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from:	Council (EPSCO/Ecofin)
to:	European Council
Subject:	**Joint report by the Commission and the Council on adequate and sustainable pensions**

Delegations will find attached the joint report by the Commission and the Council on adequate and sustainable pensions, as approved by the Council (EPSCO/Ecofin) on 6/7 March 2003.

JOINT REPORT BY THE COMMISSION AND THE COUNCIL ON ADEQUATE AND SUSTAINABLE PENSIONS

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EXECUTIVE SUMMARY

Several European Councils, from Lisbon to Barcelona, have highlighted the challenge of an ageing population and its implications for the maintenance of adequate and sustainable pensions. This challenge was underlined in the conclusions of the Stockholm European Council in March 2001, which laid the ground for the open method of coordination on pensions. This process was finally launched by the Laeken European Council in December 2001 on the basis of 11 common objectives under the three headings: safeguarding the capacity of systems to meet their social objectives, maintaining their financial sustainability and meeting changing societal needs.

National strategy reports on pensions were submitted in September 2002, in which Member States present in detail how they are trying to meet the 11 common objectives. Subsequently, the Commission services analysed the national strategy reports with a view to assessing the achievement of the 11 common objectives.

Adequacy of pensions

All Member States ensure that most people earn pension rights and provide a minimum level of income to older people who earned insufficient pension entitlements. An important achievement of pension systems is that old age is no longer synonymous with poverty. In many Member States, the poverty risk of older people is lower than for younger people. Particularly in those Member States where poverty risks remain high, a broad range of measures to improve minimum income guarantees and various benefits in cash and in kind are being introduced.

Pension systems, through public earnings-related schemes (first pillar), private occupational schemes (second pillar) and individual retirement provision (third pillar), provide good opportunities for most Europeans to maintain their living standards after retirement. As a result, and in combination with other tax-benefit policies for pensioners, older people, in most Member States, generally achieved a fair, and in some Member States even relatively high, living standard. The maturing of the pension systems and the greater participation of women have contributed to raising average pension levels. In the future, many Member States expect to maintain the level of adequacy, *inter alia*, through allowing individuals to earn additional pension rights by postponing their retirement. Adequate pensions are also being maintained by encouraging the social partners to establish sector-wide pension schemes based on mandatory collective agreements and by improving access to personal pension products notably through a better framework for voluntary provision by employers. Member States are thus also promoting increased private provision of pensions, whilst most pension income continues to be provided by first-pillar schemes.

Member States have built strong redistributive elements into their first-pillar pension schemes, notably in the form of minimum pension guarantees or credits for certain periods without pensionable income (e.g. unemployment, parental leave, etc.). This has contributed to reducing income disparities among pensioners, often more than among the population as a whole. Greater reliance on occupational pension provision, often supported by collective agreements, or public and private pension provision with strong solidarity elements and with a strong link between contributions and benefits, will increase the adequacy of pensions and promote fairness between generations.

Financial sustainability of pension systems

The financial sustainability of pension systems is a necessary precondition for an adequate provision of pensions in the future and for this reason alone should be high on the priority lists of all Member States. Failure to ensure the financial sustainability of pensions systems in the long term will seriously jeopardise Member States' efforts to maintain or even raise the adequacy of their public pension systems and would have other adverse economic consequences as well. Public pension spending is projected to rise substantially in most Member States as a share of GDP over the coming decades if policies remain unchanged. Over the past few years, Member States have recognised the urgency of making pension systems financially stable in view of the limited window of opportunity that exists before the ageing population takes effect. An approach based on raising employment rates, reducing public debt levels and reforming pensions systems, also underpinning the broad economic policy guidelines, has been widely incorporated in Member States' strategies.

Long-term fiscal sustainability is a major issue in many EU Member States. Based on policies in place or legislated for at the end of 2000, the projections by the Ageing Working Group of the Economic Policy Committee show that public spending on pensions is likely to rise by between three and five percentage points of GDP in most EU Member States between 2000 and 2050. As a result, the EU average would rise from 10.4 % in 2000 to 13.3 % by 2050, with wide variations from around 5 % to over 20 %.

All Member States see their efforts to raise employment rates as an important element in their long-term strategy for making pensions sustainable. Higher employment rates imply that the financing of pensions can be spread across a greater number of people. Projections of public pension expenditure ([1]), which already foresee higher employment ratios, indicate that, if the Lisbon employment targets were to be achieved, with continued employment growth beyond 2010, the increase of public pension expenditure as a percentage of GDP could be reduced by about one third in 2050, compared to the baseline scenario of unchanged policies. This means that higher employment rates alone will not solve the problem of the financial sustainability of pension systems. Currently, most Europeans retire before reaching the statutory retirement age. If a one-year increase in the effective retirement age could be achieved without increasing pension entitlements, the expected pension expenditure rise would be cut by 0.6–1 percentage points of GDP in 2050. This means that a one-year increase in the effective retirement age would absorb about 20 % of the average expected increase in pension expenditure in 2050. Member States have declared their commitment to delay the take-up of early pensions and are in the process of reforming early pension systems and labour-market policies. However, in many cases, the pace of reforms falls short of what is required to achieve the Stockholm and Barcelona targets for the employment rate of

([1]) Carried out by the Member States in 2001 under the auspices of the Economic Policy Committee.

older workers (50 % by 2010 compared to 38.5 % today) and for an increase in the effective retirement age by five years by 2010.

Some Member States have put, or are putting, in place comprehensive strategies for ensuring the sustainability of pension systems and public finances as a whole in accordance with the three-pronged strategy incorporated in the framework of the broad economic policy guidelines. Apart from labour-market reforms for raising employment rates, strategies are built on budgetary consolidation and reforms of pension systems. Many countries aim at using budgetary surpluses for reducing public debt or building up reserve funds and, accordingly, at using the decrease in future interest payments for financing the budgetary costs of ageing. In some countries, high debt ratios and the interest burden they entail still hamper budgetary consolidation and constitute, therefore, an additional reason to call for determined efforts on this front. Furthermore, large increases in expenditure on public pensions are projected for most Member States and financial gaps are likely to emerge. Further pension reforms are needed, in particular in those Member States which have not yet safeguarded the long-term sustainability of their pension systems.

Member States realise that, in view of the high financial burden of rapidly deteriorating dependency ratios, fairness between generations will be at risk. To prevent adverse effects on employment, care should be taken to avoid increasing the total tax burden, in particular on labour, and to achieve a sustainable balance between taxes on labour, on the one hand, and other forms of taxation, including on capital, on the other. Several Member States have addressed the consequences of the baby-boom generation on pension systems by establishing reserve funds in public pension schemes with the aim of avoiding large increases in contribution rates. Many Member States have also created better opportunities for supplementary private provision and private funding, thus reducing pressures for public expenditure increases. Two countries have changed their public pension systems to notional defined-contribution systems, with the aim of stabilising contribution rates across generations and incorporating better incentives to work, thus contributing also to meet the objective of higher employment rates.

Financial sustainability of funded pension provision depends on the sound governance of the funds and on the performance of financial markets. The risks for funded pension provision can be greatly reduced through effective supervision and prudent asset management. The directive on institutions for occupational retirement provision, currently under discussion in the Council and the European Parliament, will be a major step of progress in this regard.

Modernisation of pension systems

Statutory schemes, by and large, respond well to the challenge of providing pensions for atypical (part-time, temporary, self-employed workers) and mobile workers. In contrast, the situation in the second-pillar schemes cannot yet be regarded as satisfactory: atypical workers continue to be less well covered by occupational schemes and, in many Member States, workers who change jobs tend to end their careers with reduced occupational pension rights compared to workers who remain with the same employer.

Member States are gradually adapting their pension systems to the evolving social and economic roles of men and women. They are moving to new rules that aim at facilitating the reconciliation between family responsibilities and work for both parents. However, in spite of such measures and increased labour-market participation of women, significant differences between women's and men's pension entitlements will persist for a long time to come.

Finally, most Member States have made efforts to improve the transparency of their pension systems, both at the level of systems as whole and with regard to individual entitlements. They also acknowledge the importance of consensus building for the development and reform of pension systems.

Overall assessment

This first comprehensive assessment of national pension systems and policies at EU level shows that Member States are committed to ensuring the adequacy of their pension systems. At the same time, many Member States face very high expenditure increases in their pension systems under current policies and have yet to take measures to cope with these financial challenges without jeopardising adequacy. These expenditure increases could seriously undermine the sustainability of public finances in the long term. However, ensuring long-term financial sustainability is not only important in its own right but is also a necessary precondition for an adequate provision of pensions in the future.

Member States are fully aware of the interdependence between financial sustainability and adequacy in the context of an ageing society: the financial sustainability of pensions systems is a necessary precondition for an adequate provision of pensions in the future, while ensuring adequacy is a precondition for obtaining political support for the necessary reforms of pension systems.

The national strategy reports present a wide range of positive developments with regard to the common objectives. While financial challenges have been the main driving force for reforms, Member States have respected the social objectives of their pension systems and are making efforts to adapt their pension system to changing societal needs. This balance between social and financial concerns is key for the political success of pension reforms. All Member States have started their reform processes and a number of Member States have implemented major, a few even radical, reforms during the 1990s. Notwithstanding this, a large number of countries see the need for further reforms in order to safeguard the long-term sustainability of their pension systems as well as sound public finances.

The momentum behind the reform process to secure the sustainability of adequate pensions must be maintained. These reforms should be seen in the context of the coordinated efforts by the Member States to implement the growth strategy required by the Lisbon Summit, including structural and fiscal reforms and better and more productive public investment. Improving incentives for older workers to remain longer on the labour market will be particularly important, especially in light of the long-term implications for pension expenditures of increased life expectancy. This can be achieved notably by strengthening the link between contributions and benefits. Moreover, the financial basis of pension systems can be strengthened through increased public and private funding. Finally, future adequacy also depends on the adaptation of pension systems to more flexible employment and career patterns and to the changing roles of men and women in society.

Ageing will start to produce its effects on pension systems within the next 10 years in many Member States. It is therefore urgent to put in place credible and effective strategies and to give clear signals to citizens about what they can expect from their pension systems and what they have to do to achieve an adequate living standard in retirement.

1. INTRODUCTION

Several European Councils have highlighted the challenge of ageing populations, in particular its implications for maintaining adequate and sustainable pensions. The Lisbon Council (2000) stressed the need to study 'the future evolution of social protection from a long-term point of view, giving particular attention to the sustainability of pensions systems in different time frameworks up to 2020 and beyond, where necessary'. This was followed by the endorsement at the Gothenburg Council (2001) of three broad principles for modernising pension systems, namely: 'safeguarding the capacity of systems to meet their social objectives, maintaining their financial sustainability and meeting changing societal needs'.

A joint report ([2]) by the Social Protection Committee and the Economic Policy Committee addressed to the European Council in Laeken (December 2001) called for the use of the open method of coordination in the area of pensions 'to help Member States progressively develop their own policies so as to safeguard the adequacy of pensions whilst maintaining their financial sustainability and facing the challenges of changing social needs'. It set out 11 common objectives under the three principles endorsed at Gothenburg.

Finally, the Barcelona Council (2002) called 'for the reform of pension systems to be accelerated to ensure that they are both financially sustainable and meet their social objectives' and, in this context, stressed 'the importance of the joint Commission and Council report on pensions to the spring 2003 European Council, to be drawn up on the basis of the national strategy reports due in September 2002'. As input to the latter report, Member States submitted national strategy reports in September 2002 in which they present in detail how they are trying to meet the 11 common objectives. These reports show that Member States have taken, and are continuing to take, a variety of measures to address the 11 objectives. With regard to the goal of financial sustainability of pension systems, Member States have integrated in their approaches the three-pronged strategy to tackle the budgetary implications of ageing populations established at the Stockholm Council and thereafter incorporated in the 2002 broad economic policy guidelines. The three prongs are: raising employment rates, reducing public debt levels, and reforming pensions systems themselves. The aim is to contain pressures on public finances and place pension systems on a sound financial footing. The measures taken by the Member States include, in particular, limiting the flow into early retirement schemes, increasing incentives for lengthening working lives and retiring later, and increasing future budgetary margins by reducing public debt or building up public pension reserve funds.

The responsibility for designing and managing pension systems remains with the Member States, in accordance with the principle of subsidiarity. While there is no intention to change this, it is now widely accepted that the adequacy and sustainability of pension systems have implications that go beyond national borders. Ageing populations represent a major challenge for future public finances

(2) Quality and viability of pensions — Joint report on objectives and working methods in the area of pensions.

in view of the fact that a share of around one tenth of the EU's GDP is currently devoted to public spending on pensions.

However, ageing is also a major challenge for the ability of pension systems to meet their social objectives, namely to provide adequate and fair incomes to older people and prevent poverty in old age. From a European point of view, it is also important to ensure that increasing numbers of migrant workers who have earned entitlements to pensions in different Member States can rely on receiving the benefits they were promised and will not have to claim social assistance in their country of residence.

As requested by the Stockholm and Barcelona European Councils, the impact of rising age-related expenditures on public finances is assessed in the framework of the Stability and Growth Pact. Each year, Member States submit their stability and convergence programmes, which provide targets for achieving the long-term sustainability of public finances. In addition, the Laeken European Council, which endorsed the working methods and common objectives for the open method of coordination of pensions, states that this latter process 'takes its place alongside a range of existing, well functioning EU processes which, as part of their wider remit, deal with aspects of pension policies'. Moreover, it requires that this process 'does not change the respective responsibilities of policy-makers at European and national level'. The open method of coordination launched at the Laeken European Council establishes an integrated framework which will take into account the existing policy coordination activities in other areas (economic policy, public finances and employment, in particular) and feed its results into the further development of these other processes.

A major benefit of this new cooperation will be to promote mutual learning. Member States are faced with many similar problems — and most of all the common challenge of ageing populations. Far from imposing constraints on national policy-makers, the open method of coordination will increase their ability to assess their relative performance, raise awareness of other policy options and promote a better understanding of the advantages and problems of these different options.

This report is the first comprehensive analysis of national strategies in the area of pensions and presents how Member States are responding to the challenge of population ageing while taking into account the three broad goals of adequacy, sustainability and modernisation.

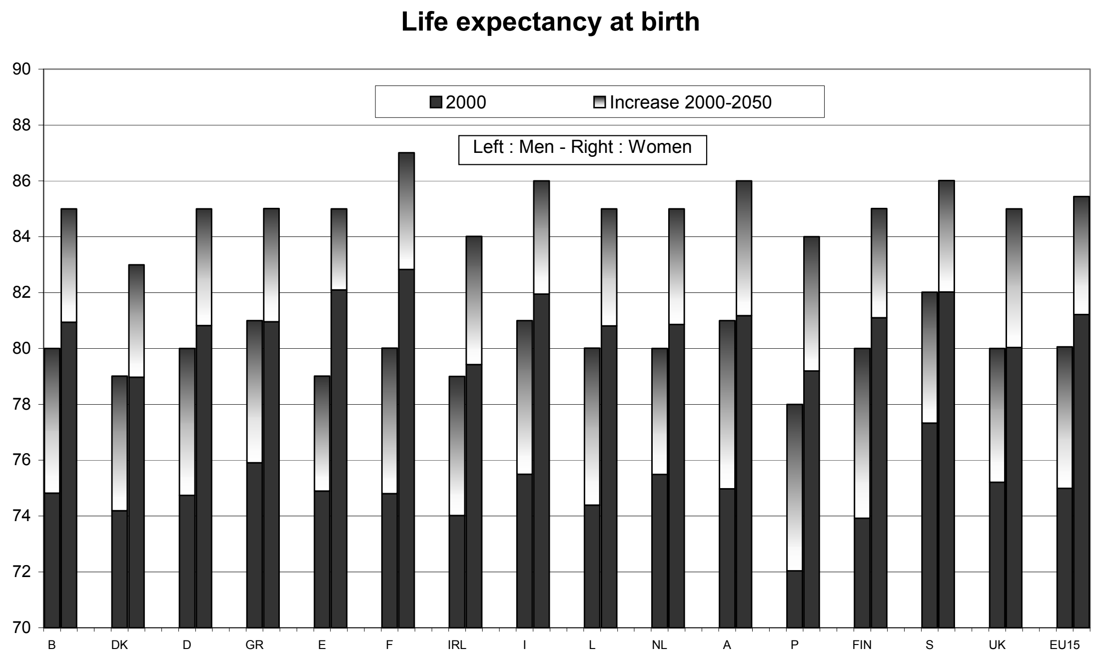
2. THE CHALLENGE OF POPULATION AGEING: DEMOGRAPHIC TRENDS AND PUBLIC PERCEPTIONS

2.1. Population ageing

Over the coming decades, the EU will face a significant acceleration of demographic ageing due to three main factors: (i) the baby-boom generation reaching retirement age, (ii) continuing increases in life expectancy, and (iii) decreased fertility since the 1970s. The first of these factors will create a temporary demographic imbalance, while the effects of the two other factors are continuous. However, all three factors combine to produce a major financial challenge for pensions systems over the coming decades when the number of pensioners will rapidly increase and the size of the working-age population will diminish. There is a risk that the resulting increased old-age dependency ratio will place an unsustainable financial burden on the active population in the future, while at the same time adversely affecting Europe's economic growth potential.

It is expected that, by the year 2050, Europeans will live at least four to five years longer than today (see Chart 1 below). Given that today's remaining life expectancy at 65 is about 15.5 years for men and 19.5 for women, an increase of five years will raise the cost of providing the same pension level by 25 to 30 %. This, however, is only about half of the demographic challenge that Europe has to prepare for. The other major change stems from the fact that large cohorts born after World War II, the baby-boom cohorts, will reach retirement age and subsequent cohorts are much smaller as a result of lower birth rates. This can be seen from Europe's population pyramid (see Chart 2) where people between 35 and 55 are currently very numerous. In the coming 10 to 15 years, these large cohorts will start retiring and drawing their pensions.

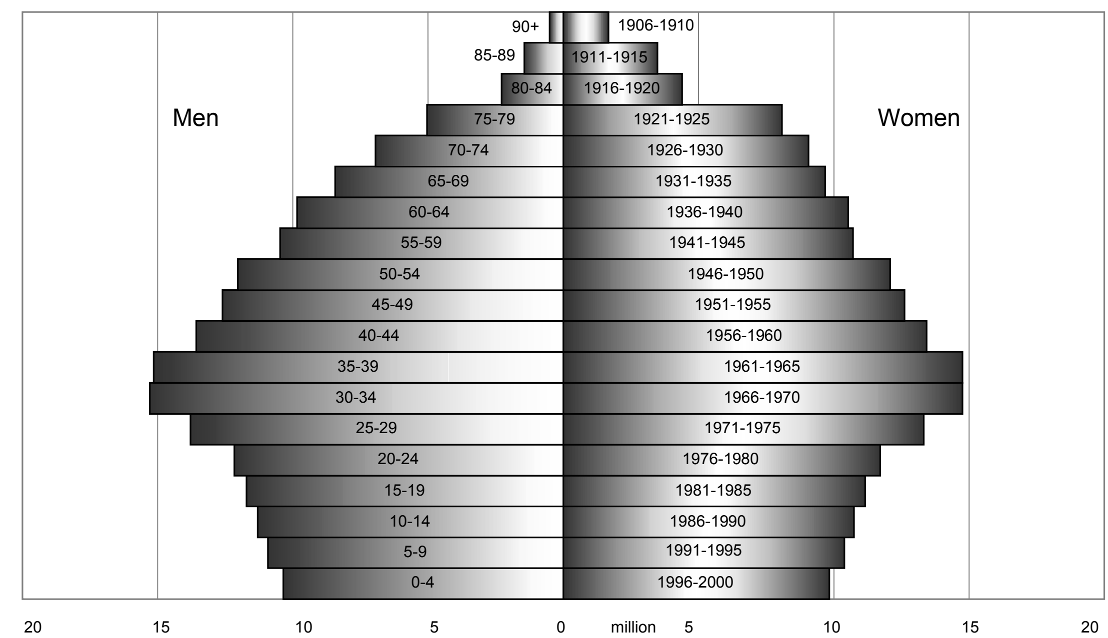
Chart 1



Source: Eurostat population projections — Baseline scenario.

Chart 2

Population Pyramid in 2000, EU-15

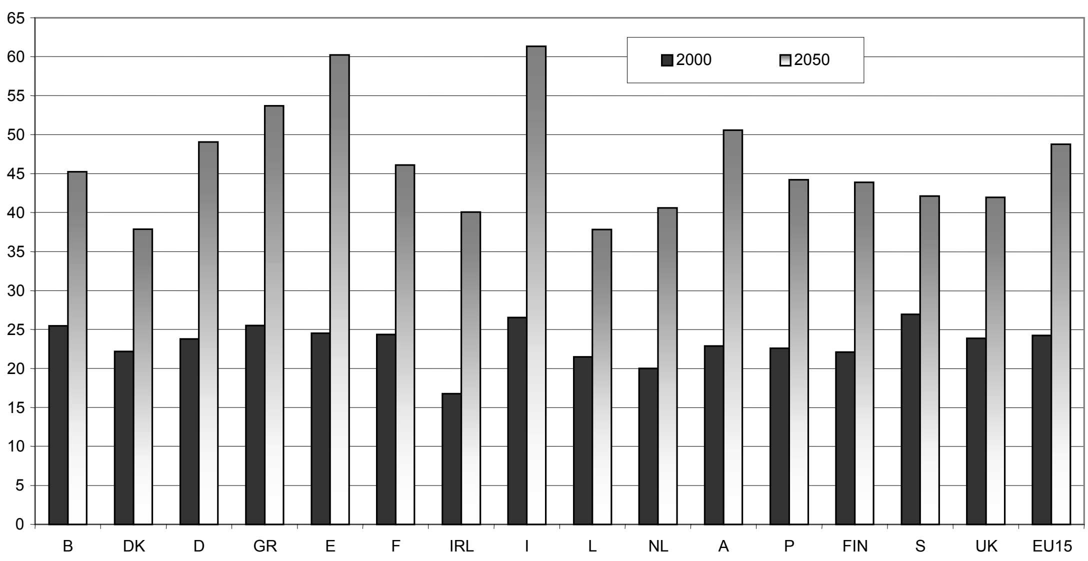


Source: Eurostat population projections — Baseline scenario

The combined effect of large cohorts reaching retirement age and rising life expectancy will be a doubling of the old-age dependency ratio, i.e. the number of people of retirement age (65+) in relation to the working-age population (15–64). In the year 2000, the over-65s represented about one quarter of the working-age population; by 2050, it will be nearly 50 %.

Chart 3

Old-age dependency ratio [1)]



1) Number of people aged 65 years and over as a percentage of people aged 15–64. *Source:* Eurostat, Population projections — Baseline scenario.

The Stockholm European Council in March 2001 addressed the demographic challenge of an ageing population in which people of working age will constitute a smaller part of the total population. It stated that ‘the number of retired women and men will increase rapidly, while the share of the working-age population will start to diminish by 2010. This will create substantial pressure on social welfare systems, in particular pensions, healthcare systems and care for the elderly (3). The union and Member States are acting now by defining new approaches […]. The coming decade offers an opportunity to address the demographic challenge by raising employment rates, reducing public debt and adapting social protection systems, including pension systems.’

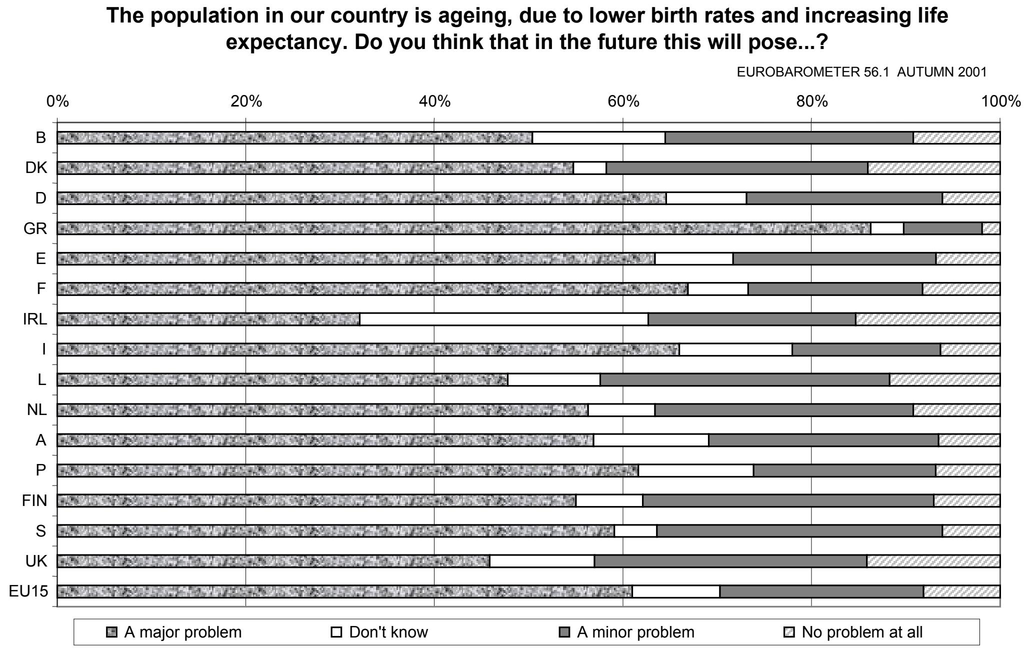
2.2. Public perceptions

The following paragraphs present some results of an EU-wide opinion survey (Eurobarometer 56.1 (4)), carried out for the Commission in the autumn of 2001 to gauge public perceptions regarding the future of the pension systems. Questions asked in such surveys have to simplify the issues involved and cannot explain all the implications of various policy options. Thus, the results of such surveys can inform policy-makers of the general level of problem awareness and the need for further public debate, but they cannot be used as a basis for making policy choices. This Eurobarometer survey suggests that the potential impact of demographic developments on pension systems causes serious concern in all Member States. Awareness of the problem has been growing, both among policy-makers and citizens (see chart below).

(3) The Commission will examine the issues of accessibility, financial sustainability and quality of health and long-term care systems for the elderly in a separate communication.

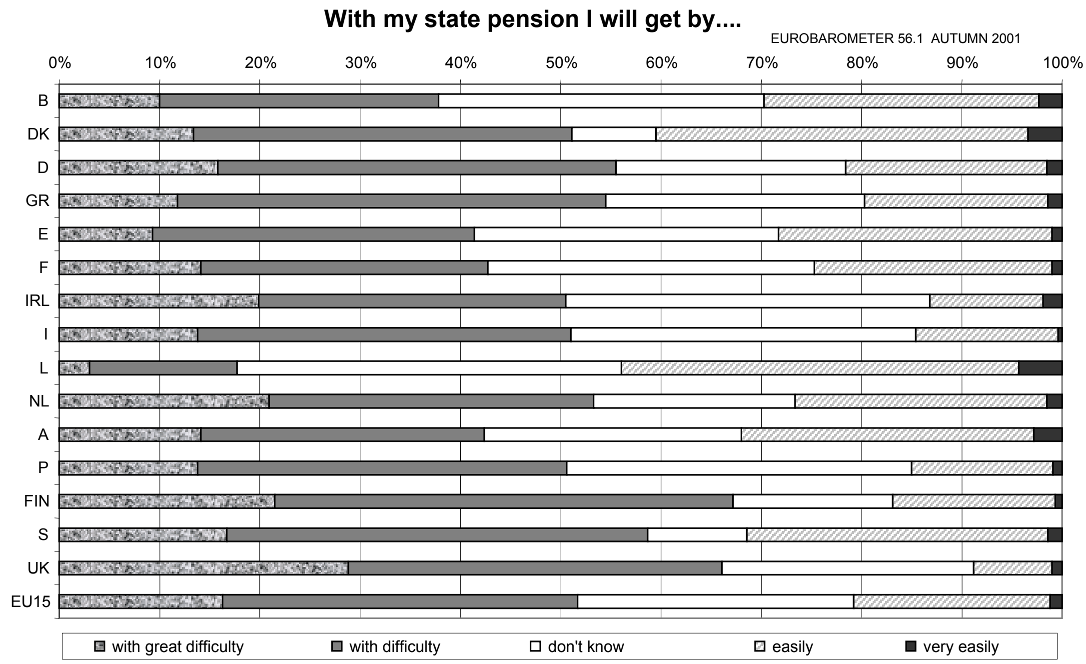
(4) The Commission announced its intention to carry out a survey on pensions and pension reform in its communication of 11.10.2000 on ‘The future evolution of social protection from a long-term point of view: safe and sustainable pensions’ (COM(2000) 622 final). The aim was to gauge public awareness and expectations regarding the modernisation of pension systems. This section only presents a small selection of results that are particularly relevant in the context of this report. A more comprehensive analysis of the results is forthcoming. Questions were presented to representative samples of the population aged 15 years and over in each Member State. The regular sample in standard Eurobarometer surveys is 1 000 people per country except in Luxembourg (600) and in the United Kingdom (1 000 in Great Britain and 300 in Northern Ireland).

Chart 4



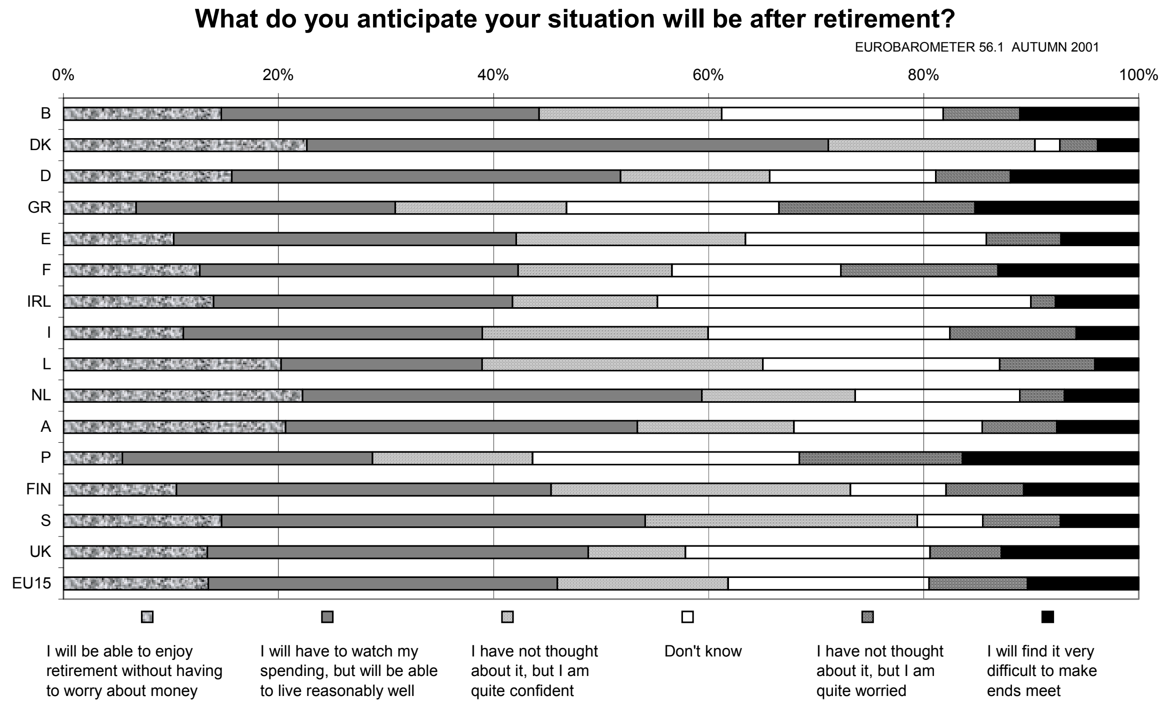
Awareness of these demographic challenges, which are mainly seen as a problem for public pension schemes, probably leads many Europeans to take a rather pessimistic view of their future State pension entitlements. A majority of Europeans expects to have some difficulties getting by on their State pension, and there is a large proportion of people who have no clear idea on what to expect: nearly 30 % of the people interviewed responded ‘Don’t know’.

Chart 5



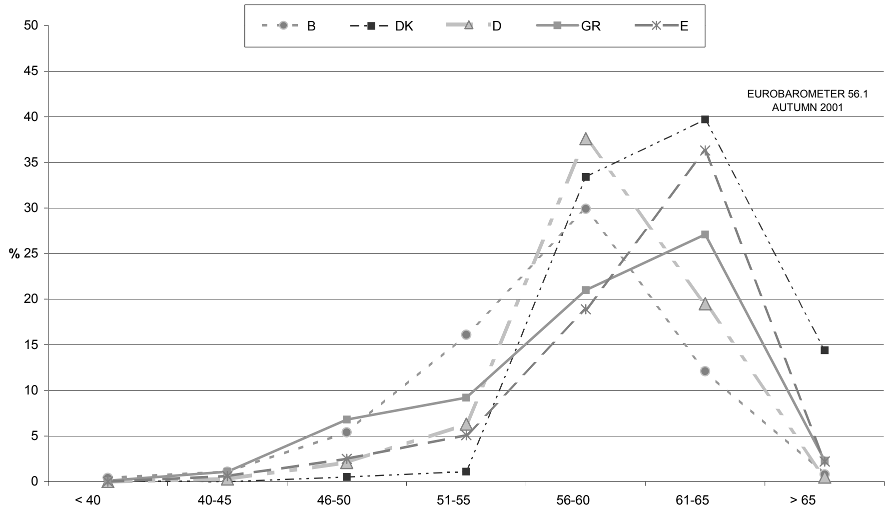
The results may reflect doubts about the future viability of statutory pension schemes and a lack of confidence in government policies, but also, at least in some countries, some confusion about what is meant by 'State pension'. In any case, confidence is fairly high regarding the financial situation after retirement which depends not only on income from different pension schemes, but also on other factors such as savings and home ownership. This more general question on people's anticipated situation after retirement shows that about 20 % of Europeans are worried about their situation after retirement, whereas more than 60 % express confidence. The highest levels of confidence can be observed in the Nordic countries. It is also interesting to note that fewer people responded 'Don't know' to this question on the overall situation after retirement.

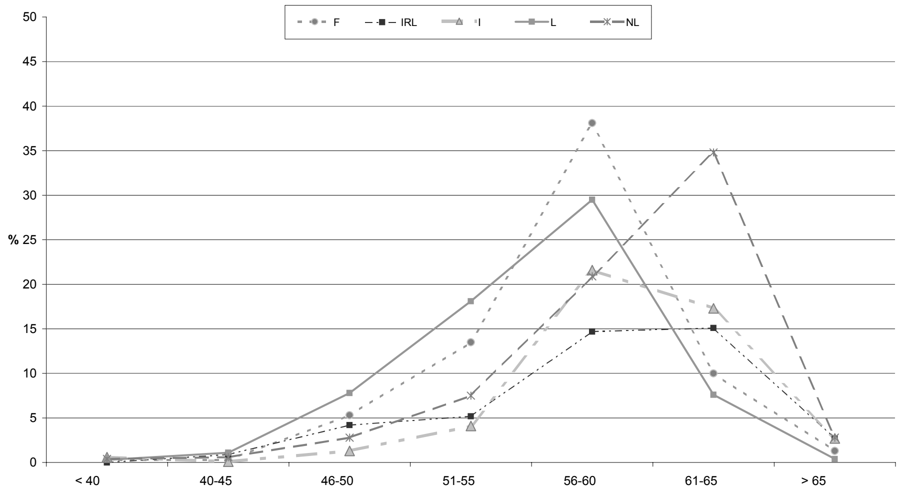
Chart 6

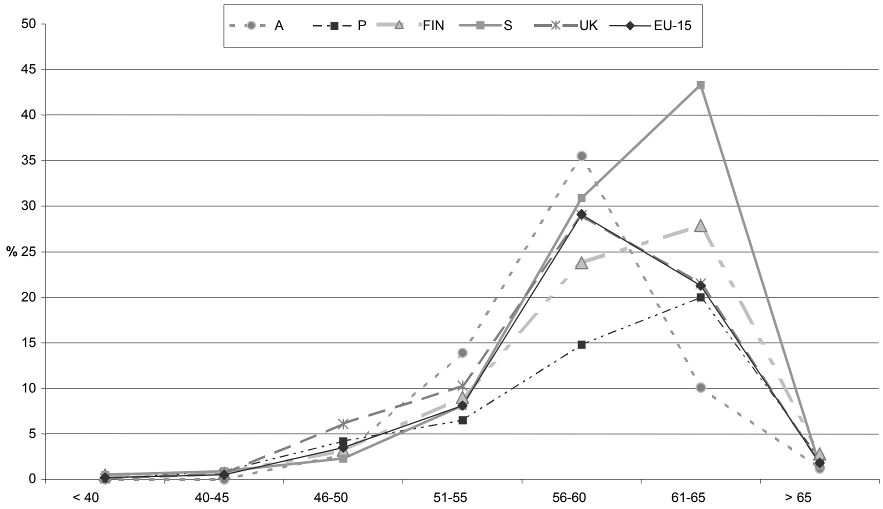


An obvious policy response to increased life expectancy would be to raise the retirement age so that the balance between time spent working and time spent in retirement remains unchanged. This would make it possible to maintain adequate pension levels without having to raise contributions or tax rates to finance pension schemes. It may not be necessary to raise the statutory pensionable age which is typically 65 years in most Member States. In practice, only a minority of people stay on the labour market until they reach the statutory pensionable age. Most Europeans intend to retire between 56 and 60, and very few expect to be still on the labour market after age 65 (see Chart 7).

