Part III, a handy summary table of key parameters and rules for all 30 OECD countries can be found.



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