

Economic Reforms for Europe

Social System Reform: Pensions



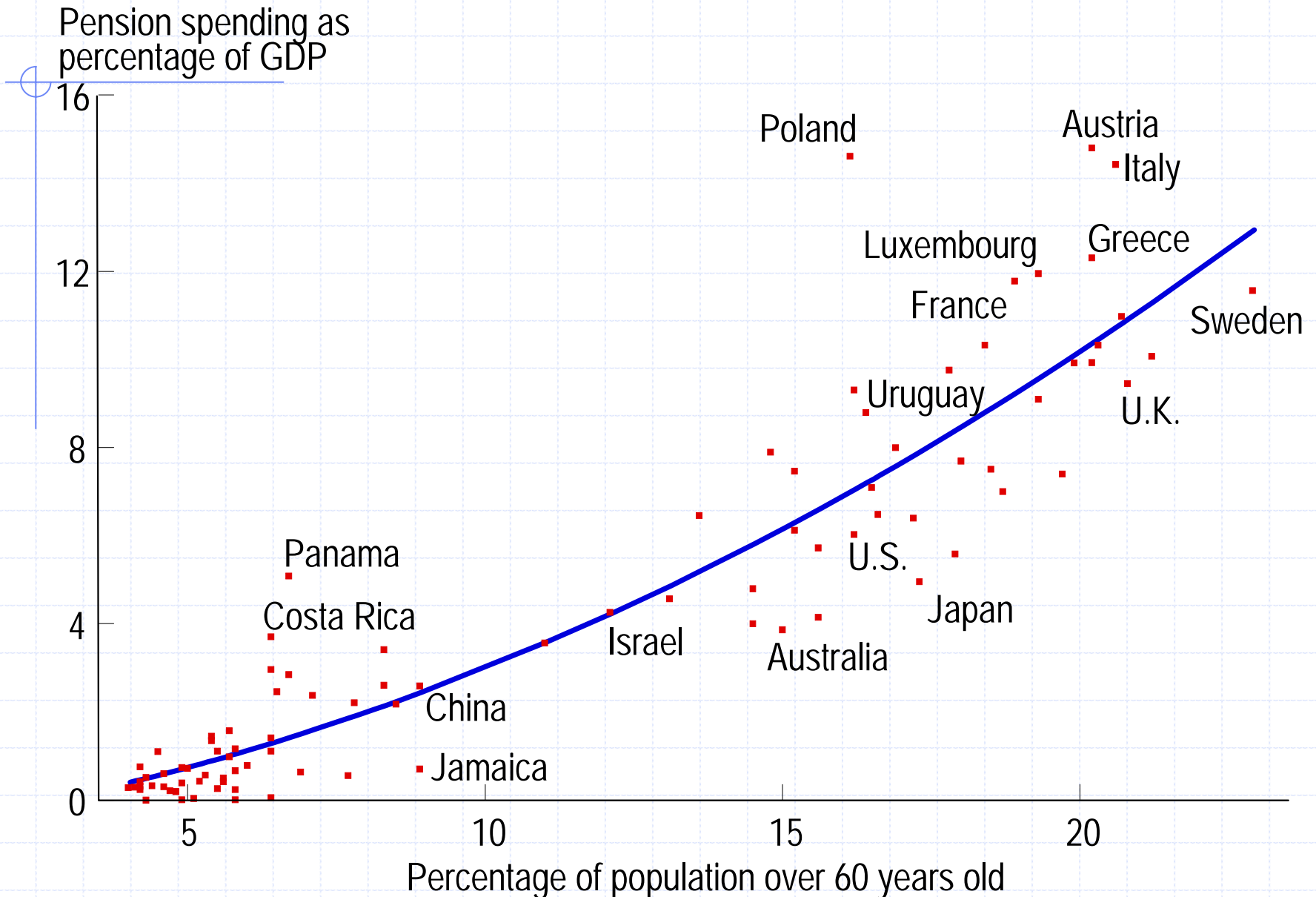
Slovak Republic,