Chart 7 At what age do you intend to retire?

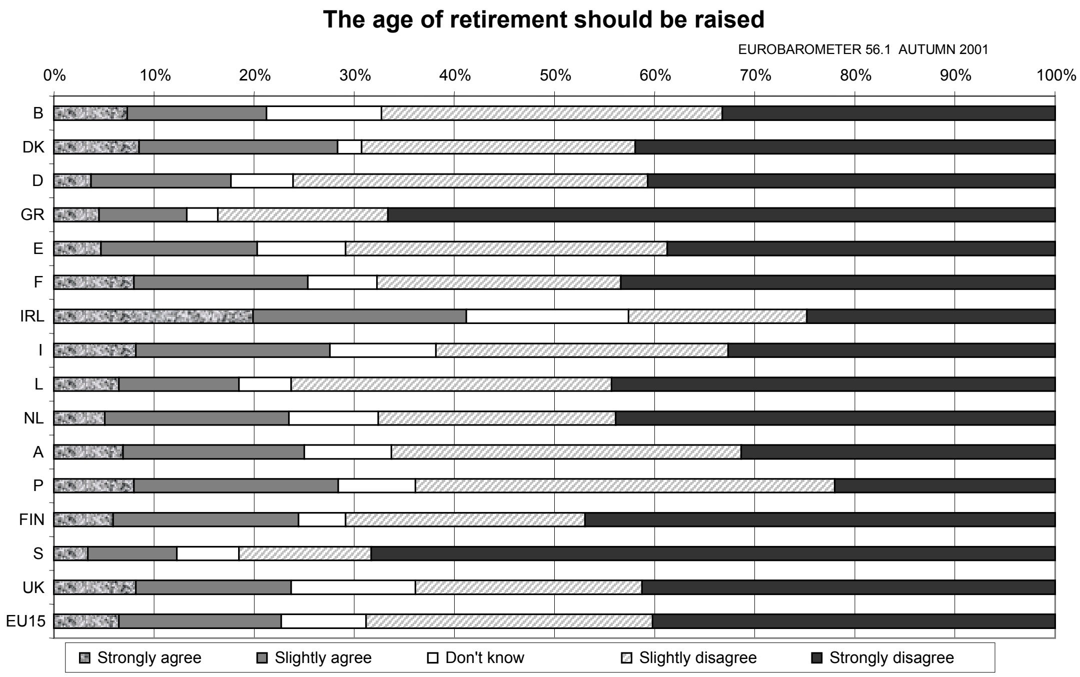






Changing attitudes with regard to retirement practices will be a major challenge for policy-makers. Clearly, raising the statutory pensionable age will not be a popular policy response to the challenge of demographic ageing: fewer than a quarter of Europeans would support such a move (see Chart 8). However, one should note that the question did not specify the time horizon for a possible rise in the statutory pensionable age or refer to rising life expectancy.

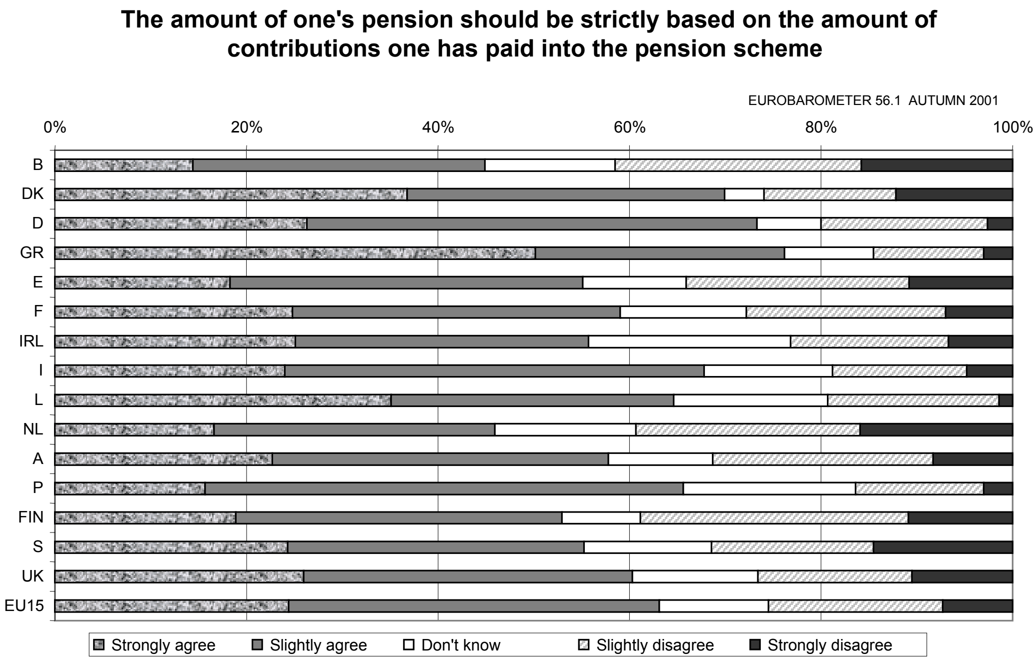
Chart 8



Maintaining the current standard retirement age does not mean that one cannot raise the effective labour-market exit age and bring it closer to the statutory pensionable age. It is also worth pointing out that the average retirement age was higher in the 1960s than it is today, even though, at the time, remaining life expectancy at 65 was much lower and the health status of people aged 65 less good than it is today or than it is likely to be in a few decades.

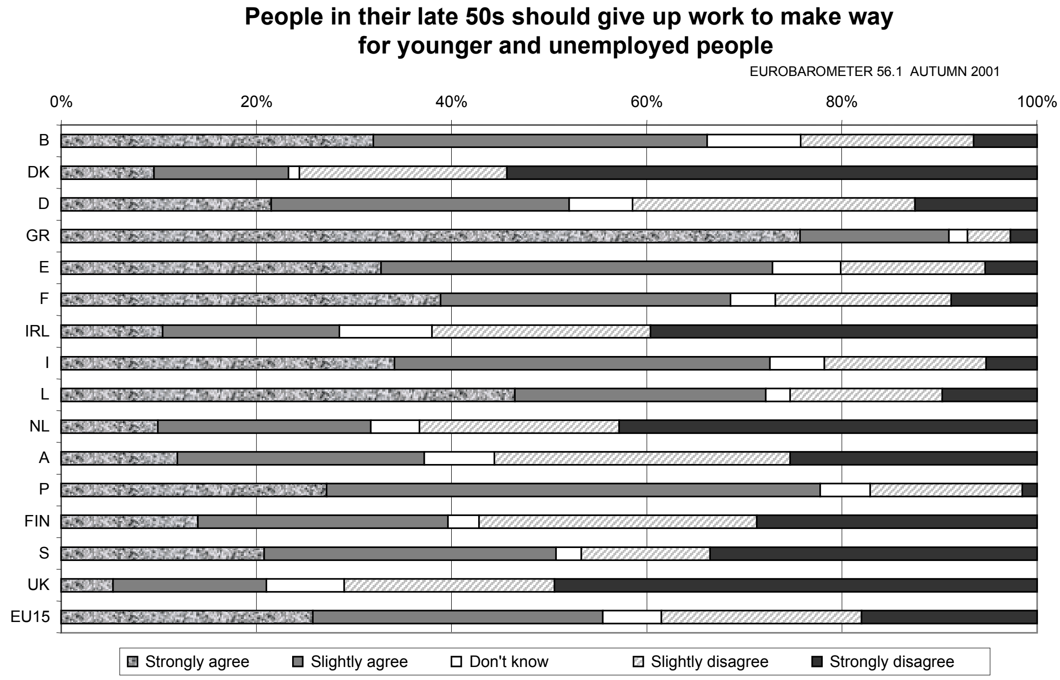
Raising the effective retirement age requires that incentives for longer labour-force participation be built into pension schemes. This can take the form of a close actuarial link between contributions and benefits, an idea that is, in principle at least, supported by public opinion (see Chart 9).

Chart 9



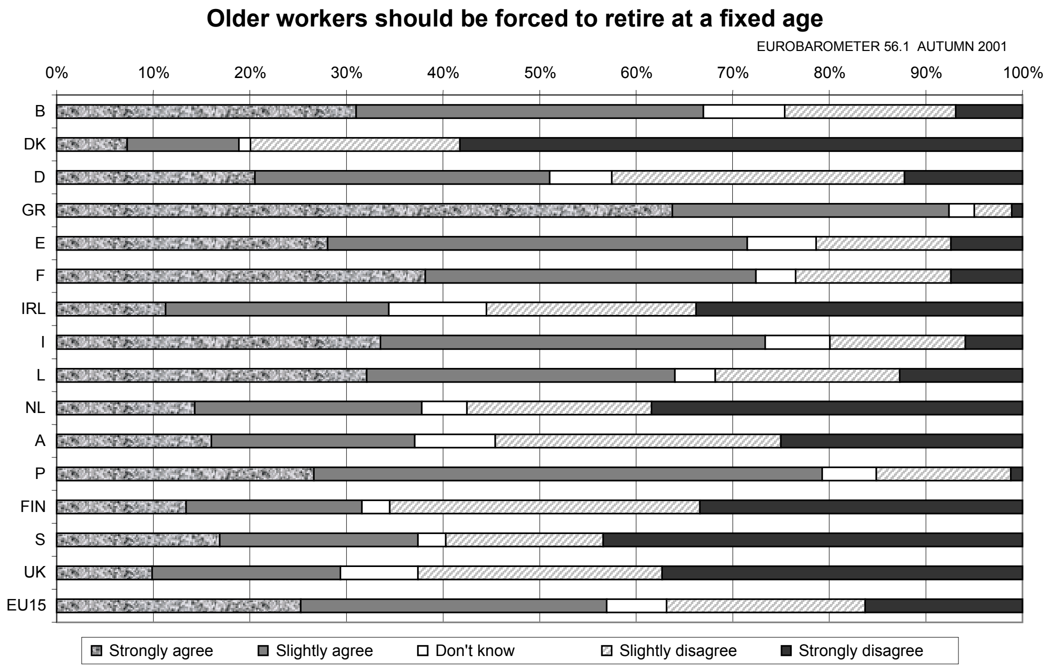
At the same time, the view that older workers should make room on the labour market for younger and unemployed people is still widely held. The ‘lump-of-labour’ fallacy, i.e. the idea that there is a given number of jobs that needs to be shared in as fair a manner as possible still appears to be deeply rooted in public opinion. But this is certainly not the case everywhere. In Denmark, the Netherlands, the UK and Ireland, where public awareness of age discrimination recently has been raised by large debates and government agency campaigns, the majority is equally emphatic in their **dis**agreement with the proposition. Since it is not so long ago that attitudes in these countries were similar to those presently held by the majority, it would appear that sentiments can develop and change when people, over a sustained period, are exposed to debates on these issues.

Chart 10



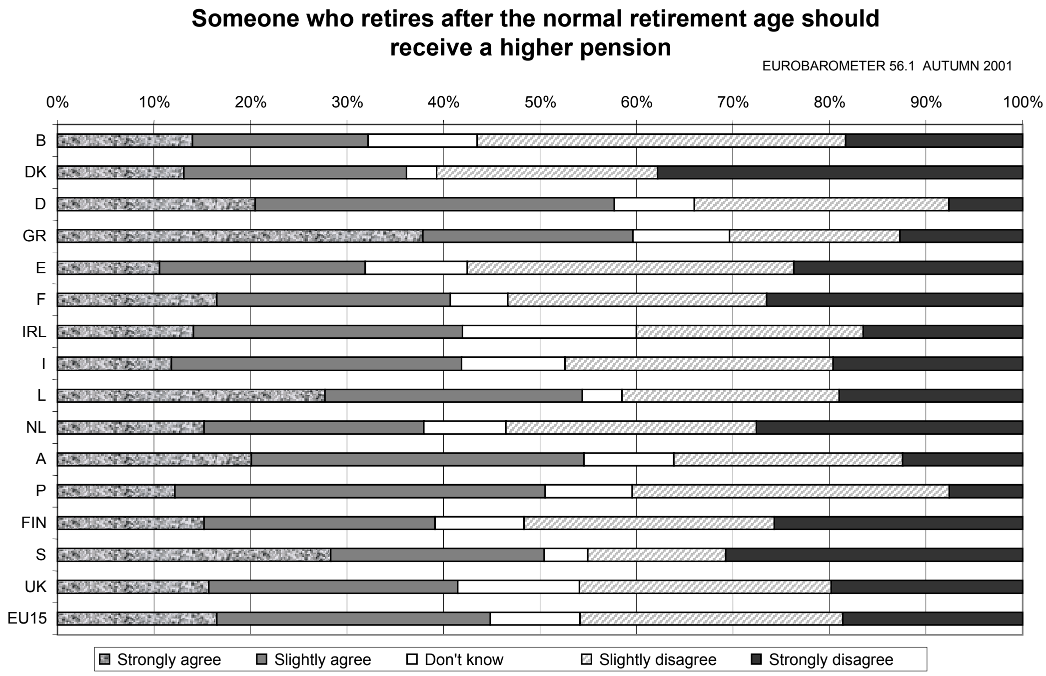
A majority of Europeans also still thinks that retirement should be mandatory at a fixed age, but again opinions differ considerably between Member States. The case of Italy is interesting: there appears to be strong support for mandatory retirement, but this did not prevent the government to introduce (over a long transition period) a highly flexible system where individuals have a large degree of freedom to decide when they want to retire and to determine their pension level through the choice of the moment when they retire.

Chart 11



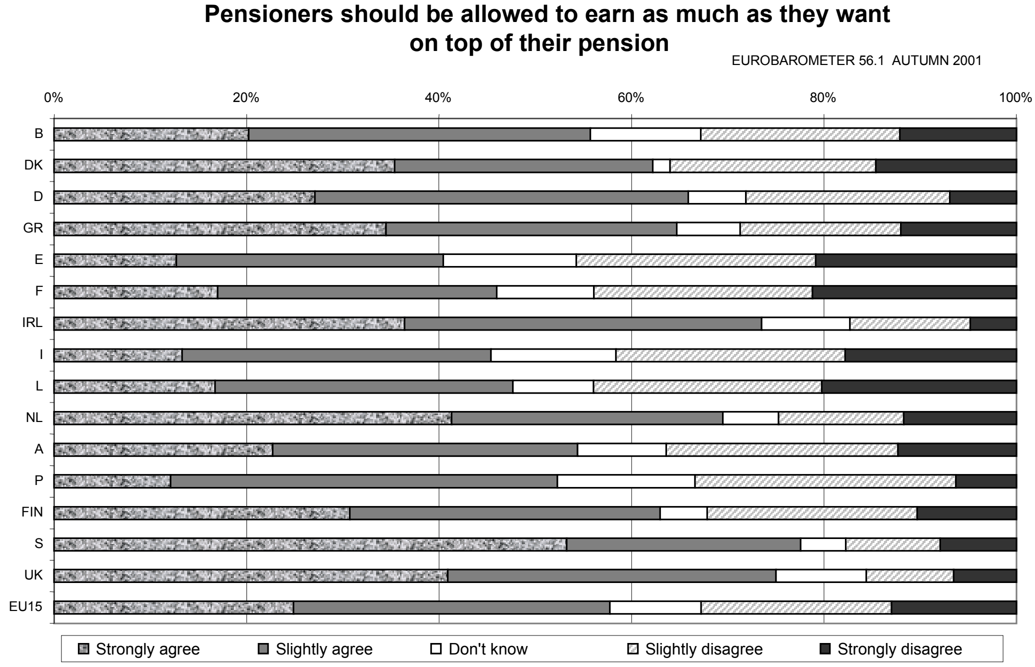
Earning additional pension entitlements by postponing one's retirement can be an important way of ensuring that pension provision remains adequate in a context where replacement rates are being reduced in response to a less favourable balance between the active and the retired. However, this idea, which is already being implemented in some reformed pension systems, is not yet widely accepted by public opinion (see Chart 12).

Chart 12



The idea that pensioners should be allowed to earn some income in addition to their pension — another way of encouraging labour-market participation of older workers and of ensuring better living standards for pensioners — is more widely accepted, but there is still a significant proportion of Europeans who think that it should not be possible to combine income from work with a pension (Chart 13).

Chart 13



These highlights from the Eurobarometer survey appear to indicate that public attitudes in several Member States lag behind a reform process that is already well engaged. Creating greater awareness of what reform measures are needed and what the benefits from these to older workers, pension contributors and pensioners can be should therefore be a priority, particularly as far as the link between employment and pension systems is concerned.

3. ADEQUACY

Pension systems are one of the major social achievements of our time. They have successfully reduced the risk of poverty in old age, so much so that older people are often less at risk of living in poverty than younger people. Pension systems are also an important feature of modern economies. They make the elderly economically independent of their descendants, allowing people of working age to be more mobile than if they lived in traditional three-generation households.

Thanks to improved health and longer life expectancy most people can enjoy their old-age pension at an age when they are still fit and healthy. Thus, retirement is regarded as an important reward at the end of one's working life, enabling people to start new projects and to change their lifestyle.

Although pension systems differ considerably from one Member State to another, all Member States pursue similar social goals as outlined in the joint report to Laeken on quality and viability of pensions: prevent poverty among the elderly; allow people to maintain, to a reasonable degree, their living standard after retirement; and promote solidarity within and between generations.

3.1. Objective 1: preventing social exclusion

Ensure that older people are not placed at risk of poverty and can enjoy a decent standard of living; that they share in the economic wellbeing of their country and can accordingly participate actively in public, social and cultural life ([5]).

3.1.1. Minimum pension guarantees

An important feature of European welfare systems is the existence of provisions to guarantee a minimum level of resources. In the case of working-age people, there may be a concern with how such means-tested social assistance schemes interact with the incentive to work. In the case of people above the retirement age, there are no such concerns, although care must be taken to ensure that means-tests applied to pensions do not weaken incentives to save and work before retirement. It is generally more accepted that older people receive a guaranteed income from the state than younger people who could be expected to earn a living for themselves.

Consequently, older people generally enjoy a better level of minimum protection than working-age people. Denmark and the Netherlands provide a universal, non-means-tested flat-rate pensions linked (indirectly in the case of NL) to earnings to all persons who have been residents at working age. The new Swedish pension system includes a guarantee pension that is only means-tested against income from the statutory earnings-related pension scheme. In other countries, tighter means-tests may apply to such top-up benefits designed to raise incomes to the guaranteed minimum level. However, comprehensive means-tests may act as a disincentive to save for ones own retirement. The UK is addressing this problem with the new 'Pension credit', a means-tested entitlement that allows people to combine income

([5]) In this respect, benefits and tax advantages other than pensions should also be taken into account where appropriate.

from their pension saving with means-tested benefits so that their income rises above the guaranteed minimum. In Ireland, the expansion of social insurance coverage throughout the 1970s and 1980s means that reliance on means-tested benefits is diminishing.

It is important to stress the subsidiary nature of many of these schemes. Pension systems are generally designed to **prevent** poverty in old age, rather than alleviating it, by ensuring that everyone builds up sufficient entitlements in public and/or private schemes to remain financially independent of their relatives or public social assistance. The minimum guarantee schemes generally act as an ultimate social safety net for those with incomplete careers (e.g. women, immigrants) or very low earnings during their working lives. Germany, France and Austria stress that the number of people relying on minimum provisions declined substantially over recent decades as a result of better pension entitlements earned in the pension system. Greece and Italy report the opposite trend, but this is due to the fact that the minimum amounts were raised.

Table 1 below illustrates the diversity of minimum income guarantees in the Member States; however, comparisons are difficult in view of the different modalities of such mechanisms — sometimes even within a given country. In some countries, the minimum income guarantee takes the form of a flat-rate benefit that is awarded after a full contribution career (UK, IRL) or on the basis of residence (NL, DK). A majority of Member States offer top-up payments to raise earnings-related pension entitlements to a specified minimum level. These mechanisms are usually sufficient to provide an adequate minimum except for people with incomplete insurance careers or people who have not been residents in the country for long enough. In such cases, fully means-tested social assistance benefits are available.

Table 1: Minimum income guarantees for older people

Minimum income guarantees for older people				
	Type of income guarantee	**Amount** (1)	**Means-test**	**Beneficiaries** (2)
	Minimum pensions (minimum 30 years insured full-time employment)	Depends on career length. Max. per year for salaried worker: EUR 11 793.71 (household) or EUR 9 438.10 (single), for self-employed worker: EUR 9 401.16 (household) or EUR 7050.60 (single). Automatic price indexation.		1/3 of pensioners.
B	Minimum pension entitlement for each career year (minimum 15 years of employment; at least 1/3 of full-time)	Calculated on the basis of minimum guaranteed pay for a 21-year old (EUR 1 163.02 per month).	Entitlement only if total monthly pension does not exceed EUR 1 084.53 (household) or EUR 867.63 (single).	
	Social assistance for the elderly over 62 (65 from 2009 onwards) (GRAPA)	Per year single EUR 7 163, Couple EUR 4775.40 (per individual). Linked to prices (discretionary adjustments possible every two years).	Household income and wealth.	
DK	Residence-based State pension *(Folkepension)*	Linked to private sector earnings. Single: EUR 14 190. Living in a couple: EUR 10 390 per year.	The basic amount is reduced on the basis of income from work earned by the beneficiary. The pension supplement is reduced on the basis of total earnings.	99 % of all pensioners.

Minimum income guarantees for older people				
	Type of income guarantee	**Amount** ([1])	**Means-test**	**Beneficiaries** ([2])
	Supplementary pension (ATP)	EUR 2 732 per year for full-time employment and after having paid contributions since 1964.	No	68 % of all pensioners.
D	Social assistance for the elderly	Around EUR 7 500 per year.	Income and wealth of beneficiary and partner	Around 186 000 in 2000.
GR	Minimum pensions (different from fund to fund) and dependent on insurance period (before or after 1.1.1993). Pension supplement given subject to a means-test (EKAS) for all non-rural pensioners		Top-up of low pensions to minimum level without means test. Means-tested pension supplement.	Primary IKA pension: some 70 % of pensioners receive the minimum pension.
	Basic pension (equal to the rural pension) for all uninsured people over 65		Yes, for uninsured people.	700 000 individuals for OGA pension; 34 000 for the uninsured.
E	Guaranteed minimum contributory pension for persons having contributed for at least 15 years	>65 years: EUR 385.50 per month or EUR 453.98 per month with dependant spouse (14 payments per year, i.e. EUR 5 397 and 6 356 respectively). <65 years: EUR 343.87 per month or EUR 406.16 per month with dependant spouse (14 payments per year i.e. EUR 4 814 and 5 686 respectively).	Yes.	20 % of pensions paid by the general scheme in 2001 (25 % in 1995).
	Non-contributory pension ‘social wage”	EUR 258.68 (14 payments per year, i.e. EUR 3 621).	Yes.	Around 470 000 in June 2002.
F	Old-age minimum (*minimum vieillesse*) for people over 65	Single: 6 835 EUR Couple: 12 257 EUR per year.	Yes.	Around 766 000 in 2000.
IRL	Contributory flat-rate old-age pension	Single: EUR 147.30 per week (EUR 7 660 per year).	No.	60 % of new pensions (expected to rise to 86 % by 2016).
	Non-contributory flat-rate social welfare pensions for people aged 66+	Single: EUR 134 (weekly, EUR 6 968 per year) to be raised to EUR 200 by 2007 (EUR 10 400 per year).	Yes.	40 % of new pensions.
I	Minimum pension supplement (*integrazione al trattamento minimo*)	EUR 5 104 per year.		About 39 % of people over 65.
	Minimum pensions for older people on low incomes	EUR 6 713.98 per year.		About 1.8 million people.
	Old-age benefit for people over 65 without any other income (*assegno sociale* and *pensione sociale*)	EUR 4 557.41 per year plus age-dependent top-up.	Yes.	About 6.2 % of people over 65.
L	Minimum pension (depending on number of insurance years; full amount after 40 years)	EUR 1 190 maximum per month (EUR 14 280 per year).	No.	15.4 % of all pensioners in 2000.
	Guaranteed minimum income	Single: EUR 942 per month (EUR 11 304 per year). Couple: EUR 1 413 per month (EUR 16956 per year).	Yes.	0.9 % of all pensioners in 2000.
NL	Residence-based State pension	Single person: EUR 869/ month (EUR 10 428 per year). Married and unmarried persons, both 65 and over (also 2 men or 2 women sharing a household): EUR 598/ month for each person. (EUR 14 352 per year for the couple).	None.	100 % (of those with full residence records).
A	Minimum pension (‘compensation supplement’)	Single: EUR 630 Couple: EUR 900 (monthly, 14 payments per year, i.e. EUR 7 560 and 10 800 per year).	Pension and other income.	11.6 % of pensioners in mid-2002 (14.4 % in 1989).
P	Minimum pension (percentage of the minimum wage net of social insurance contribution. Level depends on career length.	65–100 % of net minimum wage.	No.	58.8 % of pensioners in the general scheme (invalidity and old-age).

Minimum income guarantees for older people				
	Type of income guarantee	**Amount** (1)	**Means-test**	**Beneficiaries** (2)
	Non-contributory social pension	EUR 138.27 (14 payments per year (plus EUR 13.17 if the pensioner is less than 70 years old and EUR 26.34 otherwise i.e. EUR 2 120 per year below age 70, EUR 2 305 above).	Yes.	101 914 invalidity and old-age pensioners.
	Minimum integration income (social assistance)	Percentage of the social pension, depending on household earnings and composition.	Yes.	Around 12 500 men and 13 500 women.
FIN	Residence-based national pension	Single: EUR 467.32 (5 608 per year). Spouses: EUR 411.75 (9 882 per year per couple).	Means-tested against other pension income only.	Full amount: 10 % of pensioners. Means-tested supplements for 55 % of pensioners.
	Social assistance	Mainly as a supplement to low pensions for exceptional expenses.	Yes.	5–6 % of people aged 65 and over.
S	Residence-based guarantee pension for people aged 65+	Single: SEK 82 200. Couple: SEK 146 600 per year.	Only public earnings-related pension taken into account.	
	Maintenance support for elderly persons aged 65+ (social assistance supplemented by housing allowance)		All other incomes, wealth.	
UK	Basic State pension	GBP 75.50 per week in 2002/3 (GBP 3 926 per year).	No.	98 % of pensioner units have income from it (in 2000/1).
	Minimum income guarantee for people aged 60+ (income support, social assistance)	Single: GBP 98.15 (GBP 5 104 per year). Couple GBP 149.80 per week in 2002/03 (GBP 7 790 per year per couple).	Yes, but with higher capital disregards than for beneficiaries of income support.	Over 2 million pensioners out of 11.5 million benefit from the minimum income guarantee.
	Pension credit for people over 65 (will replace the minimum income guarantee as from 2003)	Single: GBP 102.10 (GBP 5 309 per year). Couple GBP 155.80 per week (GBP 8 102 per year per couple) Increased in line with earnings.	Yes, but more generous disregards for wealth and a gradual reduction of benefits against other pensions.	Up to 50 % of households over 60.

(1) The minimum income guarantee levels are not comparable for different Member States. Non-cash benefits and the provision of housing benefits (not included in the amounts in this table) have considerable effects on the effective minimum income guarantee provided to older people.
(2) The numbers or shares of older people/pensioners in this columns do not necessarily refer to people who can **only** rely on the minimum income level. Actual incomes will be higher depending on the type of means test associated with the minimum benefit. In particular, in countries with universal flat-rate benefits, the share of beneficiaries will be high, but most will receive income from other sources in addition to the guaranteed public pension.

3.1.2. *The risk of poverty among older people*

Several of these minimum income guarantee schemes were introduced only recently or are in the process of being introduced. Member States also report efforts they have made recently to raise minimum protection levels for the elderly. This should be borne in mind when analysing the results of the European Community Household Panel (ECHP). The latest available data were collected in 1999 and reflect the income situation in 1998.

EUROPEAN INCOME DATA: METHODOLOGY AND LIMITATIONS

The relative income situation of older people in the European Union and their risk of living in relative poverty are analysed in this report on the basis of data collected through the European Community Household Panel (ECHP). These data need to be interpreted carefully. They do not capture some important determinants of older people's living standards such as benefits in kind, home ownership (imputed rent) and wealth. This may particularly affect comparisons of poverty risks between younger and older people. The limited sample size and the fact that data are collected through interviews may also lead, in some cases, to significant discrepancies between ECHP data and national data. These are presented in footnotes where appropriate. It should also be noted that people living in institutions — most of whom are elderly — are not covered by the ECHP.

Sampling

The ECHP is a survey based on a standardised questionnaire that involves annual interviews of a representative panel of households and individuals in each country, covering a wide range of topics: income, health, education, housing, demographics and employment characteristic, etc. The total duration of the ECHP was eight years, running from 1994 to 2001. In the first wave, i.e. in 1994, a sample of some 60 500 representative households — i.e. approximately 130 000 adults aged 16 years and over — were interviewed in the then 12 Member States. Austria (1995) and Finland (1996) joined the project since then. Data for Sweden are available from 1997, and were derived from the Swedish living conditions survey and converted into ECHP format. In the United Kingdom, Luxembourg and Germany, the ECHP survey was stopped in 1997 and data from an existing national panel (i.e. BHPS, PSELL and SOEP respectively) were converted into the ECHP format to provide data for all subsequent waves.

The sample for the latest available year, i.e. 1999, included nearly 64 000 private households (approximately 131 000 persons) in the now 15 Member States. The sample sizes vary considerably from country to country, ranging from 2 552 interviewed households in Luxembourg to 5 418 in Greece and 5 847 interviewed households in Germany. Attrition, i.e. the loss of respondents over the life of a survey, was quite high in Ireland, Denmark and Spain, where the sample sizes between 1994 and 1999 fell from 4 048 to 2 378 interviewed households in Ireland, 3 482 to 2 387 interviewed households in Denmark, and from 5 523 to 3 986 interviewed households in Spain. Thus, the sample size of the ECHP survey may not yield an accurate reflection of the situation of smaller subgroups.

Income measurement

The income concept used in the analysis below is the equivalised disposable income. This is defined as the household's total disposable income divided by its 'equivalent size' to take account of its size and composition. The equivalence scale is the OECD modified scale, which counts the first adult (i.e. person aged 14 or over) as 1.0, each other adult as 0.5 and each child aged under 14 as 0.3. For instance, a household of one adult is equivalent to 1, a household of two adults is equivalent to 1.5, and a household of two adults and two children (under 14 years) is equivalent to 2.1.

Limitations

ECHP data on disposable income are based on information provided by respondents, rather than from administrative registers or other sources. The ECHP income data do not reflect the positive impacts of home ownership (as imputed rent) or negative impacts of interest payments on mortgage and other loans on disposable income, nor do they include benefits in kind. Thus, they do not capture several major determinants of living standards. Only positive capital income other than imputed rent is included in net disposable income. This distorts income comparisons between households with debt and those with positive wealth. If younger households are more likely to be indebted, the omission of interest payments will tend to overestimate their income compared to that of older households. In addition, the omission of imputed rent, i.e. the money that one saves on rent by living in one's own accommodation, is also likely to result in underestimated living standards of older households who will appear poorer than younger households and more at risk of poverty. For Denmark, it has been shown that the estimated risk of poverty among older people is up to four times greater when imputed rent and interest payments are not taken into account. People living in institutions are not covered by the survey. This may lead to higher poverty risks being observed in countries where frail elderly people are being cared within their families.

In view of these limitations of the ECHP data, reliable conclusions on the adequacy of pension systems cannot be drawn. The quality of income data and their timeliness must therefore be improved as a matter of priority. A new survey instrument, EU-SILC (survey on income and living conditions) is currently being developed.

Table 2: Relative poverty risks and relative income situation of older people in 1998 (ECHP sixth wave data collected in 1999)

	(a) At-risk-of-poverty rate, people aged 65 years and over							(b) At-risk-of-poverty rate at 60 % of median income: People aged 0–64, 65 years and over and 75 years and over			(c) At-risk-of-poverty rate at 60 % of median income: Difference between people aged 65 years and over and people aged 0–64			(d) Income of people aged 65 and over as a percentage of income of people aged 0–64			(e) Inequality of income distribution ([1])	
	50 % of median				60 % of median													
	Men	Women	Total	0–64 years	Men	Women	Total	0–64	65+	75+	Men	Women	Total	Men	Women	Total	0–64	65+
B	11	12	12	6	20	22	22	11	22	25	10	9	11	77	76	76	4.1	4.3
DK ([2])	10*(3.7)*	14*(6.0)*	12*(5.0)*	5*(3.3)*	26*(23.4)*	35*(25.9)*	31*(24.8)*	7*(6.8)*	31*(24.8)*	42*(31.0)*	19*(16.8)*	27*(18.9)*	24*(18.0)*	70*(77)*	66*(73)*	68*(74)*	2.9*(2.7)*	3.5*(2.6)*
D	5	6	6	6	9	13	11	11	11	12	– 1	2	0	98	96	97	3.5	3.6
GR	24	25	25	12	34	33	33	18	33	39	17	15	15	74	74	74	5.8	7.0
E	7	7	7	14	16	16	16	19	16	17	– 3	– 4	– 3	94	88	91	6.0	4.2
F ([3])	8	12	10	8	16	21	19	14	19	23	2	6	5	94	88	90	4.4	4.1
IRL	7	19	14	10	26	41	34	17	34	42	10	24	17	74	65	69	4.9	4.5
I	7	9	8	13	12	16	14	19	14	14	– 7	– 3	– 5	98	94	96	5.1	4.2
L ([4])	3	4	4	6	6	10	8	14	8	14	– 7	– 4	– 6	101	98	99	4.0	3.2
NL	4	5	4	6	7	7	7	11	7	8	– 4	– 5	– 4	98	89	93	3.7	3.7
A	8	12	10	6	15	29	24	10	24	31	6	18	14	90	81	84	3.6	4.1
P	18	25	22	12	30	36	33	18	33	39	12	17	15	80	73	76	6.4	5.8
FIN ([5])	1	8	6	5	9	23	17	10	17	20	0	13	7	86	74	78	3.4	2.9
S ([6])	2	3	3	5	6	10	8	10	8	12	– 4	1	– 2	92	78	83	3.2	2.9
UK	7	13	11	12	17	25	21	19	21	26	– 1	5	2	81	75	78	5.4	4.1
EU-15	7	10	9	10	15	19	17	15	17	19	0	3	2	92	86	89	4.6	4.1

Source: ECHP-UDB, Eurostat, version December 2002. Based on net disposable household income (excluding collective households). See box 'European income data: methodology and limitations'. The income concept used is the equivalised disposable income. This is defined as the household's total disposable income divided by its 'equivalent size' to take account of its size and composition. The equivalence scale is the OECD modified scale, which counts the first adult (i.e. person aged 14 or over) as 1, each other adult as 0.5 and each child aged under 14 as 0.3. For instance, a household of one adult is equivalent to 1, a household of two adults is equivalent to 1.5, and a household of two adults and two children (under 14 years) is equivalent to 2.1. It must be noted that income generated from owner-occupied housing or housing at below-market rents — i.e. imputed rent — as well as income in kind are not included in the definition of income. Moreover, while income from capital is taken into account, interest payments are not deducted from disposable income. This tends to understate the income situation of older people at least in Member States with high rates of home ownership.

([1]) Ratio of total income received by the 20 % with the highest income within a given population (top quintile) to that received by the 20 % of the same population with the lowest income (lowest quintile).

([2]) In the case of Denmark, calculations using national register-based data and the same income definitions as for ECHP data yield significantly lower poverty rates. National Danish data are derived from an official register-based sample of 176 626 individuals of which 26 322 persons are aged 65 years and above, whereas the ECHP data for Denmark are based on a sample of 3 983 individuals of which 642 are aged 65 years and over. Figures derived from the register-based sample and calculated according to the same methodology and income definitions used for ECHP data are included in brackets. According to national Danish calculations using an income definition including imputed rent and interest payments, the at-risk-of-poverty rates at 50 % of median income are: 1.1 (men), 0.9 (women) and 1.0 (total); at 60 % of median income: 4.3 (men), 3.0 (women) and 3.5 (total). For the age group 0–64, the at-risk-of-poverty rate would be 9.4, for the age group 65+, it would be 3.5 and for the age group 75+ it would be 3.1. Differences between at-risk-of-poverty rates for people aged 0–64 and 65+ are now negative when calculated using national register-based data: – 5.4 (men), – 6.3 (women) and – 5.9 (total). Relative incomes calculated on the basis of national data would be 91 % (men), 90 % (women) and 90 % (total), whereas income inequality would be 3.2 for the age group 0–64 years and 2.6 for people over 65.

([3])Due to differences in the scope of surveys, sample attrition and sampling errors in the ECHP, national survey results using ECHP income definitions indicate different at-risk-of-poverty rates: 4.2 % for people aged 65+ at 50 % of median income (7.5 % for people aged 0–64) and, at 60 % of median income, 10.2 % for people aged 65+ (13.5 % for people aged 0–64).

([4]) Luxembourg's national strategy report indicated at-risk-of-poverty rates of 5 % at 50 % of median income and 10.3 % at 60 %; relative income was estimated at 94 %.

([5]) The Finnish national strategy report presents national calculations of at-risk-of-poverty rates for people over 65 of 3 % at 50 % of median income and 10.9 % at 60 %. The relative income is estimated at 90 %.

([6]) Data for Sweden only cover persons aged less than 85 and may therefore slightly underestimate at-risk-of-poverty rates of older people and overestimate relative incomes of older people. National data indicate at-risk-of-poverty rates for people over 65 of 3.5 % at 50 % of median income and 10.5 at 60 %. The relative income is estimated at 81 %.

The wide range of benefits in kind (e.g. health and social services, free public transport, reduced prices for various goods and services such as telephone connections, energy, etc.) that are available to the elderly in some Member States are also not covered. It also needs to be borne in mind that ECHP income data are assessed for households and then individualised using an equivalence scale ([6]). Thus, income data based on the ECHP are not individual incomes of men and women or of older or younger people, but a share of the household income in which these individuals live. Higher poverty risks for women — or lower average incomes — therefore mean that women are more likely to live in a household at risk of poverty or with a lower household income. The ECHP does not cover people who do not live in private households, but, for instance, in residential care. Finally, poverty risks measured by reference to an income threshold (e.g. 60 % of median income) give an incomplete picture of the situation. A minimum income guarantee set just above the income threshold will ensure very low risk-of-poverty rates even though the actual income situation would be only marginally different from the one resulting from a minimum income guarantee slightly below the threshold. Such an effect may explain for instance the big gap in several Member States between the proportion of people living in households with less than 60 % of median income and households with less than 50 % of median income (see Table 2).

The data presented in Table 2 indicate that poverty risks vary considerably from one country to another and that they are usually higher for women than for men ([7]). However, the introduction of a new minimum guarantee or an increase in the level of this guarantee or the inclusion of non-cash benefits as part of the assessment can change the picture substantially. This could for instance be the case for the UK, where the new pension credit will make significant progress towards ending pensioner poverty. Unfortunately, the effects of better minimum income guarantees can only be observed with a long time lag in European income survey data.

For the EU as a whole, the risk of poverty for older people was only slightly higher than for the population below the age of 65, mainly as a result of the lower incomes of women. Men over 65 are no more exposed to the risk of poverty than men below 65. However, the 1998 data indicate that around 17 % of people over 65 are at risk of poverty if 60 % of median income is used as a threshold and about half this proportion if 50 % of median income is used ([8]). Older people are therefore exposed to a similar level of poverty risks as the population as a whole.

The oldest pensioners (aged 75 and over) tend to be more at risk of poverty than younger pensioners. This may be due to several factors: older cohorts may have earned lower pension entitlements (for instance through employment in sectors with less well developed pension provision or under legislation that resulted in less generous pensions); inflation may have eroded the purchasing power of an individual pension benefit since the time when it was first claimed; there may be more single-person households of widows and widowers without sufficient survivors' benefits to

([6]) For details, see the methodological note on background statistics in the country summaries annex.

([7]) For Denmark, calculations based on national data show that inclusion of imputed rent and interest payments may alter this conclusion.

([8]) Age 65 can be regarded as representative of the statutory pensionable age in most Member States. However, in some countries, the standard retirement age is lower for women or both men and women (France: 60). Moreover, in practice most people withdraw from the labour market before they reach the age of 65. Using age 60 as a threshold would result in observing lower poverty risks and higher relative living standards of older people.

maintain the same equivalised income. Women represent a majority of these older pensioners over 75.

The future need for, and hence cost of, these minimum guarantees will very much depend on whether future pensioners will have earned sufficient pension entitlements under public and private schemes to lift them above the guaranteed minimum levels. Structural change in the southern European countries has resulted in more people having completed long careers with good pension insurance cover. Increased female labour-force participation will raise women's individual pension entitlements. Finally, as will be discussed under Objective 2 below, the development of supplementary private provision is likely to compensate in several countries for somewhat less generous public pension benefits (which tend to fall in relative terms in the long run as a result of mechanisms such as index-linking to prices rather than earnings or adjustments in some schemes to life expectancy). Most Member States expect that minimum guarantee schemes will continue to play a residual role and will not have to cater to a large proportion of the pensioner population.

3.1.3. Conclusion: Eliminating poverty risks in old age

All Member States have provisions which provide a minimum level of income to older people who have not, for one reason or another, earned sufficient pension entitlements in their own right. In 1998, older people, in the EU as a whole, faced about the same risk of poverty as people below the age of 65. In several Member States, however, poverty risks are significantly higher for older people. It remains to be seen whether the measures for improving minimum pension levels and the dynamics of pension systems (more pensioners with full careers etc.) will reduce poverty risks over the coming years.

3.2. Objective 2: Enabling people to maintain living standards

Provide access for all individuals to appropriate pension arrangements, public and/or private, which allow them to earn pension entitlements enabling them to maintain, to a reasonable degree, their living standard after retirement.

The purpose of pension systems is not limited to ensuring that older people do not have to live in poverty. They should also provide arrangements that allow people to maintain, to a reasonable degree, the living standard they achieved during their working lives ([9]). The Member States recognise this need and most of them cater for it to a significant extent within the (earnings-related) statutory pension schemes. However, they also create opportunities for additional private provision in collective (second pillar) or individual (third pillar) schemes, and encourage such pension savings notably through tax incentives.

Member States generally do not have explicit targets regarding the level living standards after retirement compared to the situation before retirement. Germany is committed to maintaining replacement levels of 67–68 % under the first pillar in 2030 for a worker on average earnings and 45 insurance years, but this figure is rather theoretical and not necessarily representative of real pension outcomes. Greece has recently adopted a law which aims at adjusting replacement rates to the 70 %-

([9]) This will normally require a lower income as older people tend to have less family obligations, no more work-related expenditures and are more likely to own their accommodation.

rate from the **primary** pension scheme for all employees by **reducing** replacement rates for older cohorts and **increasing** them for younger cohorts. Finland has a target of 60 % income replacement through the statutory scheme, irrespective of the income bracket (maximum level for a full career of 40 years). These examples concern the first pillar. Regarding second and third-pillar provision, implicit targets can sometimes be deduced from tax rules. Contributions to pension schemes are only deductible from earnings up to a certain amount. In the Netherlands, this amount is limited to what is needed to achieve a gross replacement level of 70 % of gross final earnings after a 40-year career.

3.2.1. *Access to mechanisms for enabling people to maintain their living standard to a reasonable degree after retirement*

In most Member States, statutory pension schemes provide earnings-related pensions, thus contributing to maintaining one's living standard after retirement. Benefits under these pension schemes are related to earnings either during a specified number of years towards the end of the career or increasingly during the entire career.

In three Member States, Denmark, Ireland and the Netherlands, statutory provision consists mainly of flat-rate pension benefits. In the UK, in addition to the flat rate pension, the 'State second pension' provides an earnings-related additional pension which is particularly beneficial to people on low incomes. Others may choose to opt out in favour of private occupational or personal retirement provision. In these countries, the ability to maintain one's living standard after retirement depends to a large extent on access to private occupational or personal pension provision. Achieving good coverage rates of such private schemes and adequate benefit levels will therefore be important goals for policy-makers. Tax incentives alone will not automatically result in comprehensive coverage, and several Member States rely on the collective bargaining system to achieve better coverage. Table 3 below summarises information from the national strategy reports on the importance of private pension provision, mainly through occupational schemes.

Table 3: Access to private pension schemes

Country	Year	Importance of private pension schemes
Belgium	1999	▪ Beneficiaries: 12.8 % of all those receiving public old-age pension. ▪ 35 % of all employees pay contributions to an occupational pension scheme ([10]).
Denmark	1998	▪ 82 % of full-time employees aged 15–59 pay contributions to a labour-market pension scheme. ▪ ATP recipients = 68 % of population over 66.

([10]) These figures underestimate coverage because they do not take into account second-pillar pensions from sectoral pension plans governed by the Fund for Security of Existence (construction and metallurgical industry), pension promises made by employers to individual employees and voluntary supplementary pensions for the self-employed.

Country	Year	Importance of private pension schemes
Germany	1999	▪ 28 % of employees in commerce and 64 % in industry were covered (in the former East Germany, figures are 16 % and 20 %). Overall, in the former West Germany, around half the male employees last employed in the private sector of the economy receive an occupational pension in old age. ▪ Public sector employees: 87 % of men and 52 % of women last employed as public service employees in former West Germany were awarded a supplementary public service pension in 1999. The public service (excluding civil servants as such) is covered by collective agreements concerning special supplementary provision. ▪ 7 % of total old-age income stems from the second pillar. Third-pillar arrangements account for 10 % of old-age income.
Greece		▪ Occupational pension provision mainly limited to international companies. Auxiliary funds to be developed into occupational pension schemes.
Spain	2001	▪ Only 10 % of the 5.89 million people covered by a pension plan (individual life and group insurance funds, social provision mutual funds, occupational plans) are member of occupational pension schemes, compared to a total of 16.290 million people paying into the social security system in 2002.
France	1999	▪ Voluntary occupational schemes pay around 1.7 % of total pension benefits (basic scheme and compulsory occupational schemes) to employees and self-employed workers. Information on book reserves managed directly by companies is not available.
Ireland	2002	▪ 46.8 % of total workforce aged 20 to 69 are members of their employer's occupational pension scheme. ▪ Overall coverage of private schemes amounts to nearly 51 %.
Italy	2001	▪ 8.7 % of workforce contributing in the public pension scheme pay contributions to a supplementary pension scheme (both collective and individual): private employees = 13.8 %, public employees = 0.0 %, self-employed = 3.7 %; men 16.3 %, women 9.5 %.
Luxembourg		▪ Occupational pension provision mainly limited to companies of the financial services sector. ▪ A new type of personal pension plan was introduced in 2002.
Netherlands	2001	▪ 91 % of all employees are member of second-pillar schemes.
	2000	▪ 83 % of pensioners households receive a supplementary pension.
Austria	2001	▪ 283 000 have acquired rights to an occupational pension under a funded pension scheme (<10 %).
		▪ 35 000 receive an occupational pension from a funded pension scheme (<2 % of pensioners).
Portugal	2000	▪ 293 530 participants in pension funds (closed or open) in 2000 — 184 075 in closed pension funds. ▪ 106 323 beneficiaries in 2000 as compared to a total of 2 964 926 (including 436 000 retired civil servants) in 12/2001.
Finland	1999	▪ Second-pillar pension benefits = 0.5 % of GDP (first-pillar statutory schemes = 12 % of GDP).
Sweden	2001	▪ Approximately 90 % of workers are covered by some form of collective pension scheme agreement. ▪
United Kingdom	2000/2001	▪ 60 % of pensioner households had income from an occupational pension. 71 % had investment income including private pensions. ▪ 44 % of working-age population are contributing to an occupational or personal pension (males: 51 %, females: 37 %).

Policy instruments for promoting private pension provision are tax incentives, typically in the form of the EET tax model (contributions are exempt, investment income is exempt, benefits are taxed), direct financial support in the form of subsidies (as introduced by the latest German pension reform), or rules that make membership in such schemes mandatory.

Trade unions and employers' federations have a particularly important role to play in several Member States. In the Netherlands, Denmark and Sweden, the social partners conclude collective agreements on occupational pension provision at the level of sectors. Membership in these schemes is mandatory. As a result, coverage rates of such schemes are particularly high, up to 91 % of employees in the case of the Netherlands. Other countries (B, D, E) are now following this approach or are preparing measures to do so; Italy is also considering to make the participation in private funds mandatory.

Thanks to statutory schemes and binding collective agreements, membership in pension schemes ensuring fairly high income replacement levels after a full career is compulsory for a vast majority of workers in most Member States. Only Ireland has no compulsory earnings-related provision, and earnings-related pension levels from mandatory schemes are comparatively low in the UK and Belgium for people on higher incomes. In the UK, employees who are not contributing to the State scheme are obliged to be members of an occupational or personal pension scheme which meets certain specific criteria. Belgium has a low replacement rate compared to Member States with an earnings-related pension system.

There are fears about possible incompatibilities of mandatory sector-wide occupational pension schemes with European competition law. The Court of Justice of the European Communities regards such schemes as undertakings and hence requires a case-by-case assessment of whether mandatory membership is justified by social goals ([11]). So far, competition law has not been a serious obstacle to the development of sector-wide mandatory occupational pension schemes, but national policy-makers may need greater legal certainty.

Employees may be free to decide whether to contribute to an employment-related pension scheme or to save in a personal retirement scheme that has nothing to do with the employment status (and which would allow people such as homemakers and others who are not active in the workforce to provide for old age). However, offering supplementary pension provision in the employment context makes sense because the aim is, ultimately, to replace income from work. Arranging pension insurance for groups is also usually cheaper. Finally, choosing the right product for retirement savings can be extremely difficult for most consumers. The UK and Ireland have a tradition of voluntary provision of occupational pensions and are addressing issues of gaps in coverage and complexity by introducing new pension plans, namely the so-called 'stakeholder pensions' in the UK and 'Personal retirement savings accounts' in Ireland. Both are voluntary for the employee, but employers have to make such pension products available if they do not have an occupational pension scheme.

Third-pillar provision can also be difficult to distinguish from other individual efforts to provide for an adequate living standard after retirement. These include in particular home ownership which makes a significant difference in terms of living standards, but is unfortunately not yet captured by the European Community Household Survey (which does not include imputed rent in incomes). Other

([11]) See in particular judgment of the European Court of Justice of 21 September 1999 in case C-67/96 (Albany International).

mechanisms that contribute to maintaining living standards after retirement include the provision of health and long-term care (which becomes increasingly important as people grow older), housing support and certain advantages such as free public transport, television licences, etc.

The tax system can also make a significant contribution to raising the relative living standard of older people. Replacement rates net of taxes are higher than gross replacement rates reflecting progressive tax rates and special provision for pensioners and older people. Furthermore, retired people do not have to pay certain social insurance contributions. Without taking into account all these factors, it is not possible to assess whether pension levels are adequate. Gross replacement rates are therefore not sufficient to assess the adequacy of a pension system.

Bearing in mind the limitations of European Community Household Panel data discussed in the previous paragraph and under the first objective, it can be observed that incomes of people over 65 are not far below those of people below the age of 65 (see Table 2, column 'Income of people aged 65 and over as a percentage of income of people aged 0–64'). There are significant differences between men and women, with a surprisingly large gap in Sweden which may be due to the preference for individual rather than derived (survivors') benefits ([12]). However, the interpretation of such results requires that one takes into account the type of household in which people live, as they are based on household and not individual incomes.

3.2.2. Likely evolution of replacement rates

Future levels of pensions in relation to earnings (income replacement levels) will depend on a number different factors. The national strategy reports show a tendency for statutory schemes to become somewhat less generous as a result of a variety of adjustments. Several countries extended — or are still in the process of extending — the period of an individual's earnings history that is used for calculating the pension entitlement (e.g. F, E, P, FIN, I). Thus, instead of using the years of highest earnings towards the end of the career, earnings during a much longer period or even the entire career are taken into consideration. This will usually lead to lower pension levels, particularly if past earnings are not fully adjusted for (nominal) wage growth.

Pension levels can also be lowered through adjustments in the formula used to calculate benefits. One significant development has been the introduction of a demographic adjustment factor. In the new Swedish and Italian pension schemes and in Finland (from 2009 onwards), rising life expectancy will lower the replacement rate unless people postpone their retirement. If people continue to retire at the same age while life expectancy rises, they will receive lower pensions as the overall benefit entitlement accumulated in the new 'notional defined contribution' schemes of Sweden and Italy will be spread over a larger number of years. However, these schemes offer actuarial pension increments for those who postpone their retirement. Similar elements can be introduced also in defined benefit schemes, as it has been decided for the Finnish scheme. Thereby, they provide strong incentives for people to postpone their retirement in accordance with rising life expectancy and offer opportunities for achieving adequate pension levels.

([12]) The loss of one's partner results in a sharp drop in household income if the partner's own income is not partially replaced by a survivor's benefit. This will particularly affect older women who are more likely to survive their partner than men.

Among the countries with predominantly flat-rate public pensions, the Netherlands and Denmark are committed to maintaining the link to average earnings so that the replacement rate should remain unchanged. The UK guarantees a link to prices (with a minimum of 2.5 %) for the basic State pension, and links the means-tested minimum (pension credit) to earnings. Ireland is committed to raising the minimum non-contributory pension substantially by 2007 and is likely to raise contributory pensions as well so as to ensure that the latter remain above non-contributory benefits; replacement rates can therefore be expected to rise over the medium term.

A distinction needs to be made between theoretical and empirical replacement rates. In some countries, the statutory earnings-related pension schemes yield very high replacement rates for a full career. However, in certain cases, current average pension levels turn out to be low compared to current earnings, reflecting maturing pension systems and incomplete careers or underdeclaration of earnings in the past. In southern European countries, economic modernisation and the employment changes that this implies will lead to better pension outcomes in the future. Rising female labour-force participation in all Member States will also result in higher average pensions. Thus, the trend towards less generous benefit rules will, to a significant extent, be counterbalanced, at the individual level, by the effects of longer careers and higher incomes which may raise aggregate pension expenditure. However, actuarially neutral incentives to work longer would be self-financing.

An important way of preserving the adequacy of pensions from statutory schemes will be to allow people to earn additional pension rights by working longer. This is particularly the case in the Swedish and Italian pension systems which are becoming actuarially neutral. The Italian report shows that it will be possible to achieve a similar replacement rate to today’s typical worker retiring after 35 years at the age of 60 by working 40 years and retiring at 65. France does not intend to raise the low retirement age of 60, but the number of contribution years needed for a full pension was raised from 37.5 to 40, a measure that will require many white collar employees to stay longer on the labour market while blue collar workers (who started to work early in life and tend to have a lower life expectancy) can continue to retire at 60. Although pension supplements for postponing retirement have been introduced in a number of countries, further reforms are required in most Member States to allow people to improve their benefit entitlements by working longer (see Objective 5 below).

Regarding private pension provision, it can be expected that their contribution to incomes will rise in most Member States. This will reflect the fact that the development of occupational pension schemes even in countries with the highest coverage rates is still recent (by the standards of pension systems). The number of pensioners with entitlements for a complete career can therefore be expected to rise significantly over the coming decades.

Information presented in the national strategy reports does not allow systematic comparisons of current or future replacement levels in the Member States. Work is in progress in the indicators sub-group of the Social Protection Committee to try to calculate replacement rates showing and their evolution as a result of pension reforms. It is not possible to assess whether the confidence expressed in the national strategy reports is justified, as future pension levels are very difficult to project in view of the further reform measures that are required and the uncertainty about the performance of financial markets.

3.3. Objective 3: Promoting solidarity

Promote solidarity within and between generations.

3.3.1. Solidarity between generations

Member States seek to ensure that people above pension age have a decent income relative to the population as a whole. In this respect, most Member States report that the relative income situation of older people generally is good or at least satisfactory. This point is broadly supported by the ECHP data, especially if one takes into account that ECHP data may underestimate the relative wellbeing of older households. Greece and France state that older people are likely to benefit from greater wealth they are holding, particularly in the form of home ownership. According to French national statistics pensioner households have a disposable income equivalent to 91 % of the average. Finland reports average pensioner household income at 90 % of the level for the population as a whole (during the economic slowdown of the early 1990s, the figure stood at more than 100 %).

Most national strategy reports refer to their pay-as-you-go system as the main mechanism for ensuring solidarity between the young and the old. However, pay-as-you-go should not be understood as a synonym of solidarity. Clearly, the first generation of pensioners in a pay-as-you-go scheme did benefit from national solidarity (instead of solidarity within families). For subsequent cohorts, there may, however, be a clear link between contributions and benefits that implies little redistribution.

Moreover, solidarity features can also be found in funded pension schemes. The Dutch report cites the fact that its funded second-pillar schemes are usually of the defined-benefit type. This also can have a redistributive (from working to retired generation) character, as the working generation may have to partially compensate during times of low investment returns through higher contributions, while in good investment periods, surpluses can be passed on to the next generation. On the other hand, even pay-as-you-go systems can have features that act against the principle of solidarity: in schemes where pensions are based on final earnings, redistribution can occur in favour of those with rising earnings who typically also have incomes above the average.

This possibility of unfair redistribution through the pension system was one of the motivations for the replacement of the old Swedish and Italian pension schemes by new ones which are based on actuarial neutrality implying that the total value of pensions reflect the sum of contributions made during working life. Redistribution takes place within the earnings-related scheme between men and women (through unisex actuarial factors) and in favour of other categories through pension credits and guarantees financed from the general budget and hence taxation.

Actuarial neutrality in pension schemes does not prevent public authorities from granting additional pension rights for people on low incomes or in respect of periods during which an individual was not able to earn an income and pay contributions. The mechanisms to ensure guaranteed minimum incomes to older people or to improve their living standards (see under Objectives 1 and 2) are clear expressions of solidarity. Member States also grant pension rights for certain periods without contribution payments, for example periods devoted to childcare or care for elderly or disabled people, to higher education or periods of unemployment or incapacity and illness. There appears to be a tendency to strengthen these solidarity mechanisms in the Member States which are often financed out of the general budget rather from contribution revenues.

3.3.2. *Solidarity among the elderly*

Several Member States state as either an explicit or strong implicit goal of their pension systems the promotion of a more equal distribution of income among the pensioner population compared to the population as a whole (Spain, Belgium, Greece, Italy, Netherlands, Sweden). The spread between the incomes of the 20 % at the top of the distribution and the 20 % at the bottom is more even among the population over 65 than for the age group 0–64, with the exception of Greece, Denmark, Germany, Austria and Belgium where other factors outweigh the equalising effect of public pensions, see Table 2, column 'Inequality of income distribution').

Member States highlight a range of features of their first-pillar schemes that should reduce income inequality among the elderly. Indeed most Member States cite in this respect the re-distributive mechanisms of their systems and, in particular, guaranteed minimum pensions or incomes for older people and pension credits for periods of childcare, sickness or unemployment. The Netherlands points, for example, to the fact that, in its first-pillar pay-as-you-go system, all residents build up an entitlement at an equal rate annually. Belgium lists a number of provisions of its system which redistribute income form the wealthiest to the poorest pensioners. They include minimum and maximum pension rates, a charge (*cotisation de solidarité*) which is levied on the highest pensions and contributions for health insurance which are only levied above a threshold.

Solidarity mechanisms within pension systems have important implications for gender equality. Due to their lower current and past labour-market participation and earnings, women receive lower pensions than men, but benefit more from minimum pension guarantees and pension credits for childcare periods. The Netherlands, Denmark and Sweden also point out that the use of unisex actuarial factors represents a redistribution in favour of women who, thanks to their longer life expectancy, receive their pension for a longer period than men.

Most national strategy reports note that older pensioners tend to receive lower pensions than younger pensioners. A variety of factors lie behind this. The calculation of pension entitlements by reference to final salary confers an advantage on the most recent pensioners. Progressive improvements in coverage and in the conditions under which insurance entitlements are calculated have benefited those who were most recently part of the labour force. The proportion of women rises in the higher age classes, and, because of their lower individual pension entitlements and low survivors' benefits, the average income in higher age classes will be reduced. As a result, older pensioners are disproportionately represented among recipients of minimum pensions. While acknowledging this tendency, Member States point to the fact that continued attention to the improvement of minimum provisions and other solidarity mechanisms go some way to correcting the income distribution. France cites national figures which show that the average gross pension of the oldest pensioners is 60 % of that of the youngest pensioners. However, taking into account taxes and other deductions as well as benefits provided to pensioners, the figure rises to 90 %.

Belgium, and Italy acknowledge that income inequalities among pensioner households are a matter of continuing concern. Italy states that incomes are more unequal among the youngest pensioners, reflecting the increased importance of occupational pensions (which tend to be less re-distributive) and income from other sources (notably capital) for this group. The UK states that the incomes of the richest 20 % of pensioners rose by 80 % between 1979 and 1996/7, while those of the poorest 20 % of pensioners rose by only 30 %, This is attributable to the growth in private and occupational pensions, a trend from which the poorest pensioners have not benefited. Reforms introduced since 1997 have therefore focused resources on the poorest groups.

Finally, Italy and Greece made the point that the historic accumulation of different pension funds for different occupational groups, which have shown different rates of return to their members represents another dimension of inequality among pensioners. Thus, the consolidation of the system and the creation of cross-system fairness is, and has been, an aspect of their policies.

3.3.3. *Ageing and the likely evolution of inequalities*

Several national strategy reports discuss the likely evolution of inequalities and how solidarity can be maintained in the light of demographic ageing. Denmark makes the point that new current and future pensioners are more likely to be in receipt of occupational or other savings-based pensions. Accordingly, Denmark projects that replacement rates will continue to rise and that at the same time income among retired people will be more evenly distributed. Thus, on the basis of the current characteristics of their system, solidarity between and within generations can be maintained.

Most Member States argue that their systems will, on the basis of current societal trends (e.g. towards higher female labour-force participation) and thanks to the improvements to basic pension guarantees perform better in meeting these twin solidarity goals in the future. Only a few Member States refer to possible negative impacts on solidarity goals resulting from adjustments that were made in the interests of maintaining the financial sustainability of public systems. Thus, Italy acknowledges that current levels of replacement rates are set to fall. Germany also projects a fall in replacement rates from the first pillar, but offers strong support for funded pension provision to compensate for this loss. Italy, too, intends to develop supplementary pensions to compensate for reduced public benefits.

Some Member States refer to the increased pressure on systems stemming from longer life expectancy. The financial implications of this trend can be made more manageable by a move towards defined-contribution schemes so that pension schemes will take account of longer lives when determining pension amounts. However, the Dutch national strategy report explicitly refers to the fact that, under defined-benefit schemes, longer life expectancy has no direct implications for the amount of pension paid. The Netherlands also point to a study which compared defined-benefit pension plans with intergenerational solidarity to defined contribution pension plans without this form of solidarity. The study found that contributions to a defined contribution scheme would have to be 25 % higher than to a defined benefit scheme to cover the same risk of a decline in the pension result.

The Swedish national strategy report adds another dimension to the concept of solidarity. In the new statutory pension scheme, both the pay-as-you-go element and the premium (funded) element will be adjusted to reflect increases in average life expectancy for successive age cohorts. The report explains that the mechanism is designed to ensure a constant return on pension contributions for all individuals and cohorts. With such a constant rate of return, higher life expectancy has to translate either into higher contributions rates or longer working lives. As the contribution rate is fixed, people are invited to extend their working lives if they want to maintain the same pension level as earlier cohorts.

3.3.4. Conclusion: The future of solidarity

Public support for solidarity elements in pension systems is strong and Member States have strengthened many of them in their recent reforms. This should put in place effective safeguards against poverty risks, but may not be sufficient to prevent the average incomes of older people falling behind those of younger people or to prevent greater income disparities among the elderly. Greater reliance on private pension provision could increase inequality as private provision mirrors more closely earnings and tends to be more accessible to people on higher incomes. However, many Member States promote wider access to these schemes; this should improve their impact on income distribution. A major factor that will determine future inequality between the young and the old and among pensioners will be the evolution of pension rights for women. They represent the majority of older people — and currently those with the lowest incomes (see also Objective 10, below). Better tools for monitoring the effectiveness of solidarity mechanisms are required.

Table 4: Overview of the national strategies for ensuring the adequacy of pensions

	Main elements of the strategy to ensure the adequacy of pensions	Observations
B	Pension provision will continue to be ensured mainly through the earnings-related statutory pension scheme. This scheme will be complemented by occupational schemes to be set up by collective agreements so as to prevent a significant decrease in replacement rates. Minimum resources are guaranteed through provisions in the pension system and a special social assistance scheme for the elderly (GRAPA).	Social assistance to the elderly is index-linked to prices and additional two-yearly adjustments are possible. In the absence of the latter, poverty risks could increase. Replacement rates in the first pillar tend to decrease and it remains to be seen whether second-pillar schemes will develop sufficiently to compensate. Moreover, pension provision for the self-employed may need to be improved.
DK	A universal flat-rate pension is paid to all persons over 65 on the basis of residence. Income-tested supplements are available. A statutory supplementary scheme (ATP) provides a small contribution-based but not earnings-linked income supplement. Occupational pension schemes based on collective agreements expanded rapidly since the late 1980s and now cover more than 80 % of the workforce.	The flat-rate pension is linked to earnings and should therefore continue to prevent effectively severe poverty conditions. However, the relative income of the elderly is moderate, but will improve as a result of the massive development of occupational pensions.

	Main elements of the strategy to ensure the adequacy of pensions	Observations
D	The earnings-related statutory pension scheme is the main source of income in old age. A slight decline in its replacement level is to be compensated for by increased private provision which receives substantial financial support through tax rebates and grants (targeted at lower income groups). The minimum income guarantee through the social assistance scheme has been made more effective by disregarding the income situation of descendants.	Poverty risks in old age are low and the relative income level of the elderly is high. Recent reforms should improve the situation of low-income pensioners and, provided government-supported supplementary pensions develop well, income replacement should remain adequate.
GR	Public earnings-related pensions from a variety of pension institutions (primary insurance and auxiliary funds) are the predominant source of income. A large number of pensioners receive minimum benefits (non-contributory from OGA, contributory from the various funds). A means-tested pension supplement (EKAS) is granted on a uniform basis to raise incomes above the minimum pension. Auxiliary funds are to be developed into occupational pension schemes.	The Greek pension system has to face a challenge in terms of adequacy: high poverty risks, low relative living standards and high inequality. These risks are currently mitigated by family solidarity. Adequacy should improve as more people retire after a full insurance career and thanks to the consolidation of schemes and equalisation of entitlements across cohorts.
E	The public earnings-related pension scheme is the main source of income. An income floor is guaranteed through contributory (after 15 contribution years) and lower non-contributory minimum pensions. The development of occupational pensions is to be boosted, notably in SMEs, through collective bargaining.	Poverty risks are low and relative living standards of older people high. The Spanish public pension scheme offers high theoretical replacement rates. This could result in increasing average pensions if more pensioners achieve full insurance careers.
F	A two-tiered first pillar provides high replacement rates. The first tier is the public scheme with stronger solidarity elements; the second tier is based on collective agreements and has a strong link between contributions and benefits. There is little scope for second-pillar provision. A minimum income is guaranteed in the form of a minimum pension or a lower non-contributory means-tested benefit.	Poverty risks are low and relative incomes high. Adjustments in benefit levels to maintain financial sustainability are unlikely to threaten adequacy, especially if working longer allows individuals to achieve a better pension income.
IRL	The first pillar provides contribution-financed flat-rate benefits. These are at a slightly higher level than the means-tested social assistance pensions which are designed to cover living expenses and are to be raised substantially over the coming years. Income maintenance is achieved through voluntary occupational and private pensions which are encouraged through a favourable tax treatment. However, if coverage does not increase substantially over the next three years other measures will be considered.	The announced increases in public pension benefits should reduce poverty risks particularly among older women. A more comprehensive coverage of second or third-pillar schemes will be required to raise the relative income levels of pensioners in the long run. Ireland is the only Member State without compulsory income-related pension provision for a majority of workers.
I	A new notional defined-contribution pension scheme is being phased in. This will reduce replacement rates compared to the current defined-benefit scheme, but offers the opportunity to achieve similar levels through longer careers. The government also promotes occupational pension schemes, notably through the transformation of severance pay schemes into pension schemes. An income floor is guaranteed through the minimum pension.	Poverty risks of older people are low and relative incomes high. The reduction in replacement rates as a result of the introduction of the new pension scheme can be offset by working longer and possibly a greater contribution of supplementary schemes to incomes. A large number of atypical workers appear to have only minimal pension provision.
L	The earnings-related statutory pension scheme provides a high level of replacement income, thus limiting the need for supplementary pensions. Their development is, however, promoted by the government. The minimum pension is proportional to the number of contribution years. Social assistance is available as a last resort.	If current pension levels are maintained and as more women earn significant pension entitlements, there should be no adequacy problems.
NL	A universal flat-rate pension is paid on the basis of residence. The amount is linked to the net statutory minimum wage which is based on average earnings. Maintaining living standards is the task of occupational pension schemes which, thanks to binding collective agreements, cover more than 90 % of the workforce.	The Dutch system protects the elderly better against the risk of poverty than the young and provides good relative living standards for men and relatively less so for women. Women's occupational pension rights can, however, be expected to increase.

	Main elements of the strategy to ensure the adequacy of pensions	Observations
A	The public earnings-related pension scheme ensures a high level of income replacement The government seeks, however, to promote the development of supplementary pension schemes through the transformation of severance pay into old-age provision. A minimum pension is guaranteed in the form of a top-up of insufficient pension rights.	The system is designed to provide adequate pensions to people with a good insurance record. As more women with more complete career histories draw their pension, poverty risks should be reduced and relative living standards might rise even if public pensions are somewhat reduced.
P	The public earnings-related pension scheme offers theoretically high replacement rates. However, due to low earnings and short careers, actual pensions are low on average. The importance of second and third-pillar provision has declined recently. The priority of the government is to raise minimum pensions to the level of minimum wages so as to combat poverty among the elderly.	Portugal has to face the challenge of poverty risks low relative living standards. The envisaged measures to raise minimum pensions should alleviate problems in the short run. In the longer run, the situation should improve as more people retire with complete career and contribution histories.
FIN	The earnings-related statutory pension scheme aims at providing a replacement rate of 60 % even for people on high earnings. Supplementary pensions play a minor role. A basic national pension is paid to people whose earnings-related pension is less than about EUR 1 000. The amount also depends on the length of residence in Finland.	The system appears to offer effective protection against poverty provided that the value of the national pension does not fall significantly in relation to earnings. Opportunities for earning a higher pension will be improved thanks to a higher rate of accrual of pension rights for older workers.
S	The new earnings-related pension system links benefits strictly to contributions. The amount of the pension will decline as longevity rises or average earnings fall. Low earnings-related pensions are topped up to a guaranteed level that is index-linked to inflation. The guaranteed amount depends on length of residence. Occupational pensions cover about 90 % of the workforce.	The system appears to offer effective protection against poverty and opportunities to maintain living standards. The design of the earnings-related pension system, including the automatic stabilising mechanism, shifts all financial risks to beneficiaries, and the guarantee pension only rises in line with prices. Future adequacy will therefore depend on postponing retirement.
UK	Entitlement to a flat-rate basic pension linked to prices is acquired through earnings-related contributions. A compulsory earnings-related tier also exists in the first pillar, which offers improved accrual rates for lower earners; others may choose to contract out in favour of an occupational or personal pension plan. Apart from that, supplementary pension provision is voluntary. 'Stakeholder pensions' have been introduced to enhance access to supplementary private pensions. Minimum income guarantees linked to earnings have been strengthened, and the new pension credit provide additional amounts to reward people who have modest incomes from occupational and personal pension savings.	The improved minimum income guarantee should reduce poverty risks for older people. Voluntary occupational and personal provision is well-established for many but the challenge is to increase coverage ensure people are saving enough to meet their expectations for retirement.

4. FINANCIAL SUSTAINABILITY OF PENSION SYSTEMS

Whether future pensions will be adequate will depend on our ability to secure a sustainable financing of pension systems in the face of rapidly ageing societies. Clearly, adequate pension provision cannot be financed indefinitely through government borrowing. Nor can we expect funded pension schemes to deliver the expected real benefit levels if the economy does not produce sufficient resources for the active and the retired. All pension schemes, regardless of the financing mechanism they use (funding or pay-as-you-go) transfer a share of the current output of the economy from the active to the retired ([13]).

In view of the challenge of ageing populations, the joint report to the Laeken Council on the quality and viability of pensions stated that 'Member States should follow a multifaceted strategy to place the pension systems on a sound financial footing'. This strategy should be based on a suitable combination of policies reflecting the five objectives under the heading 'financial sustainability'. The objectives that should secure financial sustainability are the following:

— Achieve a high level of employment.

— Offer effective incentives for the participation of older workers, in particular in pension systems (extend working lives).

— Reform pension systems in appropriate ways taking into account the overall objective of maintaining the sustainability of public finances. At the same time, sustainability of pension systems needs to be accompanied by sound fiscal policies, including, where necessary, a reduction of debt ([14]). Strategies adopted to meet this objective may also include setting up dedicated pension reserve funds.

— Ensure that pension provisions and reforms maintain a fair balance between the active and the retired.

— Ensure that private and public pension schemes can provide pensions with the required efficiency, affordability, portability and security.

The open method of coordination on pensions for which these objectives were defined needs to take into account the progress that is being made in the areas of employment and public finances, but the coordination of policy efforts in these latter areas will continue to take place in the well-established coordination processes for economic and employment policies. In particular, the long-term sustainability of public finances, including the expected strains caused by the demographic changes ahead, is examined in the context of the stability/convergence programmes (in accordance with the conclusions of the Stockholm European Council), whereas the employment of older workers remains a priority within the European employment strategy. Therefore, particular efforts have been made in the text below to ensure that the information provided by Member States in their national strategy reports on

([13]) Countries which have large net foreign assets can, by running a current account deficit, use the output of other economies for providing resources to their retired population.

([14]) Member States strategies to ensure sound and sustainable public finances are reported and assessed in the framework of the BEPG and the Stability and Growth Pact and should be in accordance with these.

pensions is consistent with that provided in the stability/convergence programmes ([15]), the broad economic policy guidelines and the national action plans for employment. It is important that the conclusions from these different policy coordination activities be consistent with each other. In the following sections, Member States' pension systems and strategies for the future are examined in respect of the five objectives presented above.