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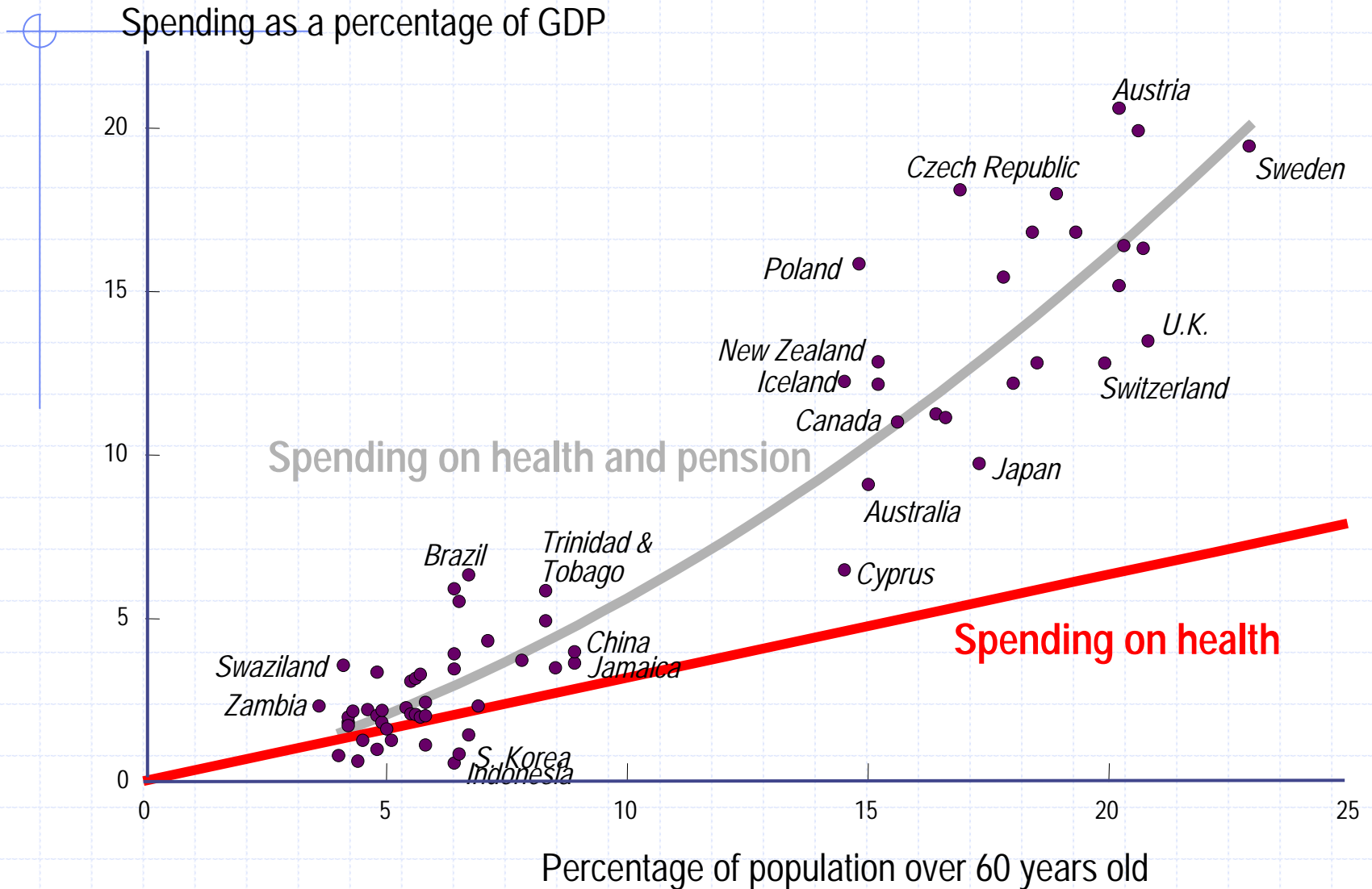
Background and Issues