4.1. Objective 4: Raise employment levels

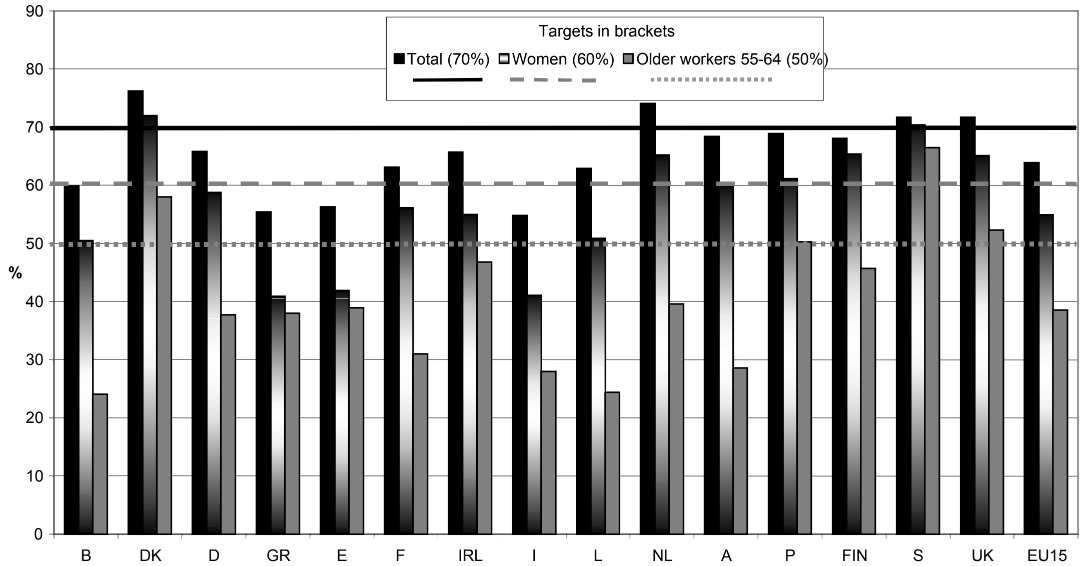
Achieve a high level of employment through, where necessary, comprehensive labour-market reforms, as provided by the European employment strategy and in a way consistent with the BEPG.

Raising the activity and employment rates of the presently inactive and/or underemployed in the working-age population is an important way in which Member States can alleviate the problems arising from the shrinking of the workforce that will result when the baby-boom cohorts begin to retire. The negative impact of demographic developments on employment and economic growth potentials can be alleviated by lower levels of unemployment and more persons of working age participating in the labour market. Governments have little influence on demographic old-age dependency ratio; even massive immigration — the demographic variable with the greatest flexibility in the short run — could not prevent the sharp rise in the old-age dependency ratio. However, what matters for the sustainability of pension systems is the economic dependency ratio, i.e. the number of pensioners in relation to the number of people who are actually in employment. Europe has considerable scope for improving this economic dependency ratio by achieving the ambitious employment goals set by the Lisbon and Stockholm European Councils (see Chart 14).

([15]) The stability/convergence programmes of autumn 2001 were available for the analysis of this report, since the 2002 programmes arrived to the Commission only in November/December 2002.

Chart 14

Employment rates and the Lisbon and Stockholm targets



Source: EU–LFS, Eurostat.

4.1.1. Brief analysis of the current labour-market situation (e.g. unused employment potential)

All countries, except Austria, have seen improvements in their overall employment rates since the mid-1990s, and all stress their commitment to the employment targets agreed in Lisbon and Stockholm for the EU as a whole, although several express concern about the recent slow-down in employment growth. Moreover, in a number of countries, the employment performance has to improve markedly before even the overall targets come within easy reach. Some of these (e.g. Belgium, Spain and Italy) acknowledge that further efforts will be called for.

Table 5

Progress towards the Lisbon and Stockholm targets									
	Total employment rate (15–64)			Female employment rate (15–64)			Older workers employment rate (55–64)		
	2001	Change 2000–01	Change 1995–01	2001	Change 2000–01	Change 1995–01	2001	Change 2000–01	Change 1995–01
B	59.9	– 0.6	3.8	51.0	– 0.5	6.0	25.1	– 1.2	2.2
DK	76.2	– 0.1	2.8	72.0	0.4	5.3	58.0	2.3	8.2
D	65.8	0.4	1.2	58.8	0.9	3.5	37.7	0.2	0.0
GR	55.4	– 0.3	0.7	40.9	– 0.3	2.8	38.0	– 0.6	– 3.0
E	57.7	1.5	10.9	43.0	1.8	11.2	39.2	2.2	6.8
F	62.8	0.7	3.2	56.0	0.8	3.8	31.9	2.0	2.6
IRL	65.7	0.6	11.1	54.9	0.9	12.9	46.8	1.5	7.0
I	54.9	1.1	4.0	41.1	1.5	5.7	28.1	0.3	– 0.5
L	62.9	0.2	4.2	50.9	0.8	8.3	24.4	– 2.3	0.7
NL	74.1	1.2	9.4	65.2	1.7	11.5	39.6	1.4	10.3
A	68.4	0.0	– 0.3	60.1	0.5	1.0	28.6	– 0.2	– 1.5
P	68.7	0.5	4.9	61.0	0.7	6.6	50.1	– 0.9	3.8
FIN	68.2	0.8	6.4	65.4	1.0	6.3	45.8	3.6	11.0
S	74.1	1.1	3.1	72.4	1.3	2.8	66.8	1.9	5.1
UK	71.8	0.3	3.2	65.1	0.3	3.3	52.3	1.5	4.7
EU-15	64.1	0.7	4.0	55.0	0.9	5.3	38.8	1.0	2.8
2010 Target	**70 %**			**More than 60 %**			**50 %**		
Source: Eurostat, LFS.									

The three employment rate targets (total, for women and for older workers) are obviously closely related to each other. The overall employment rate can only be raised if unused labour-force potentials are mobilised — and these are most likely to be found among women and older people of working age. Progress may be slowed down by the need to change attitudes, to raise the employability of people who are currently not employed and particularly regarding female labour-force participation, the need for substantial investments in care facilities for children and other dependants as was pointed out in the Greek report.

Although the unemployed still constitute an important immediate labour-force reserve in several Member States, higher employment levels will need to be achieved mainly by mobilising presently inactive among women and older workers (see Objective 5 below). Spain and Greece expect that immigrants will generate an important extra supply of labour; this may include immigrants already in the country whose situation is regularised. The Spanish national strategy report stresses the important contribution of foreign workers to the current favourable financial situation of the social insurance system. The number of foreigners covered by the social security system more than doubled from 332 000 in 1999 to 792 000 in 2002. Improving the employment rates of immigrants and their offspring form part of the strategies of Denmark and Sweden. In other national strategy reports, the issue of immigration and labour-market integration of immigrants receives little attention.

In view of their fairly tight labour-market situations, Denmark and the Netherlands also point to the potential labour reserves among people on disability benefit and the socially excluded.

Having already achieved the employment targets — or being close to them — does not prevent Member States from intensifying their efforts to further raise employment levels. Sweden, Denmark and Finland relate their employment objectives and targets directly to the prospective shrinking of their labour forces. In order to counteract the demographically induced drop in their labour supply, these Member States will intensify their efforts to activate all of working age and to achieve an earlier entry into and a later exit from the labour market.

A steady structural growth in female activity and employment rates is a key mid- to long-term objective for Austria, Germany, Spain, Greece, Ireland, Italy, the Netherlands and Portugal. Similarly, a structural improvement in employment rates of older workers is also an important goal in most Member States.

4.1.2. *Main measures envisaged for raising employment*

National action plans for raising employment are developed within the framework of the European employment strategy. Member States were asked to highlight the most important of their employment measures in their national strategy reports on pensions.

Italy and Germany are planning major labour-market reforms that are expected to significantly boost employment levels and lower unemployment. Denmark has introduced an action plan for 'More people in work', which is focused on ensuring that work pays and securing more efficiency and flexibility in the initiatives to find people a job.

For most Member States, higher employment rates are expected to result from many interconnected, yet somewhat smaller initiatives and policy measures. Sweden's general efforts to raise employment rates (which include setting national employment targets) are organised along four axes:

1. Strengthening the work incentives in tax benefit systems.

2. Active labour-market policies and efficient job-matching.

3. Quality in work and better health in working life.

4. Education and lifelong learning. Variations of these four themes can be found in the employment endeavours of several Member States.

Finland focuses on how the overall employment performance may be improved through a supportive environment including occupational safety and healthcare services, life-long learning measures, rehabilitation programmes and an environment favourable to entrepreneurship and business start-up. France discusses the positive impact on employment levels of recent anti-discrimination and equal opportunity legislation.

A few countries have detailed estimates of the relative contribution of different means to achieving the overall employment targets. Denmark, which plans to raise employment by about 153 000 persons up to 2010 (relative to the demographically induced declining trend in employment), expects 20 000 of these to come from the ranks of the presently unemployed thanks to better incentives, while about half of the remaining 133 000 is estimated to derive from older workers postponing retirement as a result of the new incentive structure in the early retirement, disability and old-age pension schemes. Finally, efforts to create higher employment rates for immigrants and their offspring and to reintegrate formerly socially excluded groups are expected to deliver the rest. In sum, higher employment rates would imply that employment in net terms, i.e., taking into account the decrease in employment due to the ageing of the workforce, would increase by some 87 000 between 2000 and 2010.

Countries with low female participation rates (e.g. Spain, Greece, Italy) generally expect these to improve through a combination of cohort-linked, cultural changes in gender roles, investments in a steady expansion of care facilities for children and other dependants and measures that improve the reconciliation of work and family life. Countries with moderate female participation rates (e.g. Austria, Belgium and Germany) also tend to emphasise that a wider realisation of gender equality in pay and working conditions will be necessary.

A number of countries with less developed nursery childcare facilities offer fairly generous support to women who take extended career breaks to care for their children in their first two to three years. Naturally, such policies may primarily reflect priorities in family policy. Yet, with a view to the impact on employment rates and the difficulties for many women of returning to the labour market after a long absence, the question arises whether it would not be better to use these resources to invest in an expansion of childcare services to speed up the return of women after parental leave.

Several Member States (e.g. Austria, Belgium, France, Germany, Greece, Spain and Portugal) use social protection contribution rebates to create and reinforce demand side incentives in order to increase the employment opportunities of workers that experience employment problems. In Austria, these are particularly targeted on older workers. Spain offer exemptions or reductions to employers hiring women, young people and those of more than 45 years of age. Adaptations to personal income tax systems (e.g. individualised tax treatment, tax credits) are also being made to improve labour supply incentives.

Many Member States furthermore expect the basic design features and recent reforms of their pensions and tax systems to have an employment promoting effect. Germany points to the employment friendly aspects of the public pension system with its tight connection between employment periods and the build up of entitlements and highlights how recent reform have reinforced basic work incentives in the contribution/benefit formula. The report also insists on the employment-enhancing effects of medical rehabilitation benefits aimed at helping people return to or retain their job. As a result of a total re-engineering of their pension systems, Sweden and Italy have greatly strengthened the work incentive effects and employment friendliness of the public pension system. Various incentive-reinforcing reforms on a lesser scale have similarly been applied in most Member States.

Almost all Member States have experienced a substantial net immigration from third countries in the last decade. Spain explicitly counts on a steady influx of immigrants to stem the erosion of its population of working age. Greece also thinks that a positive contribution from immigration is likely, but it points out that while immigrants create greater room for manoeuvre for pension systems in the short to medium term, they also build their own pension entitlements which naturally will have to be honoured in the longer run. Other Member States are aware that the positive potential of immigration can only be realised when a full economic and social integration of immigrants have been realised. The Netherlands, Sweden and

Denmark are among the ones that indicate that raising the employment rate of immigrant and ethnic groups have become an important priority.

4.1.3. *Analysis of the financial impact of the envisaged employment rate growth (excluding that of older workers) on pension systems*

As mentioned above, more employment will generate additional pension rights in the future, thereby resulting in higher pension entitlements, notably for women, and hence increased pension expenditure. The mobilisation of labour reserves among women and older workers is also likely to require extra investments and spending (e.g. training, childcare facilities). On the other hand, there will be tax and contribution revenues not giving rise to new entitlements (e.g. health insurance contributions), savings on transfer payments and a larger GDP. So, the effect on public finances and the overall economy is positive. Moreover, as more women become employed and build their own pension rights a higher level of social protection will be achieved as pensioner couples will have a higher household income.

Only a few Member States present calculations of the impact of higher employment rates on pensions expenditure. In estimations conducted by France, the impact of a 1-percentage point rise in employment rates would lower the share of pension expenditure in GDP by between 0.2 and 0.4 percentage points by 2040. In comparison, the effect of a 1-year rise in the average retirement age without increasing pension entitlements is equivalent to a drop in pension spending of 0.6 percentage of GDP.

4.1.4. *Conclusion*

All Member States see their efforts to raise employment rates as an important element in their long-term strategy for making adequate pension provision financially sustainable. Even for present high achievers such as Denmark, Sweden and the UK raising employment rates counts as an important feature of their pension strategy. As emphasised by Italy and others, higher employment rates are a precondition for achieving adequacy as well the sustainability objectives. Higher employment rates imply that more people can shoulder the financing of benefits and thus that benefit levels can be maintained.

The long-term impact of higher employment levels on future pensions expenditure is difficult to assess and the national strategy reports generally do not present comprehensive assessments. However, the EPC projections on pension expenditure growth included a number of sensitivity analyses, notably, a scenario called ‘the Lisbon scenario’. This scenario assumed an increase in employment rates corresponding to the Lisbon targets in 2010 and continued employment growth beyond this year. The results indicated that such a continuous increase in the employment rates would absorb about one third of the pension expenditure growth according to the baseline scenario, leaving the increase at about two percentage points of GDP, compared to slightly over three percentage points in the baseline scenario. In other words, higher employment rates can alleviate the financial challenge of the ageing populations but not offset it. A similar result has been presented also in an OECD study which estimated that a gradual five percentage point increase in employment would, on average, reduce the rise in the ratio of pension expenditure to GDP by about 0.5 percentage points with respect to the baseline scenario of no reform.

Obviously, the potential impact of increased employment (of women and older workers in particular) will be highest in those Member States where dependency on social benefits and early retirement can be reduced most. As several of these also are the most affected by ageing, raising employment rates is of crucial importance in overall policy responses to ageing — particularly during the next decade or two, where they can alleviate the financial impact of the retirement of the baby boomers.

Most of the national strategy reports contain a general presentation of efforts to raise employment, but only link them to pensions in a broad sense. Moreover, when labour-force reserves are identified, this tends to be done in a very broad way with little discussion of how the reserves can be mobilised and what the associated cost would be. While Member States are underscoring the importance of higher employment rates, it is clear that achieving the Lisbon targets will require further labour-market reforms in most Member States. In addition, the achievement of these targets alone will not solve the problem of the financial sustainability of pension systems.

4.2. Objective 5: extend working lives

Ensure that, alongside labour-market and economic policies, all relevant branches of social protection, in particular pension systems, offer effective incentives for the participation of older workers; that workers are not encouraged to take up early retirement and are not penalised for staying in the labour market beyond the standard retirement age; and that pension systems facilitate the option of gradual retirement.

Whereas increasing employment in general is important and necessary for responding to the transitory demographic challenge of the baby-boom cohort's retirement, rising life expectancy also calls for measures which address the relationship between the lengths of time that people spend in work and in retirement. This requires extending working lives which provides a socially acceptable way to address the issue of financial sustainability. Sweden makes this point strongly: '[…] given that average life expectancy is increasing and health improving, the number of years in working life should also grow.' Maintaining today's low effective retirement ages will not be possible without either raising contributions and taxes or lowering pension benefits.

However, trends over the past few decades have been just the opposite of what is required to make pension systems sustainable. Whereas average life expectancy at 65 years of age has continued to increase by more than one year per decade, the average effective retirement age has been dropping at an even larger speed resulting in a substantial gap between statutory pension ages and the real average age at which people stop working. Thirty years ago, the labour-force participation rates of older (male) workers aged 55–64 in EU Member States were only 10–15 percentage points lower than those of prime-age workers. Today, the difference has widened to 40–50 percentage points in several Member States. The trend towards ever-lower exit ages has been present in all Member States, largely as a result of public policies offering easy access to early retirement as a response to labour-market pressures.

This past trend is already being reversed. Policies in the Members States have been geared towards greater participation and higher employment rates of older workers, and recent years already show some progress. In order to maintain a sufficient labour supply and to raise the overall employment rate in the face of ageing and shrinking prime age labour forces, it is necessary to raise the employment rates of older workers and hence the effective labour-market exit age. While shortages of younger workers are likely to create economic incentives for employers to improve present practices of age management in workplaces and labour markets, market forces alone will be unable to bring about the necessary changes. Changes to the tax/benefit rules — notably in pension systems — that affect employer and worker decisions about retirement will have a crucial impact on retirement behaviour and thus on labour supply. These issues are also a major focus within the European employment strategy and the broad economic policy guidelines.

Extending working lives does not necessarily imply raising statutory retirement ages because the effective age of the withdrawal from the labour market is currently far below the statutory retirement age in all countries. In fact, it is questionable whether there should be a uniform age limit at which people are supposed to retire. The UK questions traditional assumptions around the pattern of working lives and the sharp cut-off between work and retirement and suggests that pensioners should not be regarded as a separate section of the population whose productive life has come to an end. Other countries, too, are moving towards greater flexibility regarding the age of retirement and are revising the incentives of the pension system in such a way that working longer will be more rewarding. Sweden is particularly advanced in this respect.

Individuals have different needs and preferences, and flexibility regarding the age of retirement is also important to allow spouses and partners to find the best arrangement for their retirement. Flexible and gradual retirement are therefore desirable goals in their own right, as was already recognised by a recommendation of the Council of 10 December 1982 ‘on the principles of a Community policy with regard to retirement age’.

4.2.1. Current labour-market participation of older workers

Chart 14 and Table 6 (see Objective 4, above) show that for the EU as a whole the gap between the common employment target and actual employment rates is greatest for the group of older workers (55–64). The Barcelona target to raise effective labour-market exit age by five years by the 2010 for the EU as a whole represents an even greater ambition. In 2001, four Member States (Belgium, Italy, Luxembourg and Austria) had a gap of more than 20 percentage points to the target and a further five had a gap of more than 10 percentage points (Germany, Greece, Spain, France and the Netherlands). For the EU as a whole, the gap was 11.5 percentage points in 2001.

In the period between 1995 and 2001, the employment rate of older workers rose in all but three Member States (Greece, Italy and Austria). For the EU as a whole, the improvement was 2.6 percentage points, but two countries achieved increases in excess of 10 points (Finland and the Netherlands) and another four in excess of 5 points (Denmark, Spain, Ireland and Portugal). Thus, the reversal of the trend towards earlier retirement has already begun, although the pace of reforms would need to be accelerated significantly to meet the Stockholm and Barcelona employment targets for older worker. Pension reforms with a particular focus on reducing incentives to take up early pensions and improving incentives for working longer will be crucial in that respect. Many countries judge that reforms, such as the removal of early pension schemes or rises in the age of entitlement to an early pension, have increased the employment rates of older workers and postponed the take-up of pensions.

Table 6 below presents an overview of present employment rates for workers (total of men and women) in different age groups from age 50 till age 70+. It also contains an estimate of the effective labour-market exit age based on labour-force survey data.

Table 6: Employment rates and average labour market withdrawal age, 2001

	Employment rates (2001, second quarter)					**Average age of withdrawal from labour market 2000/2001 (in brackets: standard retirement age, see Table 7 for details)**		
	50–54	55–59	60–64	65–69	70–74	Women	Men	Total
B	64.6	38.1	12.1	3.0	1.2	55.9(62)	57.8(65)	57.0
DK	80.9	73.5	33.7	11.6	4.3	61.1(65)	62.2(65)	61.9
D	74.5	57.7	20.8	5.3	2.6	60.4(65)	60.9(65)	60.7
GR	61.3	47.7	29.7	10.6	3.6	57.7(65)	61.2(65)	59.6
E	60.1	47.3	29.5	3.9	1.0	60.2(65)	60.7(65)	60.6
F (1)	75.8	49.3	9.9	2.1	0.9	58.0(60)	58.2(60)	58.1
IRL	65.0	54.4	37.1	14.9	7.7	62.2(66)	63.2(66)	63.1
I	60.5	36.2	18.0	6.2	2.5	59.2(65)	59.6(60)	59.4
L	66.1	39.3	8.9	na	na	55.3(65)	57.5(65)	56.8
NL	73.7	56.9	18.5	6.0	4.2	60.3(65)	61.1(65)	60.9
A	74.7	43.8	14.0	7.2	4.2	58.6(60)	60.0(65)	59.6
P	74.0	56.7	44.8	28.2	20.2	61.5(65)	62.0(65)	62.0
FIN	80.2	62.4	25.2	5.7	1.9 (2)	61.4(65)	61.6(65)	61.6
S	84.7	77.9	50.2	13.3	6.1	61.9(65)	62.1(65)	62.0
UK	77.3	64.7	37.6	10.7	4.4	61.0(65)	63.1(60)	62.1
EU-15	71.3	52.9	23.4	6.7	3.1	59.1	60.5	59.9

(1) First quarter.
(2) Unreliable or uncertain data.
Source: Eurostat, LFS.

METHODOLOGY FOR THE STRUCTURAL INDICATOR 'AVERAGE EXIT AGE FROM THE LABOUR FORCE ([16])

In order to obtain internationally comparable data on the average age at which people withdraw from the labour market, activity rates measured by the European labour force survey (LFS) are used. National data on the average age at which people claim their pension cannot be used as it may be possible to combine the receipt of a pension with income earned from work and hence continued labour-force participation. LFS data are used to estimate probabilities of labour-market exit for each age between 50 and 70 years. It is assumed that definitive labour-market withdrawal takes place only between these ages, so the probabilities for each age have to add up to one. Multiplying each age by its corresponding labour-market withdrawal probability and adding up these products yields an estimate of the average exit age from the labour market (this is in fact the average of the ages between 50 and 70 weighted by the exit probabilities for each of these ages).

([16]) The methodology to calculate an average age of withdrawal based on changes in participation rates (dynamic approach) is described in the OECD paper 'Labour market and social policy — Occasional Papers No 49 Age of withdrawal from the labour force in OECD countries', by Peter Scherer, DEELSA/ELSA/WD(2001)2, 11 January 2002. The formal description can be found on the pages 12–14. The approach is modified insofar as it uses single-year age groups rather than five-year-age groups. The methodology is still under discussion.

The input data

Starting points are the activity rates per age and year: a (age,year) coming from the EU quarterly labour force survey (Eurostat). The activity rates taken into consideration are the average over four quarterly observed rates in the year considered. 'Spring' data (quarter 1 or 2) are used in case no quarterly EU–LFS data are available. The data quality (sample sizes) in higher ages in some countries makes it necessary to artificially smooth the decline of activity rates linearly from age 65 to age 70 so that at age 71 the active population in terms of the model is zero (linear 'melt-away' hypothesis). In such cases, it is also necessary not to take the actual activity rate in the age 65 but to consider the moving average over the ages 64 to 66 instead.

The model

The model considers the relative changes of activity rates from one year to another at a specific age, that is, the conditional probability to stay in the labour market at a specific age in a specific year:

(1)

$$p^{stay}_{age,year} = a(age, year)/a(age-1, year-1); \quad 0 \le p^{stay}_{age,year} \le 1$$

In cases where the relation given in (1) would exceed 1, 100 % probability to stay on the labour market is being assumed in order to keep the counter probability not to stay on the labour market from being negative.

Consequently, the conditional probability not to stay on the labour market at the age specified is simply:

$$p^{not-stay}_{age,year} = 1 - p^{stay}_{age,year}$$

(2)

The probability still to be on the labour market at a certain age is equal to the overall probability to stay on the labour market from the theoretical starting age to the age specified (minus one). In terms of the model, the starting age is set to 50 years: it is assumed that up to the age of 49 years nobody will have left the labour force. The unconditional probability to be still on the labour market at a certain age (for example, 64) is then:

(3)

$$p^{be}_{64,year} = p^{stay}_{50,year} \cdot p^{stay}_{51,year} \cdot p^{stay}_{52,year} \cdot p^{stay}_{53,year} \cdots p^{stay}_{62,year} \cdot p^{stay}_{63,year}$$

Finally, the unconditional probability of withdrawing from the labour market at a certain age is equal to the overall (unconditional) probability to still be on the labour market at this age, see equation (3), times the conditional probability to exit from the labour market at this particular age, see equation (2):

$$p^{be-but-not-stay}_{age,year} = p^{be}_{age,year} \cdot p^{not-stay}_{age,year}$$

(4)

It is assumed that from a certain age, the probability to be still part of the labour force is zero (no labour-force participation for the age 71 years and over). That is, at the maximum age of 70, everybody who is still on the labour market will withdraw. Under this assumption, the age-specific unconditional probabilities to withdraw from labour market $p^{be-but-not-stay}_{age,year}$ from 50 to 70 will sum up to 100 %

Finally, in order to obtain an overall average age of withdrawal, the specific ages are 'weighted' by their probability to withdraw at these ages. The contribution of each age from 50 to 70 is given by $p^{be-but-not-stay}_{age,year} \cdot\times\cdot age$

Summing up over all ages considered leads to the average age of withdrawal from labour market.

$$\sum_{age=50}^{70} p^{be-but-not-stay}_{age,year} \times age$$

(5)

The data clearly indicate that withdrawal from the labour market is influenced, but not determined by statutory retirement ages. One should keep in mind, however, that withdrawal from the labour market does not necessarily mean a take-up of a pension and, similarly, remaining in the labour market does not imply that the person does not receive a pension at the same time. On the contrary, periods of employment and pension receipt can overlap, and it can be expected that in the future, when part-time retiring and accumulation of earned income and pensions is likely to become more common, this overlap will become even greater. Thus, the indicator of the exit age from the labour market, which underlies the data presented in Table 6, is likely to become a less reliable indicator of the effective **retirement** age, i.e. the average age at which age people take up a pension.

There are big differences between Member States in the thresholds and size of the decline. While some Member States still have employment rates around 80 % for the

55–59-year-old group others are at less than half that percentage. In some countries, employment rates exhibit large sudden drops from one age group to the next; in others, they fall in a more gradual way.

These differences mirror a wide range of institutional arrangements (e.g. early retirement, unemployment and invalidity schemes) and tax/benefit structures. Yet, there are also other forces at work. There appears to be a cohort effect: in countries where women started massively entering the labour market in the 1960s and 1970s they contribute significantly to current higher employment rates of older workers. This could, to some extent, explain the better performance in Denmark, Sweden and the UK. In other countries, the rapid rise in female labour-force participation took place in the 1980s; these cohorts should raise the employment rates of older workers within the next decade or two. However, the greater tendency of women to leave earlier than men on account of health problems (or possibly to retire at the same moment as their spouse/partner) is regarded as a challenge in some countries which already have high participation rates of women in their 50s and 60s. In some Member States different employment rates of older male and female workers also reflect different statutory retirement ages.

4.2.2. Medium and long-term targets regarding the employment of older workers

The majority of Member States indicate that they are committed to contributing to meeting the Stockholm targets. Only a few also mention the Barcelona target (raising the retirement age by five years). However, none of the countries acknowledging the Barcelona target have precise plans for how this target can be met. Few Member States (the Netherlands, Finland and Italy) have set quantified targets for raising the employment rates of older workers.

In the absence of quantified targets some countries, such as Germany, report on their general strategies for achieving high employment levels throughout the working life. The UK underlines that its employment rates already meet the Lisbon and Stockholm targets, but has made it a priority to further increase the employment rate of the over 50s by 2006. However, the determination of Member States to achieve higher employment rates for older workers does not depend on their present performance. Sweden, for example — with its rate of 66.5 % for the 55–64-year-olds well ahead of all other Member States — notes that the supply of labour from older workers has declined over the past decade as a result of increased labour-market exits via disability pensions and negotiated retirements and regrets that in 2001 only 55 % of the population aged 60–64 were participating in the labour force.

4.2.3. Measures to raise employment rates of older workers

In principle, all Member States recognise the need for ensuring that people work longer. Yet, the national strategy reports generally do not present a formal analysis of the incentives emanating from the full tax/benefit structure in relation to working longer. Nonetheless, many national strategy reports highlight the existence of disincentives to work in pension systems and present measures to address these.

Many Member States have already taken or are planning to take measures to encourage longer working lives. These include a large range of initiatives such as removing early retirement schemes; introducing actuarial reductions for early retirement; introducing contributions to individuals if they opt for retiring early;

tightening eligibility conditions for a disability pension, extended unemployment benefit or unemployment pension; rewarding with higher pension accrual rates when a person continues to work beyond a certain age; and introducing flexible retirement arrangements, including a removal of the statutory retirement age and allowing flexible part-time working arrangements. An overview of retirement ages and the possibility of combining earned income and a pension is presented in Table 7. It should be noted that the options for early retirement refer only to public pension schemes. In a number of Member States, occupational pension schemes may offer additional options for early retirement.

Table 7:

Flexibility in retirement in general first-pillar schemes (*Source:* MISSOC)				
	Early Retirement	**Standard Retirement**	**Deferred Retirement**	**Accumulation with earnings**
B	From 60 (subject to 28 years of employment to be raised to 35 by 2005).	Men: 65 Women: 62 (65 in 2009).	No deferred pension.	Pension reduced if annual earnings exceed a certain amount which is higher after age 65.
DK	No early pension under the public old-age pension scheme. Supplementary pension (ATP): from 65 (with actuarial reduction).	Public old-age pension scheme: 65. Supplementary pension (ATP): 67.	Public old-age pension scheme: no deferment possible. Supplementary pension (ATP): up to three years.	Gradual reduction beyond EUR 30 000 per year.
D	Under strict conditions until 2011 from 60, subject to 35 insured years from 63 with actuarial reduction of 0.3 % per month. 63 (severely disabled).	65 years (Severely disabled: 63 years).	No upper limit; actuarial increase of the entitlement by 0.5 % per month.	Yes after age 65. Pensions reduced if annual earnings exceed a certain amount until age 65.
GR (persons insured after 1.1.1993)	Full pension: From 60 (arduous work). Reduced pension: From 60.	65 years.	No deferred pension.	Reduced pension.
E	Reduced pension: from 60 years (persons insured before 1.1.1967). From 61 years (persons with 30+ years of contributions and non-voluntary unemployed).	65 years.	No upper limit.	Pension suspended in case of gainful activity. The combination of a partial pension and part-time work is possible from the age of 60. People over 65 can combine a pensions and earned income.
F	No early pension.	60 years ([1]).	No upper limit.	Subject to condition. No pension if employment with last employer.
IRL	No early pension.	Retirement pension: 65 years. Old-age contributory pension: 66 years.	No deferred pension.	Yes after age 66.
I	After 37 years of contributions or at age 57 and 35 years of contributions (for private sector employees).	Old earnings-related system: Men: 65 years. Women: 60 years. New defined-contribution system: Actuarial benefits from age 57 for men and women.	No upper limit.	Possible after 40 contribution years or upon reaching the standard retirement age. Otherwise not possible (except for the self-employed with a reduced pension).
L	60 years (480 months insurance or assimilated periods) 57 years (480 months insurance).	65 years.	Until the age of 65.	Yes for normal old-age pension. Early retirement: earnings up to 1/3 of minimum wage.
NL	No early pension.	65 years.	No deferred pension.	Yes.

Flexibility in retirement in general first-pillar schemes (*Source:* MISSOC)				
	Early Retirement	**Standard Retirement**	**Deferred Retirement**	**Accumulation with earnings**
A	Men: 61.5. Women: 56.5 (61.5 by 2029).	Men: 65 years. Women: 60 years (65 by 2033).	Unlimited possibility.	Standard retirement: Yes. Early retirement: pension discontinued if monthly earnings exceed EUR 302.
P	55 years (at reduced pension after 30 years of contributions). 60 (unemployed). 55 (unemployed, at reduced pension). 55 (unhealthy work in certain professions).	65 years.	Possible up to a maximum of five years.	Yes.
FIN	60 years	65 years.	No upper age limit	Yes.
S	From 61 with actuarial reduction.	65 years but right to stay until 67 years.	No upper age limit	Yes.
UK	No early pension.	Men: 65. Women: 60 (65 by 2020).	Maximum of five years. Deferment unlimited from 2010.	Yes.
([1]) Despite the lower retirement age in France, there is a requirement of 40 contribution years for a full pension).				

Denmark closed the so-called pre-early retirement scheme (a transitional allowance for people aged 50–59 years who had become unemployed and contributed to the unemployment benefit scheme for at least 25 years within the last 30 years) for new entrants in 1996 and it will be fully phased out by 2006. The reform of the Danish voluntary early retirement scheme in 2001 obliges individuals to make contributions to the scheme if they wish to opt for retiring early, thereby increasing incentives to work longer.

Finland has decided to phase out the unemployment pension scheme during the period of 2009 and 2014. This has allowed unemployed people to retire at the age of 60, having received extended unemployment benefits for five years at the most. Finland has also decided to close the so-called individual early retirement scheme (disability pension scheme with weak eligibility conditions) at the end of 2003.

Germany has introduced in its pension scheme reductions (3.6 % of the benefit per annum, plus reduced pension entitlements for shorter career) for all persons who retire before the age of 65 years and increased entitlements for all persons who retire after the age of 65 (6 % of the benefit per annum). In France, the statutory retirement age is 60, but a contribution record of 40 years is required to be entitled to a full pension (37.5 in public sector schemes); if people wish to retire before the age of 65 and do not have a full contribution record, reductions are applied. On the other hand, the accumulation of pension rights after the age of 60 is restricted if the person already has a full contribution record.

Austria has sought to strengthen work incentives through a number of changes including raising the statutory early retirement age, abolishing early retirement due to partial incapacity, increasing deductions for retirement before the standard retirement age of 60 for women and 65 for men; increasing pension supplements for retirement after the standard retirement age. Furthermore, the provision regarding the prohibition to work for persons drawing pension benefits was abolished. By contrast, the financially advantageous possibility of a gradual labour exit before the statutory retirement through part-time working is being maintained. These measures taken in Austria are typical of many similar approaches in various other Member States.

Although these measures represent substantial changes in many pension systems, the measures taken stop well short of eliminating all opportunities for early labour-market exit or ensuring actuarial neutrality of retirement decisions. In particular, while early retirement is increasingly financially discouraged, the rewards for working longer tend to remain weak implying a significant implicit tax on working longer.

The challenge that Member States are facing is not only political, but has much to do with poor labour-market performance. Early retirement schemes were established as a response to labour-market problems which would otherwise have spilled over into other parts of the social protection system, notably unemployment and invalidity schemes. Some countries took flanking measures on the labour market to avoid undue hardship for persons becoming unemployed at an advanced age and to increase the employment opportunities for older workers.

Greece explains that incentives in the Greek pension system cause people to retire officially from work as early as possible and then continue to work in an unofficial capacity while drawing a pension. Premature retirement is indeed very common and the statutory retirement ages (65 for men/60 for women) are of purely theoretical significance. In 1998, fewer than 20 % retired at the normal age while 80 % used other provisions including disability pensions. Italy also cites problems with undeclared work after retirement and envisages measures to bring working pensioners back into the official economy.

Early labour-market exit happens not just through early retirement schemes. Access to long-term benefits in unemployment, disability and sickness pay schemes may serve as functional alternatives. Limiting access to de facto early retirement therefore often involves changes in the conditions of a number of schemes. This can be illustrated by the case of the Netherlands where the government presently is planning a packet of initiatives to tackle a number of present disincentives which includes: the abolition of favourable tax treatment for private early retirement schemes on a pay-as-you-go basis; a reduction in the number of older employees claiming unemployment benefit (by discouraging dismissals of employees aged 57.5 and over through an obligation on employers to contribute to unemployment benefit expenditure and by reintroducing the obligation to seek work for people aged 57.5 and over); a general reform to reduce the inflow of (older) people into the disability scheme; the introduction of demand side incentives for hiring and retention of older workers through targeted tax reductions for employers.

Disability pension schemes can become an alternative route to withdraw from the labour market depending on how strictly eligibility criteria are applied. A number of countries (Denmark, Germany, Netherlands, Greece, Luxembourg, Austria and Sweden) have reviewed, or are in the process of reviewing, their disability pension schemes with a view to making conditions for granting a disability pension stricter, strengthening rehabilitation measures and offering suitable alternative work instead of granting a pension.

In several Member States, the retirement age and the transition from employment to retirement is made more flexible. The new Italian and Swedish pension systems go furthest: the 'notional defined-contribution' approach ensures a strong actuarial link between contributions and benefits and allows individuals to choose when they want to retire and at what level of pension income. At the same time, the actuarial link between contributions and benefits acts as a powerful employment incentive within pension schemes.

Finland is introducing a flexible retirement age between 62 and 68 years as from 2005 and offers higher accrual rates of pension rights at this age. Higher accrual rates of pension rights for older workers are applied also in Luxembourg. The United Kingdom stresses that people can receive statutory State pensions while continuing to work and can defer receipt to earn increments. In Spain, the law of 2002 allows the combination of pensions with income from work after the age of 65. A pension increment is awarded for each additional year worked, thus improving incentives to work after the age of 65. However, in many Member States, retirement remains fairly inflexible and persons working longer do not receive an actuarially fair reward.

The many changes in the pension and other systems that allow the exit of older workers from the labour market are sometimes accompanied by efforts to change attitudes of employers and workers. The UK report explains that the government is promoting a number of 'active ageing' initiatives ranging from the 'Age positive' campaign against age discrimination in the run up to age legislation in 2006, the 'New deal' for the over 50s looking for work, and sharing best practice between employers around flexible retirement arrangements.

Clearly, raising employment rates of older workers and the effective retirement age requires more than some changes to the parameters of pension systems. In the joint Council/Commission report on 'Increasing labour-force participation and promoting active ageing' for the Barcelona European Council in March 2002, it was emphasised that labour-market participation depends on the interplay between four factors: the availability and attractiveness of work; the balance of financial incentives; education and training; and a supportive environment of care-facilities, transport and counselling. The report thus recommended a comprehensive strategy to higher employment based on a dynamic lifecycle approach that maximises people's capacity to participate over the whole lifecycle. Longer working lives will require that the ability to work and employability are maintained at a high level during the entire working life through a combination of measures to provide more jobs and better quality in work, make work pay, secure higher and adaptable skills at work and make work a real option for all.

4.2.4. *Assessment of the financial impact of longer working lives*

The reforms undertaken and envisaged with a view to promoting longer working lives are important steps into the right direction, notwithstanding the fact that impact assessments are generally not available. In many cases, there also seems to be a mismatch between the initiatives undertaken or envisaged and the magnitude of required results in employment rates and hence the contribution towards meeting the financial challenge to pension systems.

However, some important qualitative assessments are provided. Denmark judges that the abolishment of the pre-early retirement scheme and the tightening of the eligibility rules in the disability and early retirement schemes have not resulted in an increase in the unemployment rate of older workers, thereby suggesting that an increase in labour supply does boost employment. Some countries judge that the employment rates cannot be increased to such an extent that these alone could offset a major part of expected increase in pension expenditure; they can only lower the expected increase in future expenditure.

The Ageing Working Group of the Economic Policy Committee conducted some sensitivity analyses of the impact of raising the effective retirement age on pension expenditure. An important finding was that the impact on pension expenditure is highly dependant on the design of the pension system and on how a rise will be achieved. More precisely, it depends on whether such a change in the effective retirement age is achieved without granting additional pension rights. If, for instance, an increase in the effective retirement age by one year could be achieved without increasing the replacement rate, for example, by postponing the take-up of a disability or another non-actuarial early pension in a defined-benefit scheme, the expected pension expenditure rise would be cut by 0.6–1 percentage points of GDP (relative to the baseline scenario). Thus, a one-year increase in the effective retirement age would correspond to absorbing, on average, about 20 % of the expected increase in pension expenditure in 2050. In other words, by raising the effective retirement age by five years — as called for by the Barcelona European Council — without any additional accrual of pension rights, public pension expenditure could be kept, by and large, at its current level. If, however, the additional year in employment leads to higher pension rights (as would often be the case, notably in defined-contribution schemes), the impact on pension expenditure would be significantly smaller. Nonetheless, even in this case, this reform would be beneficial in terms of increased contributions and greater economic output. Moreover, it would allow pensioners to maintain or even improve their living standard.

In view of the fact that many of the measures reported in the national strategy reports are quite recent, visible results are still fairly moderate in most countries or largely absent in some countries. As regards the financial incentives to work longer, relatively high implicit tax rates still exist and the additional years in employment do not result in an increase in the life-time pensions in many Member States. It is also clear that the pace of reforms to date is insufficient to achieve the Stockholm and Barcelona targets for older workers.

4.2.5. Conclusion: Working longer is a powerful way of ensuring financial sustainability of pension systems

Working longer represents an important way of increasing employment rates in general and, thus, a major contribution to improving the financial sustainability in a context of demographic ageing. Member States are well aware of this. However, a far more systematic approach to the impact of tax/benefit structures, employment practices and the expectations of individuals is clearly called for. If retirement behaviour is to be sufficiently changed by the year 2010, most Member States will need to strengthen their policy efforts and to ensure that they are more far-reaching and better coordinated than at present. The Council and the Commission have already stressed in several documents that priority should be given to retaining workers longer in employment and to removing incentives encouraging early retirement, as well as to reviewing incentive effects of tax/benefit systems in general with a view of making them employment-friendly [17].

4.3. Objective 6: Making pension systems sustainable in a context of sound public finances

Reform pension systems in appropriate ways taking into account the overall objective of maintaining the sustainability of public finances. At the same time, sustainability of pension systems needs to be accompanied by sound fiscal policies, including, where necessary, a reduction of debt [18]*. Strategies adopted to meet this objective may also include setting up dedicated pension reserve funds.*

The Commission and Council, in a joint report to the Stockholm European Council [19] on the quality and sustainability of public finances and their contribution to growth and employment, outlined a three-pronged strategy to tackle the budgetary implications of ageing populations:

— Member States should reduce public debt levels in order to pre-empt the budgetary consequences of ageing populations.

— Member States should undertake comprehensive labour-market reforms, including tax and benefit systems, in order to reach higher employment rates, in particular among older workers and women.

— Member States should undertake ambitious reforms of pension systems in order to contain pressures on public finances, to place pension systems on a sound financial footing and ensure a fair intergenerational balance.

The previous two sections mainly focused on raising employment rates in general and of older workers in particular, with a view to assessing how labour-market reforms can help to cope with the challenges posed by ageing populations to the financial sustainability of pension systems. This section focuses on the scope for pre-empting the budgetary consequences of ageing through pension reforms themselves and through increasing the budgetary room for manoeuvre by a reduction of public debt or the accumulation of public pension reserve funds. It examines what budgetary challenges Member States are confronted with in their pension systems, how Member States are planning to reform them and, finally, how the reforms help to meet the overall objective of financial sustainability of pension systems and, thereby, contribute to the financial sustainability of public finances as a whole. The latter is examined in the framework of the broad economic policy guidelines and in the context of the Stability and Growth Pact, as requested in the conclusions of the Stockholm European Council and reiterated in the joint report to Laeken on quality and viability of pensions.

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(17) See conclusions of the Barcelona European Council, the broad economic policy guidelines, the employment guidelines, and the joint report to the Barcelona European Council on increasing labour-force participation and promoting active ageing.

(18) Member States strategies to ensure sound and sustainable public finances are reported and assessed in the framework of the BEPG and the Stability and Growth Pact and should be in accordance with these.

(19) Council of the European Union (2001), 'The contribution of public finances to growth and employment: improving quality and sustainability', report of the Commission and the (Ecofin) Council to the European Council (Stockholm 23 and 24 March 2001), 6997/01;
European Commission (2000), 'Communication on the contribution of public finances to growth and employment: improving quality and sustainability', COM(2000)846.

A significant proportion of total pensions expenditure is funded through public budgets. This is subject to the requirements of reviewing pension systems and their long-term sustainability in the context of the Stability and Growth Pact. It is necessary to ensure that rising public spending on pensions does not jeopardise sustainable public finances. At the same time, however, sound management of public finances and the reduction of public debt will ease the constraints on public finances and help face the budgetary impact of ageing populations.

4.3.1. The current and expected impact of pension systems on public expenditure

In late 1999, the Economic Policy Committee established a working group (the Ageing Working Group, AWG, consisting of experts from national administrations) charged with carrying out projections of public spending on pensions. All calculations were made by experts in national administrations, but based on a coordinated approach, including common population projections made by the Eurostat and commonly-agreed assumptions on macroeconomic developments. While a fair degree of consistency across Member States was achieved the projections need to be interpreted with caution and it is noted that projections are not completely comparable across Member States because of differences in coverage. The estimated impact of recent reforms was only included in the calculations if the legislation concerning the reform had come into force by the end of 2000 (in some countries in 2001). Thus, these calculations did not include the estimated impact of the most recent reforms implemented or agreed in 2001 or later in some countries such as Germany, Portugal, Greece, Finland and the United Kingdom.

The results show that spending on public pensions accounted for an average of 10.4 % of GDP in 2000, with variations ranging from 4.6 % to 14.5 %. The low levels of public spending on pensions in Ireland and in the United Kingdom stem from the fact that public schemes in these countries mainly provide flat-rate benefits, aimed at providing a minimum level of retirement income, while supplementary pensions are organised through private schemes. In Ireland, the comparatively small pensioner population also explains the low expenditure level. In most EU countries, by contrast, public pension provision is in the form of earnings-related pension schemes, which may be supplemented by means-tested income guarantee pensions or social assistance, with the result that the share of public pension provision rises to around 10 % of GDP or more.

According to the projections by the AWG, public pension spending will rise by between three and five percentage points of GDP in most Member States over the next few decades under the baseline scenario which assumed that the policies in place in 2000 would remain unchanged. The differences in the expected future increase in public spending are large between Member States. The United Kingdom is the only country where the projection showed a decreasing share of GDP in pension spending while the demographic old-age dependency ratio rises. Relatively small increases were projected for Italy, Sweden and Luxembourg. In Italy and Sweden, the small increases can largely be attributed to the switch to new contribution-defined pension schemes with close actuarial links between contributions and entitlements and a benefit formula which takes account of life expectancy at the age of retirement. The largest increase was projected for Greece (12.2). In part, this is due to the maturing of the pension system which results in an increasing number of pensioners having full insurance careers. In the remaining EU countries, the projected increases were between 3.7 and 7.9 percentage points, whereas for the EU as a whole the increase amounts to 3.2 percentage points.

Table 8: Public pension expenditure (including most public replacement incomes to people aged 55 or over), before taxes, as a % of GDP (*EPC projections in 2001, not taking into account legislation introduced after 2000)* (1)

	2000	2010	2020	2030	2040	2050	Peak change
B	10.0	9.9	11.4	13.3	13.7	13.3	*3.7*
DK (2)	10.5	12.5	13.8	14.5	14.0	13.3	*4.1*
D (3)	11.8	11.2	12.6	15.5	16.6	16.9	*5.0*
GR	12.6	12.6	15.4	19.6	23.8	24.8	*12.2*
E	9.4	8.9	9.9	12.6	16.0	17.3	*7.9*
F	12.1	13.1	15.0	16.0	15.8		*4.0*
IRL (4)	4.6	5.0	6.7	7.6	8.3	9.0	*4.4*
I	13.8	13.9	14.8	15.7	15.7	14.1	*2.1*
L	7.4	7.5	8.2	9.2	9.5	9.3	*2.2*
NL (5)	7.9	9.1	11.1	13.1	14.1	13.6	*6.2*
A	14.5	14.9	16.0	18.1	18.3	17.0	*4.2*
P	9.8	11.8	13.1	13.6	13.8	13.2	*4.1*
FIN	11.3	11.6	12.9	14.9	16.0	15.9	*4.7*
S	9.0	9.6	10.7	11.4	11.4	10.7	*2.6*
UK	5.5	5.1	4.9	5.2	5.0	4.4	*– 1.1*
EU-15	10.4	10.4	11.5	13.0	13.6	13.3	*3.2*

Source: Economic Policy Committee (2001), 'Budgetary challenges posed by ageing populations: the impact on public spending on pensions, health and long-term care for the elderly and possible indicators of the long-term sustainability of public finances', Economic Policy Committee/ECFIN/655/01-EN final.

(1) A number of countries introduced important reforms after 2000, or generated new national demographic projections which the EPC could not assess in detail. Caution must therefore be exercised when interpreting those figures and comparing them with the results for other countries.

(2) For Denmark, the results include the statutory labour-market supplementary pension schemes (ATP, SAP and SP);

(3) Updated German national results based on the common EPC assumptions would show the following evolution of pension expenditure:

2000	2010	2020	2030	2040	2050	Peak change
10.8	11.1	12.1	13.8	14.4	14.9	4.1

(4) For Ireland, the results are expressed as a percentage of GNP.

(5) In the Netherlands, the second pillar is well developed. This has a direct positive impact on the public pension scheme by reducing the burden of ageing populations on the first pillar. However, there is also an important indirect implication: taxes on future pension benefits (which are drawn from the private funds) are expected to be quite high and may partially counterbalance the rise in public pension benefits.

The national strategy reports show that, for most MS, the expected trend in public pension spending is not very different in EPC projections and in national projections. Some have updated the Economic Policy Committee projections, for instance to reflect subsequent reforms, and some have presented additional alternative calculations in their national strategy reports. As already stated above, the projections made by the EPC did not include the impact of the latest reforms in Germany, Portugal, Greece, Finland and the United Kingdom.

Germany provided an update of its calculations, to take account of its most recent pension reform, in keeping with the rules and procedures that had been agreed upon for the common projection exercise. This update would result in a peak change of 4.1 %. Portugal reports an estimated increase in public pension spending from 9.7 % of GDP in 2000 to 12.1 % of GDP in 2050, after taking into account the impact of the 2002 reform (compared to 9.8 % to 13.2 % in the EPC projections). Taking account of the 2002 reform and based on revised population and employment figures, Greece reports an estimated increase from 12.6 % to 22.6 % of GDP (EPC: 12.6 % to 24.8 %). The United Kingdom reports that public pensions spending is estimated to remain broadly at its 2000 level when the impact of the reforms in 2002 is taken into account (i.e. around 5.5 % of GDP instead of 4.4 in the EPC projection). Finland considers that the latest reform agreed in October 2002 will strengthen the contribution basis, thereby reducing the need for raising the contribution rate on wages from the earlier estimate of 10 percentage points to only five by 2050.

In addition to making changes in the projections to take reforms into account, some other Member States have revised their projections, taking into account more recent information for instance on population and employment developments (see country fiches). The EPC's baseline projections are based on national population data of 1995 (Eurostat data of 1999). According to national projections on the basis of new national demographic projections in Austria and Spain, public pension expenditure will peak at 17.3 % in 2035 (A) and at 13.0 % in 2050 (E), respectively. As regards Spain, as noted by the EPC in the report on 'Budgetary challenges posed by ageing populations', higher levels of inward migration may ease somewhat the fiscal pressure of public pension expenditures; however, net inflows of immigrants would need to be raised to levels far above those experienced in the past to have a significant impact on the pressure for increased spending on public pensions. Austria submitted new projections as comments to the Commission draft of this joint pension report taking account of the latest demographic statistics which may translate into a less significant increase in public pension expenditure (i.e. the peak change would be 2.9 % in 2035). Some Member States also provided more detailed information on some parts of the pension system, notably the contribution-based social security system. Belgium has included an updated projection used in their stability programme which gives a more global picture of the impact of ageing on social security as a whole (+ 3.4 percentage points of GDP) and shows that the budgetary costs of ageing could be financed by the future decrease in interest payments. The EPC will repeat its baseline projections exercise in 2004/05.

4.3.2. *Contributions of public pension schemes*

The expenditure projections presented above highlight the financial pressures facing public pension schemes. However, financing arrangements vary from country to country. In all countries, the earnings-related part of the public pension system is generally financed by contributions levied on earned income. In Ireland, the Netherlands and the United Kingdom, the flat-rate basic pensions are financed by contributions and only Denmark finances first-pillar pensions through taxes. Means-tested minimum pensions are, by contrast, financed by taxes in all countries. In general, statutory social insurance systems are usually separated from the State budget, but only in a few cases are there statutory obligations that require deficits to be covered within the social security system itself. Large transfers from the general budget to social insurance institutions are common, also reflecting tax-financed solidarity elements in statutory pension schemes (e.g. means-tested pension supplements and pension contributions for periods of unemployment, childcare, etc.).

Under current policies, additional needs for public financing will arise in almost all countries which will require increased contributions, higher retirement ages, lower benefits, larger transfers from the general budget — or other measures to support financial sustainability. Member States respond with policies that are as comprehensive as possible. In this section, however, Member States' policies regarding contribution rates are examined first.

So far, the strongest commitment to preventing increases in taxes and contributions can be found in Sweden where the contribution rate to the new system is fixed and necessary adjustments will only be made on the benefit side. Italy has moved in the same direction with its reformed system, but the adjustment on the benefit side will come fully into force only after a very long transition period, although, during this transition period pensions being paid out will be made up of an increasing component computed under the new rules. The new contribution-based system will be fully phased in approximately in 2035. Germany is committed to keeping contribution rates below 22 % and government is obliged to propose appropriate measures to Parliament if the 15-year projections indicate that this objective will not be reached. The Netherlands intends not to raise the contribution rate above 18.25 %. The deficit in the pension system will be covered by transfers from the reserve fund or the general budget. The adjustment of the Luxembourg pension system will be made through the contribution rate which is very sensitive to a possible decline in the number of cross-border workers: if the system can maintain a relatively high growth trend in terms of the number of contributors, the impact of the ageing national population can be offset to a large extent. Financial stability of the Luxembourg system is ensured if the economy grows at about 4 % p.a. thanks to workers from neighbouring countries. Under current policies, Ireland and the United Kingdom appear to need only little or no additional financing.

In the remaining countries, there appears to be no pre-determined strategy regarding contribution rates. The national strategy reports do not provide precise information on the expected evolution of the contribution rate and appear to suggest that the contribution rate is one parameter which can be adapted according to financial need. However, this adaptation seems to be possible also by means other than the contribution rate, such as subsidies from the central government budget or further pension reforms. In several countries, room for manoeuvre will be created through a reduction of public debt and/or the accumulation of reserve funds.

In many Member States, an increase in contribution rates on wages of between 5 and 10 percentage points would be required, corresponding to an increase in the total tax burden by several percentage points of GDP. Greece, however, faces an exceptionally large challenge as transfers from the general budget would have to rise to 15.5 % of GDP by 2050. Table 9 below summarises information from the national strategy reports on the financing of public pension schemes.

Table 9: Contribution rates in public pension schemes

	Contribution rate, % of wages in 2002 ([1])	**Observations** ([2])
B	37.94 % (social security). Employer: 24.87 %. Employee: 13.07 %.	Means-tested minimum pensions are financed by taxes. The contribution rate covers all branches of social security. A subsidy of 2.6 % of GDP from the State budget to the social security system was required in 2000. This will increase to 5.5 % of GDP by 2050.
DK	223.25 DKK per month (about 2 %). Employer: 2/3. Employee: 1/3.	The contribution rate covers the statutory supplementary pension schemes (ATP and SP) for an average worker's wage. The flat-rate public old-age pension and civil servants' pensions are financed completely by taxes.

	Contribution rate, % of wages in 2002 ([1])	Observations ([2])
D	19.1 %. Employer: 9.55 %. Employee: 9.55 %.	Subsidies from the federal budget account for 37 % of pension expenditure in 2002; the share is expected to decrease to 31 % in 2030'. In addition, social assistance pensions are financed by taxes. A target has been set that the contribution rate should not exceed 22 % in the future.
GR	20 % (if insured before 31.12.92). Employer: 13.33 %. Employee: 6.67 %. 30 % (if insured after that date). Employer: 13.33 %. Employee: 6.67 %. State: 10.00 %.	The contribution rate covers all branches of social security. Tax subsidies to the financing of contribution-based pensions would have to rise from the current 4.8 % of GDP to 15.5 % in 2050. In addition, pensions of uninsured persons over 65 and civil servants are financed by taxes.
E	28.3 % (social security, except healthcare and unemployment benefits). Employer: 23.6 %. Employee: 4.7 %.	The contribution rate covers contributory benefits for old-age, disability and survivors' pensions and maternity benefits. The social security sector is expected to produce a surplus until 2015, thereafter a deficit. Means-tested minimum pensions are financed by taxes.
F	Basic scheme: Employer: 9.8 % (below ceiling), 1.6 % (above ceiling). Employee: 6.55 % (below ceiling). Supplementary scheme: Rate varies between 7.5 % and 20 %, depending on wage level and employee status.	The contribution rate covers old-age and survivors' pensions; disability pensions are covered by health insurance contributions. The public pension scheme is currently in surplus (0.2 % of GDP in 2000) but will fall into a deficit of 3.8 % of GDP in 2040, which would imply raising the contribution rate by 10 percentage points.
IRL	12.5–16 % (social security, except health). Employer: 8.5 — 12 %. Employee: 4 %.	Social insurance (flat-rate) pensions are financed by contributions. Means-tested social assistance pensions are financed by taxes.
I	32.7 %. Employer: 23.81 %. Employee: 8.89 %.	The deficit of the pension insurance system is currently 0.8 % of GDP, rising to 3.0 % of GDP when social assistance pensions are included.
L	24 %. Employer: 8 %. Employee: 8 %. State: 8 %.	One third of the contribution rate is financed by taxes. The guaranteed minimum incomes for older people and public sector employees' pensions are financed by taxes. The future development of the contribution rate depends on the growth rate. It is estimated that a rate of 26 % can be maintained for the whole period up to 2050 with a growth rate of 4 % p.a., but it would have to rise to 46 % with a growth rate of 2 %.
NL	17.9 % (old-age pension). 1.25 % (survivors' scheme). Employee: 19.15 %.	A target has been set to ensure that the old-age pension contribution rate will not be raised above 18.25 %. The contribution rate of 17.9 % is expected to produce a surplus until 2010. Thereafter, the deficit is covered from the reserve fund and taxes. In addition, a contribution rate of 1.25 % is paid for the survivors' scheme and a rate of between 7.09–13.93 % for disability benefit schemes.
A	22.8 %. Employer: 12.55 %. Employee: 10.25 %.	Tax subsidies accounted for 23 % of pensions expenditure. In the absence of transfers from the budget, the contribution rate would be 31 % in 2001 and would have to rise to 38 % by 2050 under current policies.
P	34.75 % (contributory cash benefits). Employer: 23.75 %. Employee: 11 %.	The contribution rate covers all contributory benefits (pensions, sickness, unemployment, maternity, professional diseases, family benefits). Means-tested universal non-contributory social pension and other benefits are financed by taxes (3.3 % of GDP in 2000). The social security sector currently produces a surplus of 1.7 % of GDP, projected to turn into a deficit of 1.5 % of GDP by 2050.
FIN	Earnings-related pensions: Employer: 16.7 % (private sector) 19.1 % (state sector) 22.6 % (municipalities). Employee: 4.4 %. National basic pensions: Employer: 2–4.9 % (private sector).	The earnings-related pension contribution for the private sector (21.1 %) is estimated to rise by five percentage points (taking account of the 2002 reforms and of the use of funded reserves). Means-tested (against pension income) national basic pensions are partially financed by taxes.
S	18.5 % (old-age pension). 1.7 % (survivors' scheme). Employer: 10.21 %. Employee: 7 %.	The earnings-related pension system is a notional defined-contribution system (16 %) and a pre-funded defined-contribution system (2.5 %); these rates are to be kept constant in the future. Income guarantee pensions (means-tested against public pensions), disability and survivors' pensions and contributions during career breaks are financed by taxes.

	Contribution rate, % of wages in 2002 ([1])	Observations ([2])
UK	21.9 % (social security except health). Employer: 11.9 %. Employee: 10 %.	The contribution rate covers the basic State pension and the additional earnings-related pension (SERPS/State second pension). Means-tested minimum income guarantee/pension credit benefits and civil servants' pensions are financed by taxes.

([1]) *Source:* European Commission, MISSOC 2002. The rates apply to the general, first-pillar social protection schemes In many Member States, there are floors of ceilings for earnings which are subject to contributions. Rates may also be different for the self-employed.

([2]) The observations are based on the information given in the national strategy reports.

Contributions to occupational and private pension schemes should be added to those for public schemes to assess the overall financial effort required for pension provision. In Denmark, for instance, the contribution rate for supplementary occupational pension schemes varies between 8 and 16 % of wages and in Sweden between 2 and 15 %. In Sweden, the rate tends to be higher for people on high earnings to ensure adequate replacement of earnings above the income ceiling in the statutory scheme. In Ireland, typical contribution rates are at 11 % and in Italy at 9.25 % ([20]) (including contributions from the employer and the employee and contribution to the severance pay — 'TFR' — devolved to pension funds).

4.3.3. General measures to ensure the financing of public pensions expenditure

All Member States are aware of the financial challenge posed by ageing populations and most have already made efforts aimed at ensuring the financial sustainability of their statutory pension schemes. Reforms of pension systems have been carried out in many Member States during the last decade, aimed at containing future pension expenditure. More recently, Sweden and Italy have undertaken a radical transformation of their pension systems into notional defined-contribution systems in which financial sustainability is managed, first of all, through a close link between contributions and benefits. Other countries, such as Finland, Germany and Portugal, have recently made major adjustments to the parameters of their pension system with the aim of containing future pension expenditure growth while preserving the essential structure of their pension system. Countries such as France, Spain and Austria have recognised the need for significant further reforms and are going to draw up new reform proposals within a year or two. Some Member States, notably Belgium, Denmark, Ireland, Luxembourg and the Netherlands, have operated more on the financial side with the aim of guaranteeing sound public finances and creating room for manoeuvre through the reduction of the public debt and interest payments and the accumulation of reserves for increased future expenditure, while not planning any major reform of the pension system itself. Greece took an important step in 2002 to overhaul framework conditions for pension provision and to improve the credibility of the pension system, while measures for ensuring its financial sustainability have been postponed to a later stage.

Most Member States consider a continuous reduction of public debt and, consequently, of interest payments or the accumulation of reserve funds as important ways in which they can prepare for future spending requirements resulting from ageing. Several Member States underline their commitment to sound public finances as a basic element of the strategy to cope with ageing. In addition, these commitments have often been underscored by establishing reserve funds, often

([20]) In Italy, the level of the contribution is determined through collective bargaining and, under certain conditions, fiscal advantages worth up to EUR 5 164 per year are granted.

outside the public budgets, which will allow governments to maintain adequate pension levels for the baby-boom cohorts, thereby mitigating the need for raising taxes or contributions. In addition, the development of occupational and private pension schemes provides additional resources for funding future pensions. In the long run, however, increased life expectancy calls for permanent adjustments in benefits, contributions or the length of working lives.

Significant reserves for statutory pension schemes already exist in Luxembourg, Sweden, Denmark and Finland where requirements for partial funding have already been in place for a long time. New reserve funds have recently been established in Belgium, the Netherlands, Spain, Greece, Portugal, France and Ireland. Accordingly, the amount of assets accumulated so far in the recently established funds is low (except in Ireland where it amounted to 8 % of GNP in 2001). The general intention is to increase such assets, to varying degrees through a commitment to make regular transfers, before ageing populations require pension expenditures to increase. Ireland is statutorily committed to make an annual contribution of 1 % of GNP to the reserve fund each year. Similarly, Greece has established such a fund in 2002, with a commitment of a contribution of 1 % of GDP up to 2015. In Spain and Portugal, surpluses produced by the social security sector will be set aside to meet future pension liabilities (in Portugal, the fund receives two percentage points of the employees' social security contributions, in addition to any surpluses of the social security scheme), while in Belgium and the Netherlands savings achieved through reduced interest payments due to the reductions of public debt will be put aside in an ear-marked fund for pension liabilities.

Table 10: Pension reserve funds of the first-pillar schemes, as a % of GDP

	Year	Reserves
B	2001	0.5
DK	2000	25
D	2001	None
GR	2001	None
E	2002	1
F	2002	0.8
IRL ([1])	2001	8
I	2001	None
L	2002	22
NL	2001	3
A	2001	None
P	2001	3
FIN	2001	55
S	2001	29
UK	2001	None

Ireland: % of GNP.
Source: National strategy reports.

The Netherlands, Denmark and Ireland also expect to benefit from the deferred taxation of private pensions. In exchange for tax deductibility of contributions to private pension schemes and the exemption of the schemes' investment income during the accumulation period, pension benefits, when they are paid out from the fund, are subject to income tax. This taxation model will raise tax revenue at the time when public pension payments are large, thus helping to cover increased public expenditure due to ageing. However, due to lower average tax rates on pensions (either because of special tax rules applying to pensions or progressive income tax), such deferred taxation implies a net subsidy. In other Member States, too, depending on the level of pensioner incomes and the way they are taxed, governments can expect to recoup some of the increased public and private spending on pensions through taxes levied on pensions, thus leaving the net public expenditure somewhat smaller than the gross expenditure.

The financing of public pensions is not yet fully guaranteed by the measures taken to reform pension systems themselves nor by the accumulation of assets to meet future liabilities. In order to avoid large increases in contribution or tax rates, Member States have committed themselves to conduct sound macroeconomic and public policies as well as to undertake structural reforms designed to deliver stable growth, higher employment rates and reduced debt levels. Many Member States, for instance Belgium, Denmark, the Netherlands, Finland and Sweden, consider the reduction of public debt and, accordingly, of the interest burden as an essential element in their strategies to create room for manoeuvre to cover the projected increase in pension and other age-related expenditures. They are notably focusing on achieving structural budget surpluses and have set specific targets to run annual surpluses in public finances for the years to come. In addition, all Member States recognise the importance of increased employment rates for the strengthening of the contribution base as well as for the achievement of sound public finances. A number of Member States are committed to undertaking further reforms in their pension systems. Finally, in many countries, the reduction of the public debt is considered an essential part of the fiscal strategy and a determined effort has been undertaken to move towards cyclically adjusted budget surpluses.

Table 11: General government net lending or borrowing and gross debts, as a percentage of GDP

	Balance 2001	Balance 2002	Gross debt 2001
B	0.4	– 0.1	107.6
DK	3.1	2.0	44.7
D	– 2.8	– 3.8	59.5
GR	– 1.2	– 1.3	107.0
E	– 0.1	0.0	57.1
F	– 1.4	– 2.7	57.3
IRL	1.5	– 1.0	36.4
I	– 2.2	– 2.4	109.9
L	6.1	0.5	5.6
NL	0.1	– 0.8	52.8
A	0.2	– 1.8	63.2
P	– 4.1	– 3.4	55.5
FIN	4.9	3.6	43.4
S	4.8	1.4	56.6
UK	0.7	– 1.1	39.1

	Balance 2001	Balance 2002	Gross debt 2001
EU	– 0.8	– 1.9	63.0
Source: Commission economic forecasts, autumn 2002.			

However, the latest development regarding public deficits and debts suggest that even achieving a balanced budget situation is a major challenge for many countries and that most countries have to make determined efforts to produce surpluses with the aim of reducing public debt or building up reserve funds. Only five countries (DK, E, L, FIN and S) are forecast to have a surplus in 2002; four countries (IRL, NL, A and UK) are moving from a surplus in the previous year into a deficit (and B to a balanced budget); and in the remaining countries (D, EL, F, I, P) the deficit is forecast to be even greater than in 2001 with the exception of Portugal, which is already taking measures to reduce the excessive deficit towards a balance. In the EU as a whole, the budgetary situation worsened significantly in 2002, from a deficit of 0.8 % of GDP to 1.9 %. Although this worsening is partially due to cyclical fluctuations (cyclically adjusted net borrowing has probably still increased in 2002 in some countries), it also reflects slow progress in implementing structural reforms in Member States and represents a setback for the pension strategies.

Table 12: Overview of the national strategies for ensuring the financial sustainability of pension systems

	Main elements of the strategy to ensure the sustainability of the public pension schemes	Observations
B	*The key element of the strategy is the consolidation of public finances, based on continuous budget surpluses for a long time to come and a significant reduction of public debt. Savings from reduced interest payments will be transferred to the 'Ageing fund'. The reduction in interest payments is expected to be larger than the increase in all public age-related expenditure.*	*The subsidy of the State budget to the social security system is estimated to rise from 2.6 % of GDP in 2000 to 5.5 % of GDP by 2050. This can be managed provided that large primary surpluses can be sustained for a long time to come as foreseen in the stability programme. The public debt ratio was 108 % of GDP in 2001.*
DK	*Ambitious targets have been set to run an annual surplus of between 1.5 % and 2.5 % up to 2010 with the aim of reducing public debt and to increase employment by 87 000 persons by 2010. No major revisions in the pension system are envisaged.*	*Increase in pension expenditure (4 % of GDP) can be managed provided that budgetary surpluses will be achieved and the contribution base strengthened through increased employment.*
D	*The 2001 pension reform is expected to reduce the rise in public pension expenditures (estimated at 4.1 percentage points of GDP instead of the pre-reform estimate of five points) while increasing subsidies for private pension savings. Financial sustainability will be strengthened by the fact that the calculation of pensions and their annual adjustment have been modified in such a way that the rise in total pension expenditure will be slowed. The government aims at balancing the Federal budget by 2006. A ceiling has been set for the contribution rate and the government is obliged to propose to parliament appropriate measures if the 15-year projections indicate a risk that the contribution rate has to be raised above 20 % (2020) or 22 % (2030). The need for additional reforms is currently under review.*	*Tax subsidies to the pension system cover 37 % of the current pension expenditure. According to recent estimates, the level of tax subsidies will decrease to about 31 % in 2030. Further efforts are needed to ensure the long-term financial sustainability in the context of the ongoing process to modernise and adapt the pension system to changing circumstances. The deficit of public finances in 2002 is estimated at 3.8 % of GDP.*

	Main elements of the strategy to ensure the sustainability of the public pension schemes	Observations
GR	*The 2002 pension reform laid down provisions for a fairer and more credible pension system (equalisation of replacement rates for different cohorts). Equity between generations and medium-term sustainability was pursued by reducing replacement rates for older cohorts and increasing them for post-1993 labour-force entrants. Financing measures include the creation of a pension reserve fund and strengthening the contribution base e.g. by lengthening the required contribution period. Modernisation measures are designed to open the way for second-pillar pensions to be able to absorb some of the pension burden.*	*Tax subsidies to the pension system are expected to remain below their 2000 level of 4.8 % of GDP until after 2020, but might rise then to 8.4 % of GDP in 2030 and 15.5 % of GDP in 2050. Further reforms for ensuring the financial sustainability of the pension system are necessary.* *The deficit of public finances in 2002 is estimated at 1.3 % of GDP, and the public debt ration at 107 % of GDP in 2001.*
E	*Budget discipline is to be enforced in all sub-sectors of the general government thanks to the Budgetary Stability Law. A reserve fund for future pension liabilities has been established and the contribution base is expected to be strengthened through increased employment. The social security sector is expected to run a surplus up to 2015; thereafter, if no planned or new measures are taken, the impact of the population ageing will move the social security sector into deficit.*	*The expected increase in public pensions expenditure between 2020 and 2050 is one of the highest in the EU (between five and eight percentage points of GDP). Further reforms for ensuring the financial sustainability of the pension system are needed.*
F	*A reserve fund for future pension liabilities has been recently established. Reduced unemployment will only have a small impact on the expected increase in pension expenditure. The government is committed to presenting a comprehensive reform before the summer 2003.*	*The pension system risks running a deficit from 2010; this is estimated to reach 3.8 % of GDP in 2040. The size of the reserve fund is small (less than 1 % of GDP) and can only meet part of the ageing-related expenditure increase. The announced reform is necessary. The deficit of public finances is estimated at 2.7 % of GDP in 2002.*
IRL	*The key element is the statutory requirement for the government to contribute annually to the pension reserve fund by 1 % of GNP. The reserves are estimated to amount to 45 % of GNP in 2025 and can only be used from 2026 onwards.*	*The fund will partly pay demography-related pension costs. Appears to be sustainable at current benefit levels.*
I	*The government's strategy is based on improving conditions for economic and employment growth; stabilising pension expenditure at the current level relative to GDP would require a growth rate of 2–2.2 % p.a. The government has proposed to the Parliament an enabling act with the aim of allowing the preparation of further reforms, including the development of supplementary pension provision.*	*Tax subsidies to the pension system were 3 % of GDP in 2000. Further reforms appear to be needed.* *The deficit of public finances in 2002 is estimated at 2.4 % of GDP, and the public debt ratio at 110 % of GDP in 2001.*
L	*The strategy is based on the financing method for public pensions. The contribution rate is set for a period of seven years in such a way that it allows the reserve fund to be kept at least at a level which exceeds 150 % of annual pension payments.*	*Appear to be sustainable if economic growth is at least 4 % p.a. A modest growth of 2 % p.a. between 2000 and 2050 would require raising the contribution rate from 24 % to 46 %.*
NL	*The government's strategy is based on the elimination of public debt in one generation (by about 2025), which requires, on average, an annual budget surplus over 1 % of GDP. In addition, tax revenues from second-pillar pensions increase tax revenues, notably from 2020 onwards. A reform of the disability pension scheme is envisaged with the aim of increasing the employment rate and diminishing the possibilities for using the disability pension scheme as a way into early retirement (NL).*	*Appears to be financially sustainable, despite the projected large increase (6 % of GDP) in pension expenditure, provided that budgetary surpluses will be achieved.* *Public finances are estimated to move into a deficit of 0.8 % of GDP in 2002.*

	Main elements of the strategy to ensure the sustainability of the public pension schemes	Observations
A	*A reform proposal for pension schemes is envisaged in 2003. In addition, the government aims at increasing the employment rate, both in general and that of older workers in particular.*	*Current public spending on pensions is the highest in the EU due to the high relevance of the first pillar. Austria will experience an increase by 4.2 percentage points by 2040 (around the peak). Further reforms appear to be needed.* *Public finances are estimated to move into a deficit of 1.8 % of GDP in 2002.*
P	*A reserve fund was established in 1989 and a reform of public pension schemes was implemented in 2002. The surpluses of the social security system, which are expected to continue up to 2016, and two percentage points of the employees' social security contributions are set aside in reserve fund. The reserves of the fund are estimated to be enough to cover increased expenditure up to about 2035.*	*A deficit in the social security sector will emerge around 2016 and reach a level of 1.5 % of GDP in 2050. Additional measures may be needed. The deficit of public finances is estimated at 3.4 % of GDP in 2002.*
FIN	*The government's strategy is based on ensuring economic and employment growth, reducing public debt and increasing pension reserve funds beyond the statutory funding requirement; the latter amounts to about one quarter of pension liabilities. Major revisions in the pension system were undertaken in 2001 and 2002.*	*Despite recent pension reforms and an estimated increase in reserve funds, there is a need to raise the contribution rate by five percentage points of wages. Additional measures may be needed.*
S	*The 1998 reform comes fully into effect in 2003 and introduced a two-tier defined-contribution system comprising a pre-funded part and a notional defined-contribution scheme. The system responds to economic or demographic developments. In addition, the government is committed to achieving budget surpluses over the business cycle.*	*Appears to be financially sustainable since benefits are automatically adjusted if required by demographic or economic developments.*
UK	*The latest revisions of public pension schemes will keep the expenditure share of GDP constant, while it was expected to decline before the reforms. The government is committed to sound public finances and to providing stable and secure conditions for savings in occupational and private pensions.*	*Appears to be financially sustainable.*

4.3.4. *Conclusion: Financial sustainability of public pension systems and sound public finances*

The size of the challenge faced by Member States in their public pension systems varies. This is due to many factors, such as different underlying designs of the pension system, the strength and nature of reforms taken to date, the overall situation of public finances and the size and timing of demographic changes ahead. Nonetheless, all Member States recognise the challenges in their national strategy reports and are preparing strategies for the future. The elements recommended in the broad economic policy guidelines for ensuring the long-term sustainability of public finances, namely increasing employment rates, reducing public debt and reforming pension systems, are recognised and integrated in the strategies outlined by Member States.