- ◆ Population aging is an European and a world-wide phenomenon
- ◆ Aging puts pressure on public programs, in particular pension and health
- ◆ The problems need an open public discussion about issues and reform options followed by policy decisions
- ◆ In the current and enlarged EU the pension reform needs to run parallel to that of establishing fully integrated output and factor markets

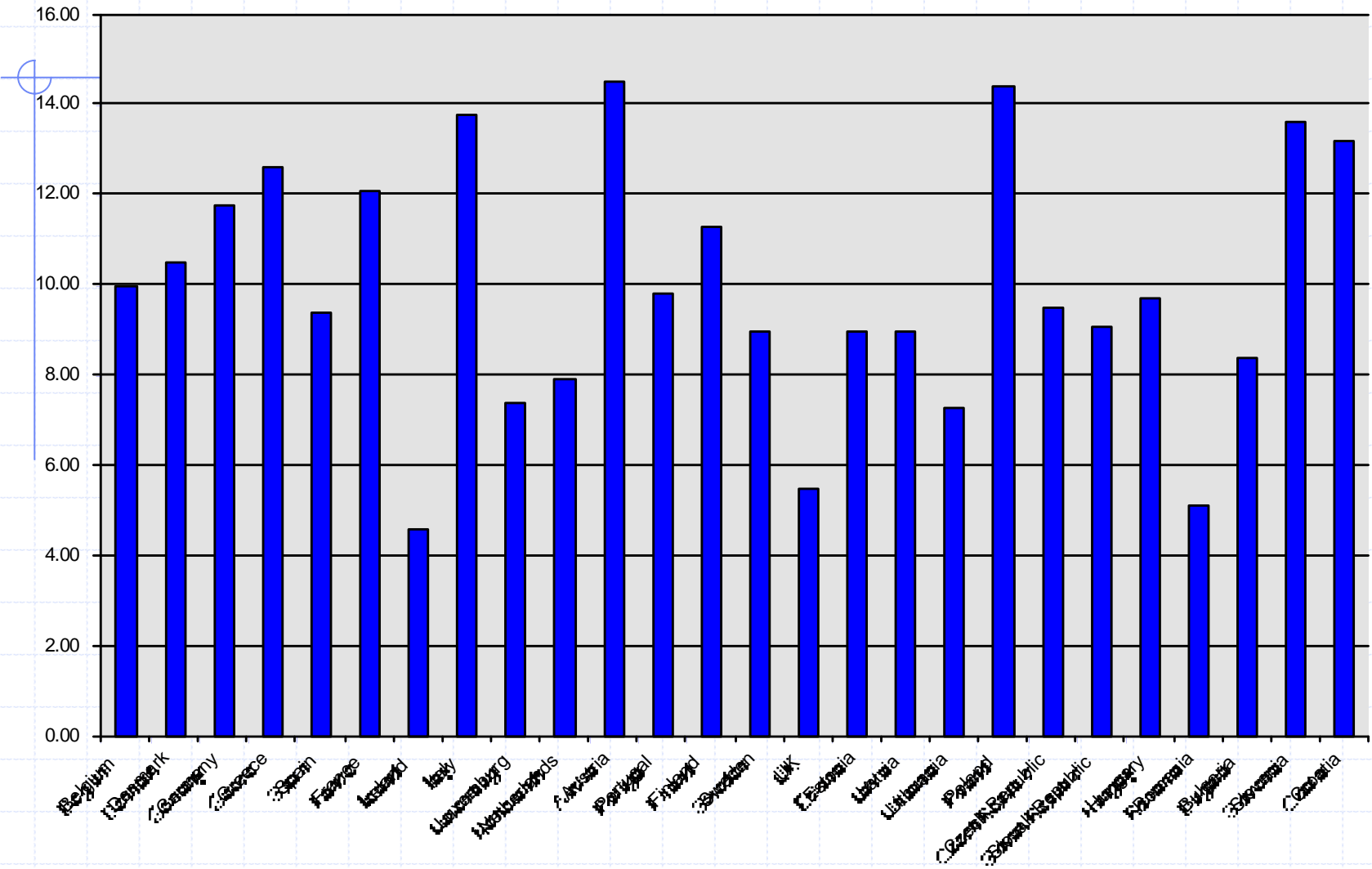
Relationship Between Percentage of the Population over 60 Years Old and Public Pension Spending