In the United Kingdom, the underlying design of the pension system and notably indexation methods for pensions explain why it does not face any major challenge in the financing of the public pension schemes. This challenge is very small also in Sweden, thanks to the comprehensive reform of the pension system. The Swedish pension system appears to be well prepared for the ageing of the population as well as for other societal changes.

In a large number of countries, comprehensive strategies for coping with major challenges posed by population ageing are already in place, including reforms undertaken in the public pension system, measures to increase incentives to work and retire later and efforts to conduct sound public policies and accumulate reserves for increased future expenditure. This group includes countries such as B, DK, IRL, NL, L, P and FIN, where public pension systems appear to be close to being financially sustainable. This means that in spite of major increases in expected pension spending, the strategy seems to ensure that increases in contribution rates, subsidies from the central government budgets or government borrowing are manageable without major reforms of the pension systems themselves. However, whether these strategies will be successful often critically depends on ambitious objectives set for various policies, notably public finance and employment policies, as well as on overall macroeconomic developments.

Italy already undertook comprehensive reforms in its public pension system during the 1990s. Nevertheless, further reforms appear to be needed, considering also that the high level of public debt is a major constraint, implying tighter limits for the pension system as well. In addition, the high level of public debt is a major constraint, implying tighter limits for the pension system as well. Therefore, further reforms appear to be needed. This is the case also in Germany, although the 2001 reform is estimated to reduce the projected increase in public pension expenditure by about one percentage point of GDP. In the remaining group of countries, including Greece, Spain, France and Austria, the expected increase in public pension expenditure is large and above the EU average. In these countries, the announced reforms are indeed needed.

This analysis largely confirms that the recommendations given in the 2002 broad economic policy guidelines for nine Member States were appropriate and, in most cases, will remain appropriate. In many cases, the national strategy reports themselves state the need for reforms and, in some cases, they refer to measures already taken this year, as is the case for Portugal and Finland.

The financial sustainability of public pension systems is to a large extent linked to the sustainability of public finances as a whole. This is due to the fact that pensions are a major component in the total expenditure of all general governments and the financing of pensions often involves interventions from the central government budgets. In a few countries, public pension systems are organised almost completely within the central government sector, while, in some other countries, the administration of public pension systems is organised jointly for the whole social security sector. Even in the case where pensions are financed by ear-marked contributions and managed in separate funds, these contributions are part of the overall tax/contribution burden, and their increase would be equivalent to a tax increase even though they give rise to higher benefit entitlements. The burden of projected increases in expenditure will be shared among contributions, taxes and reserve funds, or postponed for future generations through increased borrowing. Despite the fact that governments are building up pension reserve funds to cover future liabilities, subsidies from tax funds and/or borrowing are expected to rise in many countries when the population ageing materialises.

Finally, it needs to be borne in mind that the ageing of populations also affects other age-related expenditure, notably in the area of health and long-term care which are mainly financed by taxes and contributions in all Member States. Furthermore, the starting position of public finance balances and the level of public debt affects the long-term sustainability of public finances. The overall sustainability of public finances is and will be assessed in the context of the Stability and Growth Pact, based on the information provided in the stability and convergence programmes. According to the latest assessment, presented in the report on Public Finances in EMU — 2002, there is a risk that long-term budgetary imbalances will emerge in half the Member States: D, EL, E, F, I, A and P, however, involving different levels of risk and different reasons behind this risk (see European Commission, 'Public finances in EMU — 2002').

4.4. Objective 7: Adjust benefits and contributions in a balanced way

Ensure that pension provisions and reforms maintain a fair balance between the active and the retired by not overburdening the former and by maintaining adequate pensions for the latter.

Under Objective 3, Member States outlined their policies for ensuring that pension systems meet their traditional solidarity objectives, i.e. to deliver a decent share of societal wealth to retired people and to bring about a re-distribution of income in favour of the poorest older people. Under Objective 7, the concept of solidarity is considered in the context of the efforts required to maintain the financial sustainability of pension systems in an ageing society.

It is clear that Member States seek to avoid painful adjustments to benefit and contribution levels by raising employment and bringing their public finances in order before the financial impact of ageing will be felt. However, in many Member States this will not be sufficient in view of rising old-age dependency ratios. In these cases, it is necessary to ensure that the financial impact of ageing is equitably shared between generations. Objective 7 therefore calls on Member States to avoid the two extremes of overburdening the active generation, notably through rising contributions, and reducing pension levels below an adequate level.

4.4.1. Reducing the burden on future generations

Most national strategy reports make it clear that increased expenditure on pensions required by ageing populations cannot be financed by rising contributions. This would place too heavy a burden on the active population. Several Member States are committed to keeping contributions below a specified level or rule out contribution rises altogether. In Germany, legislation requires the government to propose appropriate measures if there is a risk that the contribution rate would have to rise above 20 % (until 2020) or 22 % (until 2030). The contribution rate in the Netherlands is not to be raised above 18.25 %, while Sweden intends to maintain contributions at 18.5 %. The Greek national strategy report rules out increases in contributions.

These commitments illustrate the determination of Member States to limit the extent to which the financial consequences of ageing will be shifted to future generations. One way to achieve this consists in reforming pension systems in such a way that increases in future public pension expenditure are curbed. Many Member States try to achieve this through changes in indexing methods applied to pensions in payment or to past earnings used for calculating pension entitlements. Changes to benefit formulae such as those signalled by Austria and Finland (similar measures have been taken in France) can have the same effect and are not only presented as having the objective of saving costs to the pension system; insofar as they strengthen the incentive to contribute over a longer time to the system, they are expected to boost the incentive to increased and longer employment.

Some Member States describe in detail the adjustments they are making to particular aspects of their pensions systems to avoid the accumulation of excessive costs in the future while maintaining the essential fabric of their systems. Finland lists a series of reform steps undertaken during the 1990s including survivors' and public service pensions; raising the lower eligibility limit for early retirement pensions; changes in the calculation of pensionable earnings and in the indexation method. The combined effect of these reforms is that pension expenditure in the long term will be considerably lower than it would otherwise have been. Austria sets out a similar list which also targets early retirement and survivors' pensions as well as changes to the formula by which benefits are calculated on the basis of earnings.

Societal change may create opportunities for reducing certain benefits for older people. Thanks to the fact that women will be increasingly likely to have adequate pension entitlements of their own, Finland and Austria expect that they will be able to reduce expenditure on survivors' pensions. This view is also shared by the Netherlands. In signalling a shift towards the individualisation of pension entitlements, Member States are both promoting, and seeking to capitalise on, increased employment participation as a means to establish a new sustainable balance between work and retirement. Similarly, the targeting of early retirement benefits involves addressing a twofold policy objective — it reduces both the burden on the pension (or pre-pension) system and increases the incentive to work for older workers.

Two Member States, Sweden and Italy, have pursued the objective of strengthening the link between contributions and benefits further and have opted for a (notional) defined-contribution system of public pension provision. In both cases, the primary objective of their reforms was to strengthen the actuarial relationship between contributions and benefits. Sweden argues that this means 'that the contract between the generations will now be more equitable than was the case […]'. Defined-contribution benefits are also the norm within the Danish second pillar and are likely to play an increasing role within the pension systems of the UK, Ireland and the Netherlands. Moves towards such defined-contribution systems should help promote longer working lives. Sweden and Italy both state that this is an important objective.

Defined-contribution schemes represent a qualitative shift in the balance between generations. However, certain risks previously borne mainly by contributors to the system are automatically transferred to beneficiaries ([21]): the risk that pension fund assets will not provide a good return and the risk of increased cost as successive age cohorts live longer and draw their pensions for a longer period. In the Swedish case, the new system is supported by well-developed information policies (discussed under Objective 11), the aim of which is to inform individuals during their working life as to what they should do in order to ensure that they get a good pension. In particular, the idea of working longer is clearly held out as a good way to cushion the other risks.

([21]) In defined-benefit schemes, discretionary changes in parameters do occur, so that beneficiaries are also exposed to financial risks.

Notwithstanding the strong commitment (discussed under Objective 3) to maintaining its defined benefit approach, the Netherlands states that it would wish to see the social partners adjust second-pillar pensions in the future to take account of present and projected longer lives.

The reforms of public pension schemes are reflected in one of the factors that drive the increase in future public spending on pension: the benefit ratio, i.e. the average pension relative to output per worker. According to the Economic Policy Committee's projections of public pension expenditure, the rise in the old-age dependency ratio (defined in this case as the ratio of persons aged 55 and over to the population aged 15 to 54) alone would drive up public pension expenditure (EU-15) by 6.4 percentage points of GDP between 2000 and 2050. Yet, the projected total increase for the EU-15 is about three percentage points. The falling benefit ratio as defined above is the main reason why public pension expenditure does not mirror exactly future demographic trends.

4.4.2. Maintaining pensions adequacy

Thus, reforms are starting to reduce the ageing-related burden that will have to be borne by future active generations. However, the strategies of Member States do not only rely on curbing the future growth of benefits. An important element of the strategy consists in increasing financial resources that will be available in the future. This can be achieved in particular by running down public debt or by accumulating pension reserves.

Public pension reserve funds, as envisaged or already in existence in a number of Member States, are a particularly visible effort to avoid over-burdening the next working-age generation at the time when the baby-boom generation will be in retirement. The creation of such funds aims at ensuring that current pension levels can be maintained or to limit the decline in pension levels. However, in many countries, these funds are at a very early stage of development and the amounts of assets accumulated are still rather limited. Although these funds are growing in importance over time, estimates of their sizes in the future are, for the most part, missing in the national strategy reports. Moreover, commitments to making contributions to these funds in some countries have been confined to bringing the social security sector into surplus which may be possible over the next 10 or 15 years only.

While public pension reserve funds allow public pensions to be maintained at a higher level than otherwise, the development of private-funded pension schemes provides an additional pension that, in several Member States, will compensate for lower public pension levels. The financial effort for building up public or private pension reserves is, in any case, borne by future pensioners, so that contributions to be paid by future active generations can be kept lower. However, it has to be kept in mind that, in real terms, only resources produced by future active generations can be shared between the active and the retired, although, through a current account surplus, pension reserve assets could be invested abroad — preferably in countries without an ageing problem — before Europe's baby-boom cohorts will start retiring. This would open, at a later stage, the option of running a current account deficit and hence increase the real resources that are available for sharing between the active and the retired.

Funding can at best address the transitory demographic ageing problem caused by the large cohort of the baby boom. The consequences of a permanent increase in life expectancy call for a more durable solution which balances the relationship between the time spent in employment and in retirement. This requires lengthening working lives which can be promoted by a close link between contributions and benefits and by adjusting benefits to changing life expectancy, as is the case in the new Swedish and Italian pension systems which nevertheless allow scheme members to maintain adequate pension levels by postponing their retirement. In the absence of a pension system design involving appropriate incentives to work and mechanisms for the adjustment of benefits to life expectancy, ad hoc adjustments in benefits and contributions will be needed.

4.4.3. *Conclusion: Risk sharing between the active and the retired*

The national strategy reports suggest that most Member States are committed to preventing excessive burdens on future generations. They have taken measures designed to curb the future growth of pension expenditure or, notably by setting up pension reserve funds and reducing public debt, increase the resources that can be used to finance future pension expenditure. Where public pension benefits are expected to fall in relation to earnings, Member States promote the development of private supplementary provision. Italy and Sweden have transformed their public pension schemes into notional defined-contribution schemes which ensure adequate pensions not only through increased contributions, but through the opportunity to earn more pension rights by working longer.

4.5. Objective 8: Ensure that private pension provision is adequate and financially sound

Ensure, through appropriate regulatory frameworks and through sound management, that private and public-funded pension schemes can provide pensions with the required efficiency, affordability, portability and security.

4.5.1. *Current and envisaged role for occupational and private pension provision*

In most Member States, private pension provision has an increasingly important role to play in ensuring adequate income protection in old age. This must be reflected in a sound regulatory framework that ensures a high degree of efficiency, affordability and security of such private pension schemes (portability will be dealt with under Objective 9). Moreover, several Member States accumulate pension reserves for their first-pillar schemes which raises the issue of how to manage these assets.

The importance of private old-age provision can be gauged in different ways. Table 3 (access to private pension schemes, see Objective 2) gives some indications on the numbers of people who are covered by supplementary (mostly occupational) pension schemes or receive benefits from them. Another measure of their importance is the total amount of benefits paid by such schemes. Some Member States have provided information on benefit payments by second-pillar schemes. In the United Kingdom and the Netherlands, these represent about 40 % of pensioners' income, representing roughly a pension expenditure equal to five to six percentage points of GDP. In Denmark and Ireland, second-pillar pensions amount to about 25–35 % of pensioners' income; while in Belgium, Luxembourg and Sweden this share is in the range of 10–25 %. In the remaining countries of the EU, the share of second-pillar pensions is currently below 10 % and almost negligible in a few countries (GR, F, A). The importance of second-pillar pension schemes is expected to increase in most countries as the development of such schemes is encouraged and a greater share of current workers pay contributions to such schemes. In many countries (UK, NL, DK, IRL, and S), the coverage of second-pillar schemes is already relatively high or on an increasing trend (as in B for instance), thus leading to a significantly more important role of second-pillar pensions in the retirement income of future pensioners. Moreover, several countries (D, E, GR, P) have taken measures to strengthen the framework conditions, such as legislative and supervisory provisions for private pension providers, and have introduced fiscal incentives or grants with the aim of promoting participation in second-pillar schemes and savings in individual pension insurance policies.

The role of individual pension insurance policies and other forms of retirement savings is particularly pronounced in Belgium where 45 % of the population participate in third-pillar schemes thanks to fiscal incentives for life insurance and pension savings. In Denmark, the Netherlands and the United Kingdom, third-pillar schemes also provide an important contribution to retirement income provision. The German 2001 reform introduced subsidies and tax incentives for saving in private pension schemes. These subsidies are expected to amount to about 0.5 % of GDP in 2008 when the new scheme will be fully phased in. The United Kingdom introduced a new type of private pension, the so-called stakeholder pension, in 2001 with the aim of promoting private saving and making it easier, simpler, cheaper and more flexible for individuals to provide for their retirement.

A more forward-looking way of measuring the importance of private pension provision is to examine the amount of assets held by such schemes. Table 13 below compiles information on pension assets mainly held by second-pillar schemes based on the report of the European Federation for Retirement Provision, and complemented, for some countries, with the information from the national strategy reports. However, these figures should not be considered as comparable. Definitions, particularly of what forms of insurance and savings are to be included in the third pillar, differ considerable from one Member State to another. Moreover, the value of these assets may have changed since the year when they were observed.

Table 13: Assets of second- and third-pillar pension schemes as a % of GDP

	Second pillar ([1]) (2000)	Second- and third-pillar schemes ([2])
Belgium	5.9	14.7 % (1999, second pillar including group insurance).
Denmark	23.9	79.4 % (2000) of which: Life insurance companies 43.6 Occupational pension schemes 18.8 Banks 17.1
Germany	16.3	
Greece (1999)	4.2	
Spain	7.0	
France	6.6	
Ireland	51.0	43 % (year not specified, pension funds only).
Italy	2.6	
Luxembourg (1999)	0.2	

Netherlands	111.1	166 % (end of 2001) of which: Pension funds: 108 Insurers 58
Austria	12.0	
Portugal	11.5	11.9 % (including open and closed pension funds, pension and share savings plans).
Finland	8.9	12 %
Sweden	56.6	
UK	80.9	
Total EU	29.2	

([1]) *Source:* EFRP. Assets included are all second-pillar pension fund assets and their equivalents as well as the book reserves within sponsoring companies. Not included are assets held by statutory social security schemes (first pillar) and group-insurance assets (except from those managed by insurance companies on behalf of pension funds).
([2]) *Source:* National strategy reports or information provided by national authorities.

While the importance of private pension provision appears to be increasing in almost all Member States, it is also likely that public pension schemes will remain the most important source of income for older people in most Member States — with the possible exception of DK, NL and IRL, the three countries with predominantly flat-rate public pension schemes, and the UK which allows the opting-out from its State earnings-related scheme. However, even if private provision overtakes public pension schemes in terms of total benefit payments, it is to be expected that for a very large proportion, if not a majority of pensioners, public benefits will remain the largest source of income in old age.

In countries with high pension levels from first-pillar schemes (France, Finland, Austria, Luxembourg), there is currently limited demand for occupational provision. Also, the social partners may have little interest in setting up occupational schemes, particular if they already play an important role in managing first-pillar schemes (as is the case in France and in Finland). Austria has reformed its severance pay scheme, which has been accompanied by tax incentives in order to strengthen the severance pay scheme as a part of occupational pension provision. In Luxembourg, occupational pensions have mainly developed in large international companies of foreign origin and in the banking sector. A new legal framework was introduced in 1999 and a new saving and pensions instrument was introduced in 2002.

In Spain, Italy and Portugal, legal frameworks were designed fairly recently, and occupational schemes have not yet developed into a significant component of national pension systems, although various initiatives are being taken to promote their development. This will also require the development of a market for annuities. New legislation was introduced in Spain in January 2002 to boost the development of occupational pension plans particularly in SMEs through collective bargaining. Greece, with the reform of 2002, wants to transform the ‘auxiliary funds’, which are currently part of the first pillar, gradually into funded occupational schemes.

In Italy, the development of private pension provision, occupational or individual, is a strategic priority for the government. Supplementary pension schemes will have to play a major role in supplementing adequate income levels for pensioners in the new notional defined contribution pension scheme. It is expected that the so-called closed occupational pension funds which are usually based on sector-wide collective agreements will gain importance as membership in ‘open funds’ is only possible in the absence of a closed fund or after three years membership in that closed pension fund (five years if the closed pension fund is in its first five years of existence). In Portugal, closed pension funds have recently experienced a slight decline in the numbers of contributors and the government is planning to set out a new regulatory framework to significantly develop second and third-pillar pension arrangements.

Several countries are now following the lead of the Netherlands, Denmark and Sweden as far as the important role of sector-wide collective bargaining for the development of occupational pension schemes is concerned. Belgium is making a determined move in this direction with the law on supplementary pensions that is now in discussion in the parliament and which also seeks to promote wide coverage, and some elements of solidarity in supplementary schemes. Spain, Germany and Italy also expect that coverage will be promoted through collective agreements. Ireland and the United Kingdom favour a voluntary approach to supplementary pensions and have recently focused their attention on designing more accessible pension products ('stakeholder pensions' in the UK and 'personal retirement savings accounts' in Ireland) and in the UK on simplifying the regulations around occupational schemes to make it easier for employers to make good occupational provision.

4.5.2. Regulatory frameworks for private pension provision

Private pension provision needs an appropriate framework for its development; the fact that public pensions are inadequate is not sufficient to trigger the development of private schemes. Such a framework includes prudential regulations, rules regarding contributions, investment income and benefits and clarity in the roles of employers and workers and, the scope for collective bargaining.

The European Union has an important role to play in developing this regulatory framework for private retirement provision. Life insurance is covered by the prudential rules of the life insurance directives. A similar framework for pension funds — or institutions for occupational retirement provision — is currently being discussed by the Council and the European Parliament. This directive aims at protecting the rights of future pensioners, at increasing the affordability of occupational pensions and at allowing the free provision of occupational pension services and cross-border membership.

In the area of social and labour law, the European Union imposes the principle of equal treatment between men and women in occupational pension schemes (such benefits are regarded as pay within the meaning of Article 141 of the Treaty). Directive 80/987/EEC on the approximation of the laws of the Member States relating to the protection of employees in the event of the insolvency of their employer obliges Member States to ensure that occupational pension rights are safe when an employer becomes insolvent. This can be achieved through external funding by setting up a pension fund that is separated from the sponsoring undertaking or through insurance.

The introduction of a modern regulatory framework for occupational pensions is quite recent in many Member States. Many important laws were only adopted in the past decade or two, and further improvements can be expected as a result of the forthcoming directive on institutions for occupational retirement provision.

There are different approaches to regulating supplementary pension provision. One option that is used for instance in Sweden, Denmark and France is to request providers to comply with insurance legislation which is long-established, including at EU level. However, occupational pension provision has given rise to the emergence of specific institutions and arrangements which will be covered by the new directive on institutions for occupational retirement provision.

In the UK and Ireland, pension funds are governed by trust law. This places the responsibility for running the schemes with a third party that is legally separate from the employer and members. The trustee has a duty to act in the best interest of the members and/or beneficiaries of an occupational pension scheme. The primary responsibility for the sound administration of the scheme lies with the trustees who assume personal liability. In Ireland, trustees and administrators of pension funds must also comply with national legislation governing pensions, and the operation of this legislation is monitored and enforced by the pensions board. In the UK, legislation also places requirements on trustees and administrators. Compliance is monitored by the Occupational Pensions Regulatory Authority (OPRA); a recent Green Paper has proposed a more proactive regulatory regime.

In the Netherlands, the social partners have the primary responsibility for the management of supplementary pensions — within the regulatory framework defined by the Pensions and Savings Funds Guarantee Act (PSW). In Italy, 'closed funds' can be established by associations or foundations operating on a not-for-profit basis and with an autonomous legal status whereas 'open funds' may be established by financial intermediaries specialised in asset management.

One particular type of occupational pension provision will not be covered by the directive on institutions for occupational retirement provision because it does not involve the creation of a separate institution to manage the scheme. Certain schemes consist in a simple promise by the employer to pay a pension. The corresponding liabilities are recorded in the balance sheet ('book reserves') and represent a convenient source of finance for the company. Such schemes exist for instance in Germany, Finland, Sweden, Luxembourg and Spain. Italy's severance pay scheme is also based on book reserves, but it is envisaged to switch to separate funds when this scheme is to be transformed into occupational pension provision. In order to provide safe pensions, these schemes have to be backed up by insurance which can guarantee the pension in the event of insolvency of the employer. Compulsory insolvency insurance for book reserves exists in Germany and Luxembourg.

The safety of pension funds depends on prudent asset management. Investment in the sponsoring employer's business must be strictly limited or guaranteed by insurance as in the case of book reserves. Otherwise, an insolvency would put employees at risk of losing both their current income and their future pension. In Ireland, investment in the sponsoring employer's business is allowed, but the amount of this investment that can be counted when the solvency of a scheme is being assessed, in accordance with the Funding Standard and regular reporting arrangements required under legislation, is strictly limited. In the Netherlands, company pension funds are allowed to invest a maximum 10 % of their assets in the sponsoring company. Apart from this general principle, approaches to investment strategies differ between the Member States. The UK, Netherlands and Ireland favour qualitative investment principles (the so-called 'prudent person' principle), whereas others such as France and Luxembourg prefer setting some quantitative limits for certain categories of assets to enhance the safety of the fund, albeit possibly at the price of lower returns. In Greece, the involvement of the State in pension fund asset management was the target of frequent criticism leading to a series of laws from 1990 onwards to ensure that asset management would be to the benefit of the insured members.

Financial risks, which any form of pension provision has to incur in some form, can be shared in different ways between pension scheme contributors and beneficiaries. Defined-benefit schemes, often still based on final earnings, guarantee a certain level of pension income depending on earnings and career lengths. It is the responsibility of the pension scheme — or of the sponsoring employer — to ensure that the fund holds sufficient assets to meet pension liabilities. As asset values fluctuate, pension funds must either be allowed to hold surpluses as a safety margin (this may be limited for tax reasons as higher contributions diminish tax revenue) or required to take other action to address the risk of underfunding. Member States have different levels of tolerance regarding managing of underfunding. In Denmark, for instance, a life insurance company or pensions fund that fails to meet investment standards will be asked by the Financial Supervisory Authority to submit a recovery plan. If this does not work, the institution will come under administration and attempts will be made to transfer the pension schemes to other companies or pension funds with adequate capital.

The definition of what constitutes adequate funding of future liabilities depends on various economic and actuarial assumptions chosen for the calculation of the technical provisions (or future liabilities) when the occupational pension schemes provide cover against bio-metric risks and/or guarantee either an investment performance or a given level of benefits. The rate of interest (or discount rate) is an important assumption needed to calculate the actuarial value of accrued pension rights. The proposed directive does not aim at harmonising this rate of interest, but it is accepted that this issue needs to be carefully monitored. By contrast, the directive will require full funding at all times for pension funds that provide their services across borders.

In the case of defined-contribution pension schemes, the commitment of the employer is limited to paying a certain amount of contributions into a savings scheme. The risk of low returns is entirely borne by the beneficiary. At the moment of retirement, in order to obtain a pension, the accumulated capital under a defined-contribution scheme needs to be converted into a regular income the amount of which will depend on interest rates at the moment of purchase of an annuity. This, too, places a significant income risk on the beneficiary.

Finally, under private schemes, the risk of inflation is often borne at least partially by beneficiaries which may result in declining real values of pension income during the period of retirement. The Dutch and the Irish national strategy reports explain that many occupational pension schemes are trying to protect their beneficiaries against inflation, but this is not a legal obligation. The ability of pension schemes to insure against the risks of financial instability or inflation depends on the availability of suitable assets such as index-linked bonds. It is common for pension funds and individuals to adapt their asset portfolio in accordance with age profiles. The closer future beneficiaries come to retirement, the safer the investment should be (i.e. typically a shift from company shares to government bonds). The reduction in public debt may have implications for the ability of pension funds to hedge against financial risks through investment in government bonds, but these were not discussed in the national strategy reports.

The national strategy reports present a variety of supervisory bodies, some of which have only recently been created or restructured. The directive on institutions for occupational retirement provision will require all Member States to have effective supervisory authorities.

Sound management of pension assets is not only an issue for managers of private schemes. Several Member States are accumulating pension reserve funds in their social security schemes to meet the future needs of the ageing baby-boom cohorts. In Finland, these assets are held by the institutions that manage the statutory earnings-related pension scheme. In the other Member States with a reserve fund, this is held at a central level but usually managed separately from the central government budget. In Ireland, the fund is controlled and managed by a commission which is independent of government and has discretionary authority to determine and implement an investment strategy in order to obtain the optimal financial return, subject to prudent risk management. In some Member States (e.g. Spain and Luxembourg), the management of the reserve fund is still under discussion.

4.5.3. *Reducing administrative costs*

Only a few Member States reported figures on administrative costs of pension schemes. Due to economies of scale and the absence of a need for sophisticated asset management, administration costs tend to be significantly lower in public pay-as-you-go pension schemes than in private-funded schemes. The OECD estimated that administrative costs of private pension schemes were in a range between 10 % and 35 % of contributions. In Belgium, management fees for old-age and survivors pensions represented 1 % of total expenses in 2001, while management fees for second and third-pillar provision amounted to 4 % of total expenses. In Finland, the total operating expenses of the pension insurance system were 2.7 % of premium income in 2000, including the operating expenses of the statutory earnings-related pension insurance, the national pension and optional supplementary pension insurance. The operating expenses of the life assurance component were about 4.9 % of their premium income. In Ireland, the cost of administering all social welfare contributory old-age pensions represent approximately 1.5 % to 2 % of total payments, whereas the administrative costs of occupational schemes was of the order of 5 % of contributions in 1994, with significant variations depending on the type, structure and size of the scheme and the level of contributions paid into the scheme. In France, the management costs of voluntary supplementary schemes are generally 4 % of contributions paid into the scheme. In the UK, the administration charges for stakeholder pensions are capped by law at 1 % of the fund’s value per year.

However, there is still scope for improvements in public schemes through rationalisation measures (e.g. merger of pension insurance institutions). In Austria, where administrative expenditure currently stands at 1.8 % of pensions expenditure, further reductions are planned thanks to the creation of a joint data-processing company for all social insurance institutions. In Germany, the proportion of management costs has steadily fallen over the past three decades and administration costs accounted in 2000 for 1.6 % of the total receipts of the statutory pension insurance. In Luxembourg, the administration of the general pension scheme amounted to 1.4 % of current spending in 2001.

In Italy, overall management costs of closed pension funds were estimated at 0.57 % of the value of assets — which represents a significant reduction in real returns. However, thanks to efforts by the social partners, there is a declining trend. Moreover, the law allows social security institutions to support such pension funds by collecting contributions and paying pension benefits. Open funds incur considerably higher costs, but not as high as private pension schemes operating through life insurance policies.

The need for reducing administrative costs is widely recognised and being addressed in various ways. 'Stakeholder pensions' in the UK and 'personal retirement savings accounts' in Ireland try to make private pension provision less onerous and hence more accessible for people on low incomes. The UK Government is determined to further simplify the occupational and personal pension system so as to make it easier to understand and to reduce costs. In particular, the report commissioned from Alan Pickering of July 2002 proposes a radical simplification of pensions legislation to reduce the administrative burdens on schemes and employers.

The latest pension reform in Germany introduced an obligation on providers of government-supported supplementary pensions to provide their customers with written information on the expected management charges before the contract is concluded. A similar obligation exists in Denmark where life insurance companies and pension funds are obliged to give adequate information on rights and obligations before and during membership in the scheme. Starting in April 2003, defined-contribution schemes (occupational, personal and stakeholder schemes) in the UK will be required to give members an annual estimate of their pension in retirement is likely to be (including future contributions, annuity rates, etc). Further obligations in terms of information to scheme members can be expected to be introduced in the wake of the directive on institutions for occupational retirement institutions.

4.5.4. Conclusion: Contribution of funded schemes to future pension provision

Significant progress is being made towards a sound regulatory framework for funded pension provision across the EU. This will be helped by the forthcoming directive on institutions for occupational retirement provision. However, financial risks will still be addressed in different ways in the Member States and further cooperation is required to achieve greater convergence. The difficulty of managing financial risks such as instability on capital markets and inflation may lead to such risks being shifted more and more to beneficiaries which may have adverse consequences for the future adequacy of pensions. Developments in this area need to be monitored and there seems to be scope for more in-depth information exchange on how to achieve the best balance between risk management and pensions adequacy.

Progress is also being made in reducing management costs. This can have considerable benefits in terms of affordability of, and hence access to, private pension provision.

The contribution of private provision to the sustainability of public finances is indirect, but may be significant in many Member States. In the UK, for instance, the costs of the 'Pension credit' scheme will depend on the extent to which private provision lifts incomes above the levels guaranteed by the pension credit. Germany has been able to lower slightly the replacement levels in the public scheme by supporting the development of private provision which offers the opportunity to compensate for the effects of this reform. In other Member States, the success of private provision may help to reduce pressures for increased public pensions expenditure and give governments greater freedom to curb future expenditure growth in public schemes.

5. MODERNISATION: RESPONDING TO CHANGING NEEDS

Pension systems need to evolve to reflect changes in society and the labour market. Pension scheme rules were often designed in a different social context, responding to different needs and aspirations. However, if they are based on outdated assumptions about family and employment patterns they will fail to provide the required pension benefits to more and more people and risk creating undesirable incentives.

Traditional pension schemes are well adapted to life-long careers in full-time employment with the same employer. This does not reflect the requirements of modern labour markets, nor the aspirations of many individuals. Pension systems must not penalise flexible forms of employment and job mobility.

Good pensions coverage of flexible forms of employment will also help achieve greater equality between men and women, as women tend to be over-represented among part-time workers and among those who have to interrupt their careers for family reasons. In some countries, equal treatment of men and women has yet to be achieved in pensions legislation, mainly with regard to pensionable ages and survivors' benefits.

Finally, modernisation of pension systems also implies more transparency. Policy-makers need clear information on future challenges and policy options that are available to them. They should seek a broad consensus on reform measures so as to avoid frequent and unexpected policy changes. This will also make it possible to provide better information to individuals about what they can expect from their pension system — and what additional effort may be required to achieve the desired living standard after retirement.

5.1. Objective 9: Adapt to more flexible employment and career patterns

Ensure that pension systems are compatible with the requirements of flexibility and security on the labour market; that, without prejudice to the coherence of Member States' tax systems, labour-market mobility within Member States and across borders and non-standard employment forms do not penalise people's pension entitlements and that self-employment is not discouraged by pension systems.

Many pension schemes are well adapted to standard employment patterns (full-time work and life-long careers), but tend to serve people in atypical jobs or people with interrupted and non-linear careers less well. Both statutory and occupational pension schemes need to be adapted to more flexible forms of employment and greater mobility by improving access to pension rights and enhancing their portability.

5.1.1. Access to pension rights

First-pillar pension provision is practically universal in all Member States although separate schemes may exist for certain categories of workers. In particular, public sector employees, the self-employed and farmers have special schemes in several Member States. A certain number of adaptations to first-pillar schemes to meet the needs of atypical workers were reported in the national strategy reports. Several of them focus on 'new self-employed' people who are not employees, but provide their services for a single company. This group of workers was given equal rights to other non-farm self-employed in Austria. Germany included self-employed persons with no employees of their own into the statutory pension scheme and introduced checks to identify fictitious self-employment intended to avoid social insurance obligations. In Italy, a compulsory scheme for atypical workers (the so-called *parasubordinati,* flexible employment relations which bear similarities with self-employment, but are characterised, in most cases, by a close and continuous relation with a single company) was established within the statutory social insurance scheme INPS in 1996; it covers around two million workers and has net receipts of almost EUR 11 billion.

An interesting feature of the Spanish system is the fact that self-employed workers can choose freely the contribution basis between a minimum and a maximum amount that is fixed every year by the government budget. This measure responds to the difficulty of assessing the true income of self-employed workers. However, for the self-employed workers over the age of 50 years, the choice is restricted to prevent people from paying high contributions only during the years that count for the calculation of the pension entitlement.

In Austria and Germany, the coverage of marginal part-time workers was extended. These were previously exempted from the social insurance obligation and did not earn any pension rights. In Austria, these workers were offered optional low-cost self-insurance under the health and pension insurance scheme, as long as the marginal part-time work is their only source of earnings. The employers are obliged to pay contributions, when they employ more than one marginal part-time worker and the total sum of salaries given to all marginal part-time workers exceeds 150 percentage points of the respective exemption limit, which is thought to prevent a drift into atypical work contracts. In other Member States, marginal employees are obliged to contribute, but they may not necessarily earn an entitlement to benefits. To address this problem, qualifying conditions were eased in several countries notably for part-timers and marginal workers. In France, 200 hours of work paid at the minimum wage (the equivalent of five weeks of full-time work) is sufficient to earn three months of insurance career. If income from short-term or other non-standard employment contracts exceeds EUR 690.97 a year (in 2002), workers in Finland are covered by pension insurance and can build up pension entitlements.

An exception to this general trend of improving the statutory pensions coverage of atypical workers is Portugal, where tighter qualifying conditions were recently introduced (120 days of employment per year compared to one day/year). This helps prevent abuse, but it can also adversely affect the pension rights of part-time, temporary and seasonal workers. Italy reports that changing from full-time to part-time work is still penalising for pension purposes.

First-pillar pension coverage of people in non-standard employment is by and large satisfactory and even involves a large degree of solidarity towards these groups, notably through the mechanisms discussed under Objectives 1 and 3. By contrast, the situation is less favourable with regard to occupational pensions.

Several Member States are nevertheless making efforts to improve access to occupational pension schemes. In the Netherlands, legislation that came into force in 1994 made it illegal to exclude part-time workers from supplementary pension schemes; legislation stipulates that employees working on temporary employment contracts should not be treated less favourably than comparable employees on fixed employment contracts. Sector-wide collective agreements on occupational pensions appear to be a good tool for ensuring that coverage is comprehensive, including in sectors in which SMEs are predominant which would normally not offer access to occupational pension provision. Such collective agreements also allow the introduction of solidarity mechanisms into the second pillar, as is envisaged by the recently presented reform in Belgium which aims at fostering the development of occupational pension provision. The intention is to offer coverage of career breaks due to unemployment or sickness within these schemes.

5.1.2. *Portability of pension rights*

Portability of pension rights under the first pillar is not an issue in countries with a single pension scheme. A change of jobs does not require membership in a different pension scheme. Countries with different statutory schemes for specific categories of workers usually have coordination arrangements between the different schemes that protect the pension rights of mobile workers. These arrangements are referred to for instance in the French and Luxembourgish national strategy reports. However, problems do seem to exist in Greece for mobility between the various auxiliary funds, particularly when a worker moves from a generous fund (usually of the public sector) to a less generous fund before having acquired a full entitlement. Many national strategy reports also refer to EU Regulation 1408/71 which guarantees the social security rights of migrant workers. Non-EU migrant workers are often covered by bilateral social security agreements.

Major problems of portability of pension rights can often arise in the second pillar. All Member States where second-pillar pension provision is well developed (e.g. Denmark, Ireland, the Netherlands, Sweden, and the United Kingdom) seek to ensure, by legislation or through agreements by the social partners, that obstacles to mobility are minimised. This includes reducing maximum vesting periods (the time after which a guaranteed pension entitlement is acquired) which are typically nine months in Denmark, one year in Belgium and two years in Ireland and the United Kingdom.

Vested rights can either remain in the previous pension scheme or be transferred into the new employer’s scheme. In case of preservation, it is important that these rights are protected against inflation. The UK requires that they be up-rated in line with inflation up to a maximum of 5 %. As earnings tend to grow faster than prices, this mechanism would still leave a person who changes jobs less well off than another worker with the same earnings, but an uninterrupted career with the same employer. In the Netherlands and in the UK, employees have a right to transfer the capital value of their pension entitlement to a new scheme (subject to the new scheme meeting certain quality requirements). If no transfer takes place, the pension rights remain in the previous employer’s pension scheme until the employee retires. The preserved pension entitlements must be up-rated in the same way as pensions in payment by the scheme.

Some countries where supplementary pension funds are not very common have yet to take measures to address the issue of portability and thereby increase the attractiveness of supplementary pension schemes. In Portugal, 54 % of pension funds do not guarantee any pension rights if a worker leaves the scheme before retirement. In Italy, three years of participation in a fund are necessary to acquire vested rights and to be able to transfer them to another fund (however, in the case of membership in a newly established scheme this period may be five years).

Measures to improve the portability of occupational pension rights are accepted as a necessary corollary of reforms that seek to promote second-pillar provision. Spain, Italy and Portugal have announced that they are planning to tackle the issue of portability. As part of the latest pension reform, Germany halved the maximum vesting periods permitted by law from 10 to five years and guaranteed immediate vesting of occupational pension rights based on employee contributions. Furthermore, the age threshold at which vested pension rights can be acquired was lowered to 30 years. In Belgium, the recently proposed reform of the second pillar will significantly improve the portability of supplementary pension rights, giving beneficiary the option to keep acquired rights in the previous scheme or to transfer them to the new employer's scheme.

Problems of portability normally do not arise in defined-contribution schemes or personal pension plans. In the case of defined-contribution schemes, each scheme member has an individual account with an amount that can be easily preserved or transferred to another scheme of the same type. The drawback of defined-contribution schemes is, however, that beneficiaries have to bear the full investment risk and thus face far greater uncertainty about their future pension income. Personal pension plans would be independent of the employment relation, but they are only an option if employers accept to pay their contributions into the personal plan, rather than the company scheme. Moreover, individual retirement provision tends to be more expensive than collective second-pillar provision and it remains to be seen whether the new products defined in the UK ('stakeholder pensions') and Ireland ('personal retirement savings accounts') can overcome these drawbacks. In any case, it remains likely that workers who frequently change jobs and, as a result, belong to several supplementary pension schemes during their careers, will tend to have reduced pension entitlements when they retire.

The issue of portability will therefore remain on the political agenda, including at the European level. The Commission has recently consulted the social partners on the issue of portability of supplementary pension rights ('Improving the portability of supplementary pension rights', first stage consultation of the European social partners SEC/2002/597 of 27/05/2002). A second stage consultation will take place during the first half of 2003 before deciding whether action at EU level should be taken.

5.1.3. Conclusion: Improvements needed in second-pillar provision

Statutory schemes, by and large, respond well to the challenge of providing pensions to atypical and mobile workers. By contrast, second-pillar schemes still pose problems on both fronts. Nevertheless, those Member States which are promoting these schemes are working to address these difficulties. Action to facilitate cross-border portability of occupational pensions at the EU level is continuing.

5.2. Objective 10: Meet the aspirations for greater equality of women and men

Review pension provisions with a view to ensuring the principle of equal treatment between women and men, taking into account obligations under EU law.

Women represent the majority of older people — nearly 60 % of people over 65 and close to two thirds among those over 75. However, pension systems are not particularly geared towards women's evolving needs. Most pension schemes were traditionally designed for men working full time and without career breaks as family breadwinners. Women's needs were met through their husbands income or, after his death, widows' pensions and complemented with child allowances. This approach is still reflected in the basic principles of many pension schemes, although many Member States are progressively adapting their systems in accordance with the existing Community law and in the light of higher labour-market participation of women and aspirations to greater gender equality.

5.2.1. *Gaps in the pension situation of men and women*

As pension systems are not only designed to provide a universal flat-rate income, but to replace earned income and to maintain living standards reached during one's working life, differences in employment between men and women will inevitably be reflected in pension entitlements. Women's current employment rates remain significantly below those of men with a long-term trend towards reduced gaps. The difference is larger for older workers and smaller in younger age groups. As a result, women who are retired today or who are reaching retirement age had shorter employment records than men and lower earnings. Women are also more likely than men to have worked part-time and in companies which did not offer them supplementary pensions. Employer attitudes as well as different qualification and career choices may also contribute to the gap between women and men's earnings over the working life.

Such differences between men's and women's employment histories are reflected in today's pensions. The gap between women's and men's own pensions can be larger than the pay gap ([22]). Thus, Finland reports that in 2000 women's average total pension is EUR 841 compared to an average for men of EUR 1 151, a pension gap of 27 % compared to a pay gap of only 20 %. In Spain, the average contributive pension was EUR 405 for women and EUR 650 for men in 2001, a gap of 37 % (pay gap based on 1998 ECHP figures: 14 %). In Austria, the average statutory pension was EUR 734 for women and EUR 1 334 for men in 2000, a gap of 45 % (pay gap: 21 %). In France, the average monthly pension for men in 2001 was EUR 1 461 compared to EUR 848 for women, a gap of 42 % (pay gap: 11 %). In the UK, in 2001, the gap is 16 % (men receiving GBP 183 per week, women GBP 153) — compared to a pay gap of 24 % — and the difference stems mainly from occupational pension benefits that tend to be significantly lower for women.

Such low individual pension entitlements tend to increase women's risk of poverty, particularly when they live alone and have no other sources of income such as a derived benefit (survivors' pension). Poverty risks in the late 1990s were indeed higher for elderly women than for elderly men in most Member States (see Table 2). Only in Spain and the Netherlands were women exposed to lower risks of poverty

([22]) The data in this paragraph are drawn from the national strategy reports and thus come from national sources and use national definitions. The pension gap is the difference between average pensions received by men and by women as a percentage of average pensions for men. Pay gap figures are estimated by Eurostat for the year 1999. They correspond to the structural indicator 1.3 in the Commission communication on structural indicators, COM(2002) 551 final (Comment: It was specifically requested by the EPC to have the definition of the pay gap, not only a reference to another document.)

than men, and in Belgium the difference is very small. However, the gaps are generally larger for older people living on their own.

Many of the measures designed to strengthen the adequacy of pension systems should particularly benefit women who more often than men rely on minimum income guarantees. Women are also the main beneficiaries of pension credits for bringing up children or caring for relatives.

Increasing second- and third-pillar provision presents a new challenge. Maintaining and improving pension levels for women will require higher participation on the labour market. Access to second and third pillars schemes is improving, but solidarity features (e.g. pension credits for parental leave) remain scarce in such schemes. Moreover, women may receive reduced annuities from such schemes due to their longer life expectancy than men's (by around four years).

Chart 15

Source: Demographic statistics, Eurostat.

5.2.2. *Gender differences in pension legislation*

Community legislation requires equal treatment of men and women in statutory social security matters, but allows for certain exceptions regarding the pensionable age, survivors' benefits and pension rights for bringing up children (Directive 79/7). These derogations have been interpreted very restrictively by the European Court of Justice. The directive clearly considers these exceptions as transitional and requires Member States to examine periodically, in the light of social developments, whether such derogations from the principle of equal treatment are still justified. In the area of occupational pensions, Directive 96/97/EC has modified Directive 86/378/EC to bring it in line with Article 141 as interpreted by the ECJ. It also restricts the possible derogations compared to Directive 79/7 as Article 141 of the Treaty requires that women and men must receive equal pay for equal work. This includes not only direct pay, but also other forms of remuneration such as occupational pensions.

Member States are generally committed to achieving full equal treatment in their pensions legislation, although some Member States have yet to fully ensure it in their various provisions. The Swedish report underlines the importance of this by arguing that compensation in social insurance systems for gender differences on the labour market will merely serve to reinforce traditional gender roles. Giving more generous survivors' benefits or higher allowances and pension credits for bringing up children to women than to men might act as a financial incentive for maintaining traditional gender roles and discourage men from taking career breaks.

The equalisation of pensionable ages for men and women in occupational or equivalent schemes is achieved by raising the retirement age of women to that of men. This represents a major contribution to raising employment rates of older workers and reducing future pensions expenditure. Regarding the pensionable age, Belgium aims for equality in 2009, the UK in 2020 and Austria by 2033. Some Member States including Sweden, Italy and Spain offer flexible retirement possibilities allowing people with shorter careers — and hence many women — to earn a full pension.

As the new pension scheme is phased in in Italy, the same flexible pensionable age will apply for both men and women. However, mothers will obtain a higher pension corresponding to up to two additional years of employment (for three or more children). Various other benefits or advantages that are linked to the retirement age or pensioner status will also have to be equalised (notably invalidity benefits and advantages offered to pensioners such as reduced transport fares).

Another discrimination between men and women that is accepted by Directive 79/7 concerns compensation for raising children. Germany, Greece, Germany, France, Ireland, Italy, Luxembourg, UK and very recently Sweden are using this option. As recently stated by the European Court of Justice, this option should be allowed on an equal basis for men and women in public sector schemes. Equal treatment of mothers and fathers has to be applied to schemes where pensions are considered as a remuneration, and some public sector schemes will have to be adapted accordingly.

France awards contribution periods to mothers regardless of whether they have interrupted their career or not to compensate them for having to shoulder professional and family obligations. Luxembourg has introduced baby years (minimum two years) for one of the two parents. In Germany, pension credits for childcare can be awarded to either the father or the mother and it is up to the parents to declare who is to be credited with these pension rights. However, in the absence of concurrent declarations by both parents the childcare periods must be credited to the mother. In Sweden, it will be offered to the parent with the lowest income, if the parents do not specify which one of them should be given the pension credit.

5.2.3. *Measures to promote greater gender equality in pension systems*

The main reason for women's limited employment records is the fact they have to assume most of the caring and household responsibilities. Bringing up children often means career sacrifices for the parent who bears most of the caring responsibilities — typically the mother who, as result, will have reduced pension entitlements. Many statutory pension systems recognise career breaks for raising children by crediting pension rights or by counting such years towards the number of years that is required for obtaining the right to a pension. These credits are often calculated at the level of the minimum pensions. Some occupational schemes with stronger solidarity elements also award pension credits for such periods, but have to do so on strictly equal terms for men and women to comply with 141 of the Treaty (equal pay for men and women).

Leave arrangements, such as parental leaves, are important tools for allowing women and men to reconcile work and family responsibilities. Provisions concerning allowances and pension credits are very contrasted among Member States. In all, 11 Member States take into account in one way or another the leave periods in the pension calculation at its minimum level. On the one hand, generous support through direct cash allowances or pension credits may encourage fathers to take up the leaves but, on the other hand, when associated to longer career interruptions they may have a negative impact on aggregate employment and may jeopardise the mother's chances to resume a career.

In terms of equal opportunities on the labour market, it might be more efficient to reallocate some resources from generous full time leave allowance to the combining care and work and developing childcare services, as some Member States suggest. Part-time arrangements are offered by some Member States. Luxembourg for instance offers a parental leave allowance of EUR 1 650 per month, or EUR 825 for a parent who works part-time, and credits pension insurance contribution for this period. France is currently discussing a 'free of choice' benefit which would be available to parents to alternatively reduce their activity or to pay for care services.

In view of the weaker labour-market participation and lower earnings of women, survivors' benefits remain an important tool for ensuring adequate living standards of older women. Several countries (Austria, Germany, Netherlands, Sweden, UK) are reducing in various ways these benefits as women become less dependent on them either because of better employment and hence contribution records or as a result of other policy measures that will increase women's individual pension rights. Thus, Germany lowered survivors' pensions from 60 % to 55 % of the spouses pension while at the same time increasing pension credits for bringing up children.

The Greek report points out that the conditions attached to survivors' benefits may create perverse incentives by guaranteeing married women higher incomes through derived benefits from their spouse pension than they would be able earn through their own employment. It is likely that other survivors' benefit schemes also interfere in undesirable ways with individual choice regarding employment or remarriage, but these are not discussed in other national strategy reports.

In Sweden, where female labour-force participation has been high for a long time, there is a strong emphasis on individual rather than derived rights; the acquisition of individual pension rights is helped by pension credits for childcare periods. Survivors' pensions are available on equal terms for men and women since 1990 in the form of an 'adjustment pension' which provides 'reasonable economic support for a certain period following the death of a partner'. For surviving spouses under the age of 65, the period is limited to 10 months (12 in 2005). However, the adjustment pension is always granted until the youngest child reaches the age of 12. A widow's pension which is only payable to women still exists but will be phased out over an extended period; widows who married before 1990 will generally be eligible. Occupational pension schemes usually offer survivors' benefits.

The Swedish national strategy report does not discuss the social impact of cutting survivors' benefits, but the partner's death might imply a significant drop in the surviving spouse's living standard. It is interesting to note that in Sweden there was a large gap between men and women in the relative income of people over 65 compared to people aged 0–64 (see Table 2). Sweden allows individual premium pension rights (the funded part of the new Swedish pension system financed from 2.5 percentage points of the contribution) to be transferred to one's spouse. This can be decided every year for the totality of premium pension rights earned during the year. However, very few people use this option and the charge for this transfer amounts to 14 %.

A major issue is the sharing of pension rights in the event of family breakdown. The UK report explains that 'for many married women, the adoption of caring and domestic responsibilities has enabled their husbands to work and build up a decent pension. So the husband's pension reflects the contribution that both have made to the marriage'. Since December 2000, the value of pension rights can be shared in divorce proceedings, although this is not compulsory. Pension sharing is also possible in Denmark, Ireland, Germany and it is statutory in the Netherlands. Germany has also introduced the possibility of splitting pension rights for spouses who continue to live together as a way of individualising pension rights. Similar options are currently also discussed in Austria.

5.2.4. Conclusion: Impact of pension systems on gender equality

Member States are gradually adapting their pension systems to the new social and economic roles of men and women. They are moving from direct discrimination in pensions legislation in favour of dependant housewives to new rules that aim at facilitating the reconciliation between family responsibilities and work for both parents. However, in spite of such measures and increased labour-market participation of women, significant differences between women's and men's pension entitlements will subsist for a long time to come. Further gender assessment is needed to understand the impact of recent reforms on the relative situation of men and women.

The strengthening of minimum income guarantees can be expected to diminish poverty risks while pension credits for periods of childcare or care for elderly relatives should raise individual entitlements. Survivors' benefits, by contrast, tend to be reduced, reflecting the tendency towards individual rights which is made possible by towards a greater labour-force participation of women. The increasing importance of supplementary pension provision might have an adverse impact on equality between men and women, although access to occupational pension schemes is being improved in many Member States. While it is clear that women have a right to the same pension benefits as men under defined-benefit occupational schemes, in private defined-contribution schemes women may receive lower pension benefits due to the use of gender-specific actuarial factors (reflecting the longer life expectancy of women). However, in public defined-contribution schemes (Sweden, Italy), unisex actuarial factors will be used so that women and men obtain the same annual pension for identical amounts of contributions. The Netherlands introduced a statutory requirement for equal benefits for men and women even under defined-contribution schemes; this will come into force in 2005.

The Lisbon target of raising female employment rates to 60 % remains well below the employment rate for men. However, achieving this target will certainly enhance future pension entitlements of women. Further progress will require combined efforts from three major policy fields, social protection, employment and family affairs which should aim at a better sharing of rights and responsibilities within families, a better sharing of paid and unpaid work between men and women, better rewards for caring responsibilities for both women and men, and better professional care services as an alternative to career breaks.

5.3. Objective 11: Demonstrate the ability of pension systems to meet the challenges

Make pension systems more transparent and adaptable to changing circumstances, so that citizens can continue to have confidence in them. Develop reliable and easy-to-understand information on the long-term perspectives of pension systems, notably with regard to the likely evolution of benefit levels and contribution rates. Promote the broadest possible consensus regarding pension policies and reforms. Improve the methodological basis for efficient monitoring of pension reforms and policies.

Achieving the 10 common objectives discussed so far will secure the future of European pension systems. However, this is not simply a task for technocrats. Without determined political leadership and strong public support for necessary reform measures it will not be possible to build solid pension systems. Building safe and sustainable pensions poses particular challenges for governance — the issues are complex; the impact of changes are slow and out of step with the normal rhythm of political change, but their effects on the lives of citizens are profound. The preparation and publication of the national strategy reports should contribute to the necessary open debate on reforms of pension systems. However, a rational debate must be based on sound information about the current and future situation of pension systems. This should be the basis for developing a broad consensus which is necessary to avoid frequent about-turns after each election. Policy-makers should seek to give citizens a clear idea of what they can expect from their pension systems — and what they have to do themselves to prepare for their retirement.

5.3.1. Monitoring of pension systems

Mechanisms for monitoring the aggregate financial situation of pension systems, and increasingly also their impact on the social situation, have been significantly improved in many Member States.

Some countries have introduced statutory obligations to report on public pension schemes. The German Government must submit an annual pension insurance report to the legislator. This must include projections regarding the required contribution level for the next 15 years. Once in each legislature, the report must also present a survey of the income situation of pensioners. In Ireland, actuarial reviews of the Social Insurance Fund are statutorily required every five years and the first report covers the period 2001 to 2056. In addition, the quarterly national household survey has been adapted to track improvements in occupational pension coverage (the government has a target of 70 % cover for those over age 30 and must review the situation by 2005). In Austria, a 'Commission on the long-term safeguarding of the pension system' has been established. It will not only determine the annual factor for adjusting the pension amounts, but also report on the long-term trends in the development of the Austrian pension scheme once every three years.

The regular monitoring of the main parameters of a pension system is a precondition for more or less automatic adaptation mechanisms. Sweden and Italy have gone furthest in this direction by fixing the contribution rate and building automatic stabilisers into the system. Sweden has an automatic stabilising mechanism which will adjust the indexation of benefits and of notional pension capital if pension liabilities exceed pension assets; the system is monitored through reports that the National Social Insurance Board is required by law to present annually. In the case of Germany, should the projections referred to above indicate that targets in terms of contribution rates or benefit levels will not be met, this will trigger an obligation for the government to propose adjustments.

Greece and France make the point that the complexity of their systems makes it more difficult for them to provide good information regarding future prospects of their systems than for other Member States. Nevertheless, France has developed various statistical tools that will also allow medium- and long-term simulations of the pension system and information from the many different schemes is being centralised. Finland, too, envisages improving the collection of harmonised data from pension institutions and first results should be published in 2003. The UK is currently developing a new dynamic microsimulation model for the long-term analysis of pensions policy. This will allow to estimate the income situation of pensioners under various assumptions about public and private pension schemes and economic parameters, thus linking financial and social aspects.

Regarding information on private pension schemes, the Dutch national strategy report explains that, since 1994, the supervisory authority PVK has been obliged to collect annual data on supplementary pensions, including coverage and benefits offered. In Denmark, where defined-contribution schemes are predominant, the emphasis is on financial performance data. The Danish financial supervisory authority publishes comparable financial ratios covering administration costs of schemes and returns on assets.

In some countries, ad hoc reports were commissioned as a basis for reform discussions. A major economic analysis on the impact of ageing on government finances, healthcare and pensions in the Netherlands was published by the Central Planning Bureau and became a basis for policy-making. It was recommended that this analysis should be updated every four years.

Finland was the only country to mention opinion surveys on public confidence in the pension system. These are conducted from time to time and allow the monitoring of public perceptions of the pension system. The last one took place in late 2001 and showed rising confidence.

While there is certainly room for improvement in most Member States, only Greece presents a very critical assessment of its own situation with regard to the monitoring of the pension system. Building confidence in the system is the central theme of the Greek report; the report stresses a need for bringing about structural change before the kind of information policies envisaged under this objective would be feasible. Transparency is hampered by fragmentation of the system and the complexity of legislation. Moreover, it reports that many funds do not comply with the statutory obligation to carry out actuarial studies every five years. The situation can be expected to improve through the consolidation of funds into larger units and the creation of a national actuarial authority. Thus, the Greek report place modernisation at the core of its pension strategy, assigning to it a key role in preparing the way for progress on the other two overall objectives (adequacy and sustainability).

5.3.2. *Mechanisms for building political consensus*

The measures described above will contribute to a more informed policy debate in the Member States and hopefully strengthen the consensus on the required policy responses. The need for consensus building is widely recognised and several Member States report on the structures in which all interested parties are associated in policy development.

Several national strategy reports insist on the leading role of the social partners. This is obvious in the case of occupational pension schemes based on collective agreements (as in Denmark and the Netherlands). However, even in some statutory schemes, they are important players. In Finland, the future of the earnings-related pension scheme is shaped through the negotiations of the social partners which are then translated into legislation by Parliament. The social partners are also represented in many of the consultative bodies that exist across the EU. In Italy, the 1995 reform was approved, prior to its adoption by Parliament, via a referendum of workers promoted by the trade unions.

Two countries particularly insist on cross-party agreements. Sweden explains that the new pension system is the result of work done by representatives of all parties between 1991 and 1994. Five out of the seven parties represented in the *Riksdag* supported the reform proposal and pursued their cooperation in an implementation group which prepared the adoption of the reform in 1998 and continues to monitor the implementation of the reform. The Spanish 'Toledo Pact' is a set of recommendations issued by Parliament in 1995 after expert hearings in a parliamentary commission composed of representatives from parties across the political spectrum. However, unlike Sweden the recommendations issued by Parliament were not directly translated into government policy, but were first submitted to the main trade unions who reached an agreement with the government in October 1996. A new agreement on reforms between the government and the social partners came into effect in April 2001 for the period up to 2004 and covered in particular minimum pensions, the pension reserve fund and flexible retirement.

Partnership and consensus building are regarded as an essential component of policy formulation and implementation in Ireland where the pensions strategy is based on extensive consultation and agreement with social partners, representative groups and industry; objectives and targets are incorporated in national partnership agreements. The UK has a less institutionalised approach than most other Member States: reforms are prepared by consultative documents which are used as a basis for discussions with a wide range of interested parties, including with representatives of management and labour, but also pensioner organisations and pension providers.

5.3.3. *Information to beneficiaries*

Providing beneficiaries with information regarding acquired rights and prospective pension levels represents a strong commitment. Such information may not be, in formal terms, contractually binding, but it creates expectations put those who are responsible for a pension scheme under pressure to deliver these expected benefits. Thus, better information to beneficiaries can be seen as an indication that governments and pension scheme managers are confident about their ability to pay well into the future.

Member States report considerable improvements in the information provided to beneficiaries on their statutory pension rights. Whereas the traditional approach seems to be to give information only on request and mainly to people who are close to retirement age, the new trend clearly is to provide regular statements of pension rights accrual to all scheme members. Sweden pioneered this approach with the 'orange pensions envelope' that is sent, since 1999, every year to all those covered by the public pension scheme. The envelope contains information about pension rights acquired during the previous year, the total accumulated notional pensions capital and a forecast of the future pension under different assumptions about economic growth, rates of return and the retirement age. In Italy, workers under the new scheme receive annual statements of their contributions.

Germany will follow a similar route from 2004 onwards when statutory pension insurance institutions will have to send annual 'pension information reports' to all insured persons above age 27. The report covers pension entitlements earned to date and the pension amount that would be paid in the event of incapacity. Moreover, an estimate of the future old-age pension is included, based on the assumption of that the current employment continues until retirement age. For insured persons above age 54, a triennial pension statement will be provided with information on the pension amount under current legislation.

In Finland, pension records are sent within 12 months following the termination of an employment contract in the private sector. Municipal employees above the age of 35 receive a record once every five years. New legislation introduced in 2000 in Portugal establishes an obligation to provide regular information to insured persons about their pension rights.

Several national strategy reports present initiatives to allow access to pension information via the Internet. This may be general information about current legislation (Austria) or information about one's individual pension situation (Finland, Denmark, Portugal). People covered by the general pension scheme in France have a statutory entitlement to personalised information on their pension rights as soon as they reach the age of 58; simulations of pension rights based on typical cases are available on the Internet.

Improved access to information not only applies to statutory schemes. In some cases, legislation on information disclosure may be more advanced for private pension schemes than for public schemes. Belgium requires employers to provide annual information on rights acquired to-date and on when they will be due. Denmark has already information duties for life insurance companies and sector-wide pension funds and plans to extend these to company pension funds. The 'PensionsInfo' web site is a joint initiative of the public authorities and private pension providers and aims at giving individual beneficiaries an overall picture of their pension situation. Holders of the new personal retirement savings accounts in Ireland will be entitled to regular updates on the current and projected value of the benefits they can expect. Members of occupational pension schemes in Luxembourg have a right to regular information on prospective pension benefits at the end of their career and on guaranteed rights in the event of a job change or insolvency of the employer. The UK Government is working with employers and pension providers to provide, on a voluntary basis, 'combined pension forecasts' covering State and private pension entitlements. Moreover, defined-contribution schemes will be required, from April 2003, to give members an annual illustration of their prospective pension under various assumptions.

Better individual information will raise awareness about pension matters, but it does not necessarily enable individuals to take appropriate action if they feel that they should do more to provide for their retirement. The UK has launched a 'Pensions education publicity campaign' to raise awareness about the need to save for retirement and the options that are available.

5.3.4. Conclusion: Information as a driver of change

Objective 11 may seem secondary compared to the previous 10 objectives, but it could have a profound impact on the future of pension systems. Creating a high degree of consensus has been a sine qua non for the successful introduction of reforms. Most of the reform efforts recounted here have also involved the creation of ongoing mechanisms aimed both at ensuring continuity and a basis on which further reform discussions can, where necessary, be undertaken. High-quality information on pension systems, both for policy-makers and citizens, should make it easier to build the required consensus for reforms — and might, for example, increase the support for automatic stabilising mechanisms, if the risks can be shown to be acceptable.

Regular information to individuals about their pension rights creates a sense of ownership and allows individuals to take responsibility for their own retirement provision. It could change the very nature of certain pension systems and accelerate the move towards schemes where the acquisition of rights is more linear and more closely linked to contributions or other efforts that can be rewarded through pension entitlements (e.g. caring responsibilities).

It is clear that the degree to which it is possible to provide good information depends very much on the nature of the system. Thus, approaches developed within the highly integrated Swedish system, or planned for the German system, may not easily translate to other systems. Nevertheless, it is clear that the Member States attach considerable importance to the issue and that considerable scope exists for organising exchanges regarding good practices in this area.

6. General conclusions and next steps

6.1. Meeting the common objectives

This first comprehensive assessment of national pension systems and policies at EU level shows that Member States are committed to ensuring the adequacy of their pension systems. At the same time, many Member States face very high expenditure increases in their pension systems under current policies and have yet to take measures to cope with these financial challenges without jeopardising adequacy. These expenditure increases could seriously undermine the sustainability of public finances in the long term. However, ensuring long-term financial sustainability is not only important in its own right but is also a necessary precondition for an adequate provision of pensions in the future. The balance between social and financial concerns is key for the political success of pension reforms; the three broad goals of adequacy, financial sustainability and modernisation are not separable.

All Member States have started their reform processes and a number of Member States have implemented major, a few even radical, reforms during the 1990s. However, most Member States see pension reform as a continuous process rather than a one-off, discrete event. A large number of countries also see the need for further reforms in order to safeguard the long-term sustainability of their pension systems as well as sound public finances. The momentum behind the reform process to secure the sustainability of adequate pensions must be maintained. These reforms should be seen in the context of the coordinated efforts by the Member States to implement the growth strategy required by the Lisbon Summit, including structural and fiscal reforms and better and more productive public investment.

Adequacy of pensions

Preventing social exclusion — All Member States ensure, by making some provision for old age compulsory and by promoting wide access to pension schemes, that people usually earn pension rights contributing, where possible, to their financial autonomy in old age. In addition, they have provisions which provide a minimum level of income to older people who have not, for one reason or another, earned sufficient pension entitlements in their own right. Thanks to pension systems, old age is no longer synonymous with poverty for a large proportion of the population. Income data from the European Community Household Panel (ECHP) show that, in 1998, the risk of poverty (i.e. living on an income below 60 % of the median income) for people over the age of 65 was only slightly higher than for people younger than 65. However, in some countries, higher poverty risks persist for older people and in particular older women. The national strategy reports present a range of measures to lower poverty risks, including minimum income guarantees and various benefits in cash and in kind. Moreover, future pensioners, and in particular women, are likely to acquire more pension entitlements during their working lives.

Enabling people to maintain living standards — Pension systems comprising flat-rate or earnings-related first-pillar scheme, private occupational schemes (second pillar) and individual retirement provision (third pillar) offer good opportunities for most Europeans to maintain their living standards after retirement. This is reflected in average income levels of people over 65 that were close to 90 % of the average income of people under 65. Most of these pension incomes are provided through first-pillar schemes which can be expected to remain the most important source of income for older people in most Member States. However, the national strategy reports present a wide range of pension reforms implemented to date with the aim of containing future public pension expenditure growth, leaving more scope for private provision. In this context, an important way of maintaining future adequacy of pensions is to allow people to earn additional pension rights by postponing their retirement. It should be noted, however, that allowing people to earn additional individual pensions rights limits the room to ease the overall tax/contribution burden. Occupational and personal pension provision is also developing in many Member States so that lower replacement rates from first-pillar schemes can be complemented by higher benefits from private schemes. However, voluntary private provision may not automatically fill the gap left by reduced public provision. An increasing number of countries therefore allow the social partners to establish sector-wide pension schemes based on mandatory collective agreements which make it possible to achieve high rates of coverage. Others seek to facilitate access to personal pension products and to improve the framework for voluntary provision by employers.

Promoting solidarity — Member States build strong redistributive elements into their first-pillar pension schemes, notably in the form of minimum pension guarantees or credits for certain periods without pensionable income (e.g. unemployment, studying, parental leave, etc.). This is not incompatible with stronger links between contributions and benefits, particularly if solidarity elements are financed from general budgets. Strong solidarity elements can also be present in occupational pension schemes based on collective agreements. The latest available income survey data suggest, for the EU as a whole, somewhat smaller income disparities among older people than among the population as a whole.

Financial sustainability of pension systems

Raising employment levels — All Member States see their efforts to raise employment rates as an important element in their long-term strategy for making pensions sustainable. Higher employment rates imply that more people can shoulder the financing of benefits and, thus, that adequate benefit levels can be maintained. Projections of public pension expenditure ([23]) indicate that, if the Lisbon employment targets were to be achieved, with continued employment growth beyond 2010, the increase of public pension expenditure as a percentage of GDP could be reduced by about one third in 2050, compared to the baseline scenario of unchanged policies. This means that higher employment rates alone will not solve the problem of the financial sustainability of pension systems.

Extending working lives — Currently, most Europeans retire before reaching the statutory retirement age. If a one-year increase in the effective retirement age could be achieved without increasing pension entitlements, the expected pension expenditure rise would be cut by 0.6–1 percentage points of GDP in 2050. This means that a one-year increase in the effective retirement age would absorb about 20 % of the average expected increase in pension expenditure in 2050. Member States have declared their commitment to delay the take-up of early pensions and are in the process of reforming early pension systems and labour-market policies and promoting active ageing ([24]). However, in many cases, the pace of reforms falls short

([23]) Carried out by the Member States in 2001 under the auspices of the Economic Policy Committee.
([24]) Joint report to the Barcelona European Council on increasing labour-force participation and promoting active ageing.

of what is required to achieve the Stockholm and Barcelona targets for the employment rate of older workers (50 % by 2010 compared to 38.5 % today) and to increase the effective retirement age by about five years by 2010.

Making pension systems sustainable in a context of sound public finances — Some Member States have put, or are putting, in place comprehensive strategies for ensuring the sustainability of pension systems and public finances as a whole in accordance with the three-pronged strategy (raising employment rates, reducing public debt levels, and reforming pensions systems themselves) incorporated in the framework of the broad economic policy guidelines (BEPGs). However, large expenditure increases on public pensions are projected for most Member States and, in addition, some countries are still hampered by high debt ratios and the need for budgetary consolidation. Further reforms in all three areas are needed, in particular further pension reforms in those Member States which have not yet safeguarded the long-term sustainability of pension systems. This was highlighted in the 2002 BEPGs, where the need to reform pension systems to put them 'on a sound financial footing' was underlined and specific recommendations to this end were addressed to a large number of Member States.

Adjusting benefits and contributions in a balanced way — While Member States are committed to maintaining adequate pension provision in spite of demographic ageing, they also realise that this cannot be achieved by overburdening future active generations. To prevent adverse effects on employment, care should be taken to avoid increasing the total tax burden, in particular on labour, and to achieve a sustainable balance between taxes on labour, on the one hand, and other forms of taxation, including on capital, on the other. No Member State envisages increased pension expenditure to be financed solely by raising contribution rates. Several Member States set an upper limit for contribution rates. In the case of the new notional defined-contribution pension schemes, benefits are automatically adjusted to maintain the financial balance of the schemes, notably in the face of rising life expectancy. In view of the financial impact of the baby-boom cohorts' retirement on pension systems during the next few decades, several Member States have established reserve funds in public pension schemes which should allow them to avoid major increases in contributions. Some expect to be able to afford larger transfers from the general budget to their public pension schemes thanks to debt reduction over the coming years and hence reduced future interest payments — or thanks to increased tax revenue from future pension benefits that are subject to deferred taxation. Several Member States have taken measures to reduce gradually replacement rates under public pension schemes, while at the same time creating better opportunities for supplementary private provision.

Ensuring that funded pension provision is adequate and financially sound — Financial sustainability is not only an issue for public, pay-as-you-go financed pension schemes. Funded pension provision depends on the performance of financial markets. The risks of funded pension provision can be greatly reduced through effective supervision and prudent management of the assets. Significant progress is being made towards sound regulatory frameworks for funded pension provision across the EU; in this regard, the directive on institutions for occupational retirement provision, currently under discussion in the Council and the European Parliament, will play a major role. Progress is also being made in reducing management costs of private schemes which are usually significantly higher than those of public schemes.

This can have considerable benefits in terms of affordability of private pension provision and, hence, improved access.

Modernisation of pension systems

Adapting to more flexible employment and career patterns — Statutory schemes, by and large, respond well to the challenge of providing pensions for atypical (part-time, temporary, self-employed workers) and mobile workers. By contrast, second-pillar schemes still pose problems on both fronts. Member States with highly developed occupational pension schemes are aware of the problems and have started addressing them through legislation or collective bargaining. However, in spite of improvements achieved in many Member States, the situation cannot yet be regarded as satisfactory: atypical workers continue to be less well covered by occupational schemes and, in many Member States, workers who change jobs tend to end their careers with reduced occupational pension rights compared to workers who remain with the same employer.

Meeting the aspirations for greater equality between women and men — Member States are gradually adapting their pension systems to the evolving social and economic roles of men and women. They are moving from direct discrimination in pensions legislation in favour of dependant housewives to new rules that aim at facilitating the reconciliation between family responsibilities and work for both parents. However, in spite of such measures and increased labour-market participation of women, significant differences between women’s and men’s pension entitlements will persist for a long time to come. Further gender assessment is needed to understand the impact of recent reforms and notably the development of supplementary pension schemes on the relative situations of men and women.

Demonstrating the ability of pension systems to meet the challenges — Most Member States have undertaken efforts to improve the transparency of their pension systems, through systematic information to individuals about their entitlements and through regular monitoring of the aggregate performance and sustainability of the pension system as a whole. This is important both in order to allow individuals to plan for their retirement and make provision that will allow them to achieve the desired living standard, and in order to guarantee the long-term viability and stability of the system and, hence, public confidence in the future of pension systems. High-quality information on pension systems for policy-makers and citizens should also make it easier to build the required consensus for reforms. Regular information to individuals about their pension rights creates a sense of ownership and allows individuals to take responsibility for their own retirement provision. It could change the very nature of certain pension systems and accelerate the move towards schemes where the acquisition of rights is more linear and more closely linked to contributions or other efforts that can be rewarded through pension entitlements (e.g. caring responsibilities).

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The momentum behind the reform process to secure the sustainability of adequate pensions must be maintained. These reforms should be seen in the context of the coordinated efforts by the Member States to implement the growth strategy required by the Lisbon Summit, including structural and fiscal reforms and better and more productive public investment. Improving incentives for older workers to remain longer on the labour market will be particularly important, especially in light of the long-term implications for pension expenditures of increased life expectancy. In this context, reviewing early retirement schemes and strengthening the link between contributions and benefits are particularly important. Moreover, the financial basis of pension systems can be strengthened through increased funded provision, both public and private. Finally, future adequacy also depends on the adaptation of pension systems to more flexible employment and career patterns and to the changing roles of men and women in society.

Ageing will start to produce its effects on pension systems within the next 10 years in many Member States. It is therefore urgent to put in place credible and effective strategies and to give clear signals to citizens about what they can expect from their pension systems and what they have to do to achieve an adequate living standard in retirement.

6.2. Further cooperation at EU level

Pension reform is almost a continuous process in most countries and the impact of past reforms needs to evaluated to check whether the desired results in financial and social terms have materialised. This first comprehensive exchange of information should therefore be followed up in a number of different ways.

One priority is to work on common indicators which would allow to measure the extent to which the common objectives are being achieved. Work on this is in progress in the Indicators Sub-Group of the Social Protection Committee and, regarding financial sustainability, in the Ageing Working Group set up by the Economic Policy Committee. There should be close cooperation between both groups. Indicators should not just focus on the present or recent past (ECHP data reflect the situation four to five years ago). As far as possible they should also include projections of the future situation. Other examples of this are expenditure projections carried out within the Ageing Working Group or the attempt to calculate prospective replacement rates in the Indicators Sub-Group of the Social Protection Committee. In addition to indicators relating to individual objectives, it might also be useful to assess at regular intervals overall confidence in pension systems as is done in Finland.

The latest ECHP data capture the income situation in 1998, that is before many of the significant reforms presented in the national strategy reports, and show that about 20 % of older Europeans were at risk of poverty. However, the quality of income data is still unsatisfactory, and the ECHP may not be sufficiently representative for a population subgroup like the population aged 65 and older. It also fails to capture substantial determinants of living standards, which can be particularly significant for the elderly, such as home ownership, wealth consumption, and benefits in kind for the elderly. Before being able to draw reliable conclusions on the adequacy of pension systems, the quality of income data and their timeliness must be improved as a matter of priority. Moreover, work is required on indicators describing future adequacy as determined notably by reforms of pension systems and the development of second-pillar schemes. The national strategy reports and the first peer review on pensions that took place on the basis of these reports on 23 and 24 October 2002 confirmed that there is much scope for mutual learning. Such exchanges of information and experiences could be continued in greater depth by focusing on specific topics.

This cooperation on pensions will have to be extended to new Member States. The Gothenburg European Council invited the applicant countries to translate the Union's economic, social and environmental objectives into their national policies. Building adequate, sustainable and modern pension systems is part of these objectives to be translated into national policies, and the Council and the Commission encourage candidate countries to make use to this end of the Member States' experience presented in this report.

In particular, applicant countries could be invited to prepare their own national strategy reports based on the 11 common objectives. Preparatory meetings with the Commission could be held in late spring or early summer so that applicant countries can develop their strategies and present their reports within an appropriate timeframe.

Finally, it should be recalled that the joint report of the Social Protection Committee and the Economic Policy Committee on objectives and working methods in the area of pensions presented to the Laeken European Council in December 2001 requests the Commission and the Council to assess, before the end of 2004, the objectives and working methods and to decide on the objectives, methods and timetable for the continuation of this coordination on pensions. This will be done taking into account any reports from the new Member States as well as any updates to the strategy reports submitted by the current 15 Member States.

ANNEX — COUNTRY SUMMARIES

This section briefly presents, for each Member State, the main characteristics of the pension system, the major challenges that it is confronted with and the reform measures that have been taken to date to meet these challenges. In addition, some background statistics are presented on the income situation of pensioners, the current level and projected trend of public spending on pensions as a percentage of GDP and the scope for policy action to enhance the financial sustainability of pension provision.

Inevitably, these statistics do not tell the full story but they do provide a useful tool for promoting understanding of the situation of pensioners and pension systems in the Member States. Work on a comprehensive set of common indicators is still in progress within the Indicators Sub-Group of the Social Protection Committee and the Ageing Working Group of the Economic Policy Committee, and it represents a major task. The data in these tables should not, therefore, be used as indicators to establish a ranking of country performances.

The projections of public expenditure on pensions up to the year 2050 are the first attempt of this kind at EU level. These are, first of all, estimates of the impact of the population ageing on public expenditures on pensions. As with any exercise covering a very long time period, the projection results need to be interpreted with care.

The aim of these projections was to examine, on a comparable basis across all EU countries, the long-term sustainability of public finances. The Ecofin Council has decided that such an exercise will be repeated, possibly in 2005, when new census data are available, providing a firm basis for new population forecasts. In addition, further refinements in the methodology of the expenditure projections are also envisaged. These include, for instance, the inclusion of future revenues and other types of social spending that may be affected by demographic changes (notably health and long-term care). These issues are being considered by the Ageing Working Group of the Economic Policy Committee.

Moreover, the focus of these projections is on public pension spending, including means-tested old-age benefits, but not covering privately provided pensions. It should be noted that some Member States have a much higher degree of private provision than others. Regarding future living standards of older people, work on indicators to describe the future evolution of replacement ratios for pensioners in a range of hypothetical cases, possibly also using microsimulation techniques, is still in progress.

Background statistics for the joint report on pensions: methodological note

At-risk-of-poverty rates are defined as the share of persons with an equivalised disposable income below an at-risk-of-poverty threshold. Equivalised disposable income is defined as the household's total disposable income divided by its 'equivalent size' to take account of its size and composition ([25]). The at-risk-of-poverty threshold is set at 50 % and 60 % of the national median equivalised

([25]) The data use the modified OECD scale which gives a weight of 1.0 to the first adult, 0.5 to other household members aged 14 or over and 0.3 to each child aged less than 14.

disposable income. It must be noted that income generated from owner-occupied housing or housing at below-market rents — i.e., imputed rent — is not included in the definition of income. Inclusion of this element of income could make significant difference in the measurement of risk-of-poverty rates. The data source is the European Community Household Panel, 1999 wave (version of the users' database of December 2002 ([26]). The weights for the Spanish data will be revised). Data refer to the socio-demographic circumstances of individuals in 1999 and to their income situation in the previous year, 1998, since in the ECHP, annual income, which is constructed on the basis of all income components at the individual and household level, refers to the year prior to the interview.**Inequality of income distribution (or income quintile ratio)** is defined as the ratio of total income received by the 20 % with the highest income within a given population (top quintile) to that received by the 20 % of the same population with the lowest income (lowest quintile). Income must be understood as equivalised disposable income and is defined as the household's total disposable income divided by its 'equivalent size'. The definition of income does not include imputed rent. The data source is the European Community Household Panel, 1999 wave. Data refer to the socio-demographic circumstances of individuals in 1999 and to their income situation in the previous year, 1998, since in the ECHP, annual income, which is constructed on the basis of all income components at the individual and household level, refers to the year prior to the interview.For the indicator on **income of people aged 65 and over as a ratio of income of people aged 0–64**, income is also understood as equivalised disposable income as defined above.

Factors determining the evolution of public pensions expenditure (2000–50): the projected total increase in public pension expenditure between 2000 and 2050, expressed in percentage points of GDP, is decomposed into its main determining factors. The algebraic sum of these contributions, plus a residual, corresponds to the total.

These projections provide estimates of the impact of population ageing on public pension expenditure. The baseline scenario, the results of which are presented in the tables, assumes unchanged policies in the pension system. The underlying assumptions of population and macroeconomic developments were commonly agreed within the Ageing Working Group of the EPC, while it was recognised that a considerable degree of uncertainty is inherently involved in such calculations covering a very long time span. A number of sensitivity analyses were made to test the impact of different assumptions on the results. Overall, these tests led to the conclusion that the results of the baseline scenario are robust and provide an adequate representation of magnitude of the demographic challenge ahead. Moreover, even if the figures for 'public pensions' in these calculations refer to all public revenues for older persons and not only to old-age pensions, the coverage of the projections may slightly differ across countries. Furthermore, the very recent reforms in some Member States are not reflected in the projections, but the text of the country summaries presents their features and, where available, their impact on expected pension expenditure.

([26]) See the box 'European income data: methodology and limitations' in Section 3.1.2 for a full discussion of the survey methodology and its limitations.

The ‘pension expenditure’ aggregate according to the Esspros definition goes beyond that of public expenditure to also include expenditure by private social protection schemes. ‘Pension expenditure’ is the sum of seven different categories of benefits, as defined in the Esspros Manual 1996: ‘Disability pension, early-retirement benefit due to reduced capacity to work, old-age pension, anticipated old-age pension, partial pension, survivors’ pension and early retirement benefit for labour-market reasons’. Some of these benefits (for example, disability pensions) may be paid to people who have not reached the standard retirement age.

BELGIUM

Main characteristics of the pension system

The first-pillar pay-as-you-go earnings-related pension system is composed of a general compulsory scheme covering all salaried workers in the private sector (some 70 % of pensioners receive a benefit from this scheme), a scheme for self-employed workers (liberal professions, farmers, traders, artisans) and a scheme for civil servants. Financing and methods of calculation of benefits differ from one scheme to another. Since 1995, a global financial management of social security was introduced. Financing of the different branches of social security relies on social security contributions and State transfers. As from 1995, an annually defined percentage of value-added tax has been earmarked for social security (25 % in 2002). Total social security contributions currently stand at 37.9 % of gross wages (24.9 % paid by the employer and 13 % by the employee).

Pensions in the private sector are calculated on the basis of the full contributory career, up to 45 years of contributions, with the same calculation coefficients for both men and women, i.e. 60 % (for a single person) or 75 % (for a head of family) of the revenues earned in the whole contributory career. Under the scheme for civil servants, pensions are calculated on the basis of the average income of the last five years. Early retirement is possible from the age of 60, on the condition that the beneficiary has cumulated 35 years of contributions (this will be implemented starting from 2005, while the minimum contributory career was 20 years in 1997). There are also other arrangements, not linked to the old-age pension system, notably for the unemployed, which make it possible to benefit, de facto, from an early retirement.

Second-pillar pension arrangements take the form of voluntary company pension funds set up in full autonomy at the initiative of the employer. Occupational pension rights are vested after one year of membership in the pension fund and are transferable to the fund of the new employer. The penetration rate of second-pillar pension schemes was 35 % in 1999, but only 8.3 % for the self-employed alone.

Third-pillar pension provision can take the form of pension savings or life insurance. In all, 44.4 % of the overall population make generally small contributions to third-pillar pension schemes; this is encouraged by certain fiscal advantages. Thus, the degree of penetration of the third pillar exceeds that of the second pillar.

Approximately 90 % of pensioners are entitled to the minimum pension or more. Older people (above 62 or 65 from 2009 onwards) with insufficient income are protected by a social assistance scheme for the elderly, GRAPA (*Garantie de Ressources aux Personnes Agées — GRAPA* — guaranteed income for the elderly).

Challenges

Poverty risks among older people are close to the EU average, but higher than for the Belgian population below age 65. First-pillar provision for the private sector only guarantees low replacement rates as pensions are calculated on the basis of earnings during the entire career, subject to a ceiling. Past earnings are indexed by a price index for the calculation of the pensionable wage. The fact that pensions in payment in the private sector are also linked to prices rather than wages can involve a progressive erosion of a beneficiary's pension during the years after retirement; this can be prevented through periodical additional adjustments.

Income inequality among older people is close to the EU average and slightly higher than income inequality among the Belgian population below 65.

The expected increase in the old-age dependency ratio is somewhat lower in Belgium than for the EU as a whole. However, due to the low employment rate, actual dependency on transfer incomes is very high: in 2000, for every 100 gainfully employed persons, there were approximately 86 who were entitled to a replacement income and 43 % of these were under the age of 65. This reflects, in particular, one of the lowest employment rates for older workers (25.1 % in 2001) in the EU.

On the basis of the Economic Policy Committee's projections, spending on public pensions and other replacement revenues for people over 55 (including unemployment and disability benefits paid to people over 55) is projected to rise from 10 % of GDP in 2000 to 13.3 % in 2050. Given the institutional arrangements put in place in Belgium (global financial management of social security since 1995; act of 2001 on the pension reserve fund), the financial sustainability of public pensions should be viewed in the context of revenues and expenditure for social security as a whole as well as interest payments on public debt. In the latter context, projections were presented by the Belgian authorities in the stability programme for Belgium and the Belgian national strategy report (see table below). On this basis, public old-age pension expenditure (excluding disability and early pensions) is projected to rise from 8.7 % of GDP in 2000 to 11.8 % in 2050 ([27]). The budgetary implications of ageing (taking all social expenditures into account) is projected to rise by 3.4 % of GDP over the next 50 years. The social security system, including public pensions, is partially financed by transfers from the federal government. The government expects to increase these transfers and to finance this increase completely from the decrease in interest payments which will be made possible by budgetary surpluses and a reduction of the public debt.

Budgetary cost of ageing and public finances: level in 2000 and projections (2000–50) in % of GDP

Budgetary cost of ageing ([1])	2000	2050	Change 2000–50	Public finance ([2])	2000	2050	Change 2000–50
Pensions	8.7	11.8	3.1	Primary surplus (no change in policy)	7	1.6	– 5.5
Healthcare	6.2	9.3	3.1	— Budgetary cost of ageing			– 3.4
Other social security expenditures	7.3	5.0	– 2.2	— Other factors (tax reform, etc.)			– 2.1
Education (salary)	4.3	3.7	– 0.5	Interest charges of public debt	7	1.2	– 5.8
Total	26.4	29.8	3.4	Budget balance	0	– 1.2	– 1.2
				Public debt	112.9	21.7	– 91.2

([1]) *Source:* Stability programme for Belgium 2002–05, Table 9; Belgian national strategy report on pensions, Annex 12 and Bureau Fédéral du Plan, Planning Paper 91, 'Perspectives financières de la sécurité sociale 2000–50. Le vieillissement et la viabilité du système légal des pensions', January 2002, Table 24. 'Pensions' include old-age public pensions. 'Other social security expenditures' include other replacement revenues for people aged 55 or over such as early retirement pensions, unemployment and disability benefits.
([2]) *Source:* Belgian national strategy report on pensions, Section 6.1 and Bureau Fédéral du Plan, ibid, Table 28.

Further adaptations to the pension system are needed to respond in particular to the needs of atypical workers and the self-employed. The national strategy report also stresses the need for further improvements in the transparency of the system and information to beneficiaries.

([27]) This rise of 3.1 % of GDP can be disaggregated into four factors: demographic dependency (+ 4.54 %), employment (– 0.98 %), eligibility (+ 1.34 %) and level of benefits (– 1.8 %).

Meeting the challenges

The government is addressing the issue of poverty risks by improving the minimum pension introduced in 1980 for salaried workers. This minimum is subject to having worked full-time for 30 years, i.e. two thirds of the career required for a full pension. The reform in 1997 introduced a 'minimum entitlement per year of the career' subject to having worked for at least 15 years. The minimum entitlement is guaranteed for each career year corresponding to at least one third of full-time employment. The amount thus guaranteed is linked to the minimum wage.

The minimum pension applicable to the self-employed was reformed in 1994, so as to bring it more in line with the minimum guaranteed income for older people, although the minimum amount applicable to the self-employed still remains lower than those for salaried workers. This situation is currently under review. The means-tested social assistance scheme for those among the elderly who have insufficient means to live on (GRAPA) has been modernised in 2001, especially with regard to the individualisation of rights.

In order reduce the gap between final earnings and pension benefits, the government is committed to widely develop second-pillar pension schemes for both salaried workers and the self-employed. To this end, it has presented a draft law to the Parliament. These schemes will be based on collective agreements and should comprise elements of solidarity. Fiscal incentives will be used to boost the development of the second pillar.

The government's strategy to cope with the financial challenge to the pension system relies heavily on a reduction of the large public debt (over 100 % of GDP in 2002) and, hence, on reduction in interest payments; this is projected to be larger than the increase in expenditure due to ageing populations. For the government's strategy to succeed, budget surpluses will have to be achieved for several decades to come. The government has indicated its commitment to cope with the financial challenge of the ageing population through the establishment of a reserve fund in 2001. Savings resulting from the reduction of public debt will be transferred to this fund and thereby earmarked for future expenditure on ageing-related needs. At the end of 2001, the fund amounted to 0.5 % of GDP. Future expenditure growth was already curbed by the pension reform of 1997 which adapted the way of calculating pension benefits in such a way that average pensions relative to average wages, i.e. average benefit ratios ([28]), will continue to decline over time. Thus, average benefit ratios for employees in the private sector are expected to decline from 29.9 % of final earnings in 2000 to 25.5 % in 2050. Moreover, it was decided to raise the pensionable age for women — and the required number of years for a full pension — to the level of men by 2009.

A number of measures with the aim of increasing the employment rate of older workers have been and are being taken, such as tighter conditions for obtaining early retirement pensions (reform of 1997), some improvements in pension levels for workers who prolong their careers, subsidies to employers who employ older workers, improvements in working conditions and access to training, and the possibility of gradually reducing one's working time before retirement. The possibilities to cumulate work and pension income were improved by raising the salary ceilings. However, such employment for pensioners does not create any additional pension rights. Although there has been some progress in increasing the employment rate of older workers, the pace is slow and further reforms seem to be necessary

([28]) The average benefit ratio is not a replacement rate but the average pension (including very small pensions of women with very short careers) divided by the average wage.

in order to come closer to the EU-wide target of a 50 % employment rate of older workers by 2010.

Conclusion

Although public pension expenditure is expected to rise significantly due to ageing populations, it may be manageable provided that large primary surpluses can be sustained for several decades so that the large public debt and interest payments can be reduced. Further reforms appear to be necessary with regard to early retirement so as to encourage a higher labour-force participation of people in their 50s and 60s. This would make a contribution to financial sustainability. The promotion of occupational pension schemes could raise replacement rates in the long run and hence the relative living standards of pensioners. It remains to be seen whether this and other measures to improve adequacy will also reduce inequality among pensioners.

Background statistics

	B						EU-15					
Recent income situation (1999 ECHP data)												
	Total		Men		Women		Total		Men		Women	
	0–64	65+	0–64	65+	0–64	65+	0–64	65+	0–64	65+	0–64	65+
At-risk-of-poverty rate (1) (at 50 % of median)	6	12	5	11	7	12	10	9	9	7	10	10
At-risk-of-poverty rate (1) (at 60 % of median)	11	22	10	20	13	22	15	17	15	15	16	19
Inequality of income distribution (1)	4.1	4.3					4.6	4.1				
Income of people aged 65+ as a ratio of income of people aged 0–64 (1)	0.76		0.77		0.76		0.89		0.92		0.86	

	B				EU-15			
Long-term projections of public pensions spending (EPC 2001)								
	Level			% increase 2000–50	Level			% increase 2000–50
	2000	2020	2050		2000	2020	2050	
Old-age dependency ratio (2)	25.5	32.7	45.0	76.0	24.2	32.2	49.0	102.5
Public pensions expenditure, % of GDP (3)	10.0	11.4	13.3	33.0	10.4	11.5	13.3	27.9
Factors determining the evolution of public pensions expenditure (2000–50) (3)	Contribution to change in percentage points of GDP				Contribution to change in percentage points of GDP			
Demographic dependency	5.2				6.4			
+ Employment	– 0.9				– 1.1			
+ Eligibility	0.9				0.6			
+ Level of benefits	– 2.0				– 2.8			
= Total (including residual)	3.3				3.1			
Esspros pensions expenditure (4) (1999)	11.6				12.7			

	B			EU-15		
Scope for policies to ensure sustainable pensions						
Employment (2001)	Total	Men	Women	Total	Men	Women
Employment rate (15–64) (5)	59.9	68.5	51.0	64.1	73.0	55.0
Employment rate (55–64) (5)	25.1	35.1	15.6	38.8	48.3	28.7
Effective labour-market exit age (6)	57.0	57.8	55.9	59,9	60,5	59,1
Public finances (2001) (7)						
Public debt, % of GDP	107.6			63		
Budget balance, % of GDP	0.4			– 0.8		

Notes:

(1) *Source:* ECHP–UDB, Eurostat, version December 2002. The weights for the Spanish data will be revised. Data for Sweden only cover persons aged less than 85; see methodological note preceding the country summaries and the box 'European income data: methodology and limitations' in Section 3.1.2 for a full discussion of the survey methodology and its limitations.

(2) *Source:* Eurostat, demographic projections. Number of people aged 65 years and over as a percentage of people aged 15–64.

(3) *Source:* Economic Policy Committee, report on 'Budgetary challenges posed by ageing populations', 24 October 2001. Public pension expenditure (including most public replacement incomes to people aged 55 or over), before taxes. See methodological note.

(4) *Source:* Esspros, Eurostat. Includes expenditure by certain private social protection schemes; see methodological note.

(5) *Source:* European labour force survey, 2001.

(6) *Source:* European labour force survey, 2001. Calculation method still under discussion.

(7) *Source:* European Commission, Directorate-General for Economic and Financial Affairs.

DENMARK

Main characteristics of the pension system

The first pillar of the Danish pension system consists of the universal, residence-based and non-contributory, statutory old-age pension scheme that is financed from general taxation and consists of a flat-rate benefit and an income tested element. It is designed to secure a decent minimum standard of living for all citizens from the age of 65. A full public old-age pension is conditional on 40 years' residence in Denmark. The benefit is indexed to private sector wages and is taxable. It consists of two parts, a basic amount that goes out to everybody and a supplement which is income tested. The post-tax, net value of the two benefit elements corresponds to 47 % of the average take-home pay of a worker. At present, the basic pension is paid to 99 % of residents above retirement age. Of these, 99 % receive the full basic amount and 64 % the full supplement. For single pensioners, the basic pension constitutes 61 % of their income.

A second tier of the first pillar consists of the statutory, working time-related, fully funded ATP scheme (a mandatory scheme covering all wage earners and certain groups of recipients of transfer payments, e.g. unemployed and persons on sick leave, offering benefits at a moderate level equivalent to 20 % of the first-pillar pension) and the statutory labour-market supplementary pension scheme for recipients of anticipatory pensions (SAP). The ATP scheme provides for a substantial amount of redistribution notably in favour of the unemployed and disabled.

The second pillar consists mainly of occupational schemes based on collective agreements at the sectoral level which are fully funded defined-contribution schemes. These schemes have been expanded significantly since the 1980s and now cover more than 80 % of the employed workforce. The vast majority of public sector employees are now enrolled in this type of second-pillar schemes (the defined benefit schemes formerly applying to some groups of public sector employees are gradually losing their importance). While based on individual accounts, these trade-union-initiated schemes have important solidarity elements, in particular invalidity insurance and the absence of health criteria for qualification purposes. In addition, they do not present barriers to labour mobility, thanks to immediate vesting and transferability between schemes. The normally regressive distribution effects and public budget costs of tax incentives for supplementary pension provision are fairly small in the case of Denmark. The value of the deductibility of contributions is, in aggregate, fully offset by deferred taxation and means-testing applied to public pensions. An overall subsidy results from the fact that the return on investment earned by pension funds is taxed at a lower rate — 15 % — than the return on other household wealth in Denmark (typically from 25 to around 60 %). In 2002, the statutory special pension savings scheme was redefined as a savings scheme without any redistribution objective and based on individual accounts.

The third pillar consists of individual pension savings schemes, many of which result in lump sum benefits instead of annuity payments.

Access to a number of needs- and income-tested cash supplements (e.g. housing, heating and medicine allowances), to free health and long-term care and to recreational activities contribute to guaranteeing a decent minimum standard for all.

Challenges

The Danish pension system appears to provide a solid and decent income level to all long-term residents. Since most Danish second-pillar schemes are not yet fully mature (a majority of new pensioners have not yet contributed during a full working life), living standards of pensioners relative to the working-age population will improve gradually, in particular for people on low and average incomes. Coverage of occupational pension schemes could be improved for a small number of people in non-standard employment. These include notably the self-employed many of whom have substantial wealth in the form of ownership of a firm that can be used to finance consumption after retirement. There is a statutory requirement for all second-pillar schemes to use unisex actuarial factors; this ensures that women, despite their longer average life expectancy at the age of retirement, receive the same annuities as men for the same amount of contributions, implying a cross-subsidy from men to women. Following a question from the Danish Parliament, a government working group has been mandated to provide more precise information on pension benefits in a longer time perspective with special emphasis on the consequences of periods of absence from the labour market.

Expenditure on public old-age pensions stands at 4.4 % of GDP and is estimated to increase by 3.4 % of GDP by around 2035. However, including all public pension schemes (such as disability pensions, civil servants pensions and statutory supplementary pension schemes), the total expenditure amounted to 10 % of GDP in 2000 and is estimated to rise to 14.5 % by 2030 and to decrease to 13.3 % by 2050 (Economic Policy Committee projections). The strategy for financial sustainability hinges upon maintaining a surplus on public finances averaging 1.5–2.5 % of GDP up to 2010 and a contribution to labour-force growth of 133 000 persons from higher participation rates. Both of these goals are ambitious and at the same time crucial for the strategy to succeed, given the relatively short period of time for reacting if underlying assumptions on economic developments should not hold.

Since Denmark already has one of the highest employment rates in the EU, labour reserves are small. The pension reforms undertaken during the 1990s are expected to increase the labour-force participation of older workers during this decade, but only by about the amount that is needed to offset the impact of the ageing workforce. In addition, employment is to be raised through substantially improved employment rates among immigrants and an improved integration into employment of the disabled as well as by increasing the effectiveness of labour-market policies.

Meeting the challenges

The Danish national strategy report expresses satisfaction with the reforms implemented over recent years and stresses that no major adjustments to the system are planned at present. The system is based on a broad consensus between the major parties about the overall structure and the relative role of its various elements. In addition, a large majority in parliament agreed in 2000 on the principle that the public old-age pension should form a sound income basis for present and future pensioners.

The expansion of occupational pension schemes is expected to raise replacement rates significantly and hence to reduce the current income maintenance gap. Yet, the first pillar will continue to play a lead role in pension provision. By 2045, income from the basic pillar will still account for about 50 % of the average income of pensioners.

A major focus of the reforms during the 1990s was employment promotion through better work incentives and working conditions for older workers. The pre-early retirement scheme, which was a transitional allowance for people aged 50–59 years who had become unemployed and had contributed to the unemployment benefit scheme for at least 30 years, was closed for new entrants in 1996 and will be fully phased out by 2006. The voluntary early retirement scheme was made less attractive for individuals in 2001 through the obligation to contribute to the scheme if a person opts to retire early. In addition, a special tax exemption for contributions was introduced for people who postpone the take-up of a voluntary early pension. Yet, the implicit tax on working beyond the ages 60, 62 and 65 is in many instances still substantial. Regarding the disability pension scheme, rehabilitation measures have been reinforced and the focus has been switched to encouraging people to continue at work by mobilising the remaining capacity to work from those wishing to benefit from the scheme. Measures taken have already resulted in a lower number of new disability pension claimants.

An increased labour force and a further reduction in unemployment are also seen as crucial for enabling the government to face increasing expenditure while implementing its debt-repayment strategy. The government aims to maintain on average a general budget surplus of 1.5 to 2.5 % of GDP up to 2010.

The complex structure of the Danish system (means-tested elements, ATP, defined-contribution schemes) can make it difficult to have a clear idea of a person's income situation after retirement. This issue is addressed by an obligation on pension schemes to disclose their administrative costs and performance records. In addition, the ATP scheme, in cooperation with almost all other pension providers, runs an Internet site where individuals can have their prospective net income from various pension schemes calculated.

Conclusion

The strategy for ensuring adequacy and financial sustainability of pension provision seems appropriate. The reforms needed to achieve the adequacy and solidarity objectives have been put in place over the last decade with support from a broad majority in Parliament. A budget policy leading to quick debt reduction has already been sustained for some years and all major parties support the continuation of this policy until 2010, when the public debt will have been substantially reduced. A further rise in employment will be difficult to achieve in view of the limited labour-force reserves, but it is not implausible given Denmark's proven track record in employment. In particular, the incentives for older workers to defer their retirement could be further strengthened.

In sum, the pension system seems to be financially sustainable in the long term under present policies with a fairly equitable sharing of the burden between generations. Building up occupational pensions will increase replacement rates in the future and thereby alleviate potential pressure for increases in public pension rates. Yet, the sustainability calculations hinge critically on maintaining large surpluses in public finances during this decade. Further labour-market reforms would seem to be needed to ensure the assumed increase in the labour supply, which in turn is needed for ensuring the debt-reduction strategy necessary for financial sustainability.

Background statistics

	DK						EU-15					
Recent income situation (1999 ECHP data)												
	Total		Men		Women		Total		Men		Women	
	0–64	65+	0–64	65+	0–64	65+	0–64	65+	0–64	65+	0–64	65+
At-risk-of-poverty rate (1) (at 50 % of median)	5 *3.3*	12 *5.0*	4 *3.3*	10 *3.7*	6 *3.4*	14 *6.0*	10	9	9	7	10	10
At-risk-of-poverty rate (1) (at 60 % of median)	7 *6.8*	31 *24.8*	7 *6.6*	26 *23.4*	8 *7.0*	35 *25.9*	15	17	15	15	16	19
Inequality of income distribution (1)	2.9 *2.7*	3.5 *2.6*					4.6	4.5				
Income of people aged 65+ as a ratio of income of people aged 0–64 (1)	0.68 *0.74*		0.70 *0.77*		0.66 *0.73*		0.89		0.92		0.86	

	DK				EU-15			
Long-term projections of public pensions spending (EPC 2001)								
	Level			% increase	Level			% increase
	2000	2020	2050	2000–50	2000	2020	2050	2000–50
Old-age dependency ratio (2)	22.2	30.5	36.0	65.0	24.2	32.2	49.0	102.5
Public pensions expenditure, % of GDP (3)	10.5	13.8	13.3	26.7	10.4	11.5	13.3	27.9

	DK	EU-15
Factors determining the evolution of public pensions expenditure (2000–50) (3)	Contribution to change in percentage points of GDP	Contribution to change in percentage points of GDP
Demographic dependency	4.1	6.4
+ Employment	– 0.2	– 1.1
+ Eligibility	0.5	0.6
+ Level of benefits	– 1.7	– 2.8
= Total (including residual)	2.7	3.1
Esspros pensions expenditure (4) (1999)	10.7	12.7

	DK			EU-15		
Scope for policies to ensure sustainable pensions						
Employment (2001)	Total	Men	Women	Total	Men	Women
Employment rate (15–64) (5)	76.2	80.2	72.0	64.1	73.0	55.0
Employment rate (55–64) (5)	58.0	63.0	49.8	38.8	48.3	28.7
Effective labour-market exit age (6)	61.9	62.2	61.1	59,9	60,5	59,1
Public finances (2001) (7)						
Public debt, % of GDP	44.7			63		
Budget balance, % of GDP	3.1			– 0.8		

Notes:

(1) *Source:* ECHP–UDB, Eurostat, version December 2002. The weights for the Spanish data will be revised. Data for Sweden only cover persons aged less than 85; see methodological note preceding the country summaries and the box 'European income data: methodology and limitations' in Section 3.1.2 for a full discussion of the survey methodology and its limitations. The figures in italics (second line) were calculated using national register-based data, but in accordance with the methodology applied to EHCP data. When using an income definition including imputed rent and interest payments, Danish national calculations yield substantially lower risk-of-poverty rates and a higher relative income in those aged 65 years and above.

(2) *Source:* Eurostat, demographic projections. Number of people aged 65 years and over as a percentage of people aged 15–64.

(3) *Source:* Economic Policy Committee, report on 'Budgetary challenges posed by ageing populations', 24 October 2001. Public pension expenditure (including most public replacement incomes to people aged 55 or over), before taxes. See methodological note.

(4) *Source:* Esspros, Eurostat. Includes expenditure by certain private social protection schemes; see methodological note.

(5) *Source:* European labour force survey, 2001.

(6) *Source:* European labour force survey, 2001. Calculation method still under discussion.

(7) *Source:* European Commission, Directorate-General for Economic and Financial Affairs.

GERMANY

Main characteristics of the pension system

The general pay-as-you-go, earnings-related pension scheme covers around 82 % of the employed population in Germany (33 million people). The contribution rate currently stands at 19.5 %, paid in equal shares by employers and employees. This contribution pays 63 % of the expenditure on this pension scheme, while 37 % is paid out of the federal public budget. Civil servants' pensions are paid directly from public budgets. Special schemes exist notably for farmers and the liberal professions (funded schemes e.g. for doctors, lawyers, architects). First-pillar schemes account for 78 % of all incomes of people aged 65+. The general scheme alone provides 60 % of all incomes in old age in West Germany and more than 90 % in East Germany. While, the self-employed are normally not compulsorily insured under the general scheme, they have the option of contributing to the scheme. In 1999, 96 % of the population over the age of 65 were receiving benefits from old-age pension schemes which were publicly funded in whole or in part. Survivors' benefits are available under the statutory scheme. In addition, the 2001 pension reform introduced the option of splitting pension rights between spouses (previously pension rights were split only in the event of a divorce).

Second-pillar provision tends to be organised at company level in the private sector. Different financing models are possible, ranging from book reserves (internal funding guaranteed by compulsory insolvency insurance) to external funds and group insurance. The 2001 reform favours the development of contributory schemes, also at sectoral level. Occupational schemes also exist for public sector employees who are not civil servants. These schemes contribute 7 % to the total income of senior citizens.

Individual third-pillar provision (life insurance) accounts for around 10 % of total income in old age.

Older people without sufficient incomes are entitled to means-tested benefits. Since the 2001 pension reform, the resources of descendants are no longer taken into account. This should improve the take-up of such benefits.

Challenges

Maintaining financial sustainability in the face of an expected doubling of the old-age dependency ratio over the coming decades is seen as the main challenge. According to the Economic Policy Committee projections, public pension expenditure was expected to rise by five percentage points from 11.9 % of GDP in 2000 to 16.9 % of GDP by 2050 before the impact of the 2001 reform. The latest revised national estimates, which are based on the same population and macroeconomic assumptions as the EPC projections, also take into account the impact of the reform, project an increase of public pensions expenditure from 10.8 % of GDP in 2000 to 14.9 % in 2050, a rise of 4.1 percentage points. The difference in the level of pension expenditure in 2000 is largely explained by the fact that a transfer from pension insurance funds to health and long-term insurance schemes, which is actually part of health expenditure, had been included in the initial projections of public pension expenditure.

A major factor that is expected to reduce the estimated expenditure increase is tightened eligibility criteria for pensions, which should reduce the number of people taking up an early pension. Financial sustainability will also be strengthened by the fact that the calculation of pensions and their annual adjustment have been modified in such a way that the rise in total pension expenditure will be slowed. In the new formula, increases in the contributions to old-age pension insurance and in the contributions to the voluntary private-funded pension schemes are deducted from the gross wage which constitutes the pensionable wage and the basis for the calculation of the adjustment index. Any increase in contribution rates will lead to a reduction of the level of new pensions to be granted and to a lower index applied to annual pension adjustments. From 2011 onwards, an increase in the contribution rate will have an even higher impact because it will be multiplied by a factor of 1.11 to take account of the increase in the old-age dependency ratio. Contributions to private-funded pension schemes reduce the pensionable wage by up to 4 %. Furthermore, the government is legally obliged to propose to Parliament appropriate measures if the 15-year projections indicate that there is a risk that the contribution rate has to be raised above 20 % (until 2020) or 22 % (until 2030).

The contribution rate is currently 19.5 % of gross income. In addition, large subsidies from the Federal budget for the financing of current pension expenditure are needed, rising to 37 % of current pension payments. These subsidies also include contributions paid for by the state for career breaks, such as child rearing periods, and other benefits not based on an individual's contributions. The government expects that the subsidy from the Federal budget will decrease to 31 % by the year 2030. In the pension reform of 2001, the government made a firm commitment to maintain the contribution rate to the general public scheme at an appropriate level (20 % by 2020 and 22 % by 2030). To this end, the pension reform foresees a modest reduction in replacement rates of public pensions due to changes made to the definition of the pensionable wage (see above). This is accompanied by generous support for savings in mostly voluntary private retirement schemes. This should ensure that the level of pensions will remain adequate, but in view of the small reduction in public pension levels and in the absence of automatic adjustment mechanisms, major financial challenges persist.

Apart from the latest pension reform, the government's strategy to cope with the financial challenge relies on increasing employment and productivity, in other words, strengthening the contribution base. There is scope for lowering the unemployment rate and raising labour-market participation, in particular of women and older workers. The introduction of actuarial reductions for early pensions is likely to produce results in the coming years. In addition, the government aims at achieving a balanced budget by 2006. Achieving sound public finances will be important to meet future spending commitments due to population ageing, including those for health and long-term care and for civil servants' pensions, as well as for increased transfers to the general pension scheme.

As private pension provision develops, it becomes increasingly important to ensure that individuals have sufficient information to be able to make the right choices, that occupational pension provision is made widely accessible (notably through collective agreements) and that it does not exclude certain groups of workers (notably part-time and temporary workers) and discourage labour mobility.

Due to labour-force participation rates and earnings of women that are likely to remain below those of men (although the situation is improving), individual pension rights for women will continue to be comparatively low. Adequate pension provision for women will therefore continue to depend on survivors' benefits, splitting