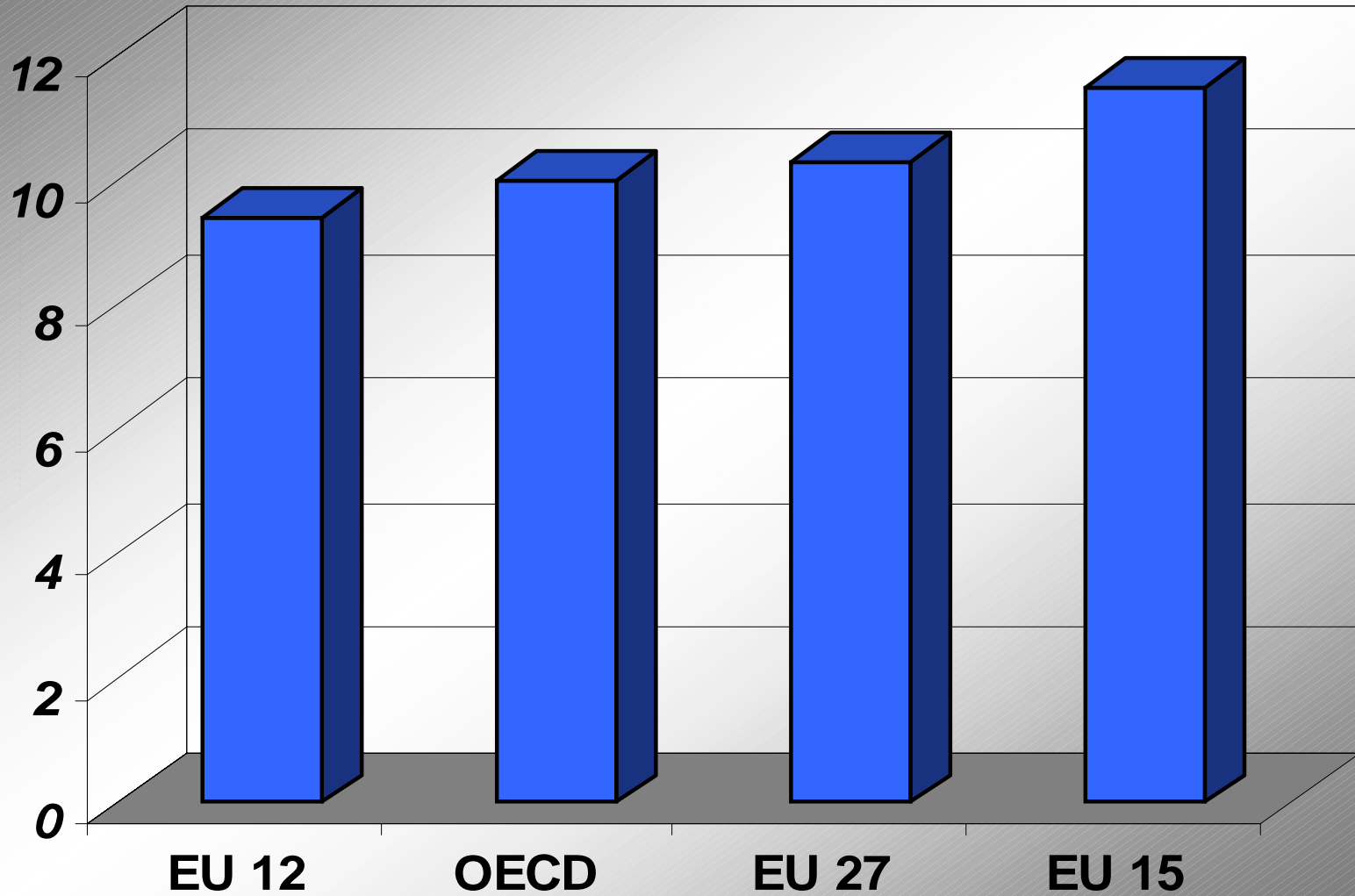
Public Health and Pension Spending versus Population Aging



Pension Expenditure in EU and Accession Countries (plus Croatia), 2000



Average Pension Expenditure over GDP



Increase in pension expenditure from 2000 to 2050

Flat rate system	% of GDP	Earnings related	% of GDP
DK	2.8	A	2.5
IRL	4.4	B	3.3
NL	5.7	FIN	4.6
UK	0	F	3.7
		D	5.0
		I	0.3
		P	3.4
		E	7.9
		S	1.7

Source: EPC

Options for Old-Age Income Support

- ◆ Pre-funding of pension expenditure
 - ◆ Higher labor force participation
 - ◆ Higher contributions/lower benefits/
increased retirement age
- ⇒ Move toward a more flexible pension system for an integrated Europe

Status of pension reform in an integrated Europe

◆ Needs and promises

- Flexibility between education, work and retirement spell over life cycle
- Incentives for life-long learning
- Labor mobility between professions and member states

◆ Reality

- Pension issues not yet fully on the EU agenda
- Fragmented and largely unreformed schemes
- Discussion and tough decisions on harmonization/coordination needs so far avoided

Status of pension reform in an integrated Europe

◆ Parametric Reform

- Attempt to rationalize pension system by seeking more revenues and reducing expenditures while expanding voluntary private pension provision.
- Austria, Czech Republic, France, Germany, Greece, and Slovenia

◆ Paradigmatic Reform

- Fundamental change in pension provision typically through introduction of mandatory funded pensions, drastic reform of PAYG pillar and expanded voluntary retirement saving.
- Bulgaria, Croatia?, Denmark, Hungary, Italy, Latvia, Poland, Slovakia, Sweden, and UK.

Elements of a Flexible Pension Scheme

- ◆ Dealing with old-age poverty: social assistance or dedicated social pension?
- ◆ Close link of benefits to contribution record: Reformed defined benefit or notional defined-contribution scheme?
- ◆ Funded scheme: Mandatory or voluntary, DB or DC, publicly or privately managed, choice?

Contributions and Benefits Link

- ◆ Reforming defined benefit schemes
 - Life-time earnings record
 - Increase in retirement age
 - Actuarial decrements/increments
- ◆ Moved toward notional defined contribution schemes
 - Sweden, Italy, Latvia and Poland

Notional Defined Contribution Scheme

- ◆ DC systems, but remains unfunded
- ◆ Individual accounts, with contributions and notional interests credited
- ◆ Pension is calculated by dividing accumulated amount by life expectancy – “G-value”
- ◆ Main issues:
 - Choice of notional interest rate
 - Choice of G-value
 - Reserve funds against demographic and economic shocks

NDC Advantages for EU

- ◆ Breaking reform deadlock in countries
- ◆ Harmonizing schemes between professions in countries
- ◆ Could be a common denominator in EU
- ◆ Labor mobility between member countries
- ◆ Easy integration with funded schemes

Conclusions

- ◆ Population aging is a challenge for society and social protection. It is an achievement.
- ◆ Pension programs in the EU need to be reformed independently of population aging
- ◆ To respond to aging, pension programs need to become more flexible, to take account of individual preferences and to rely more on informal and market-based arrangements to deal with diverse risks

Conclusions

- ◆ To adjust pensions to aging population requires major changes in the system design. Multi-pillar systems, NDC the first pillar, and funded second pillar offer opportunities.
- ◆ Portability of rights and pensions across professions, sectors, and countries make DC schemes (un and/or funded) a preferred choice.
- ◆ Requires an open discussion within the EU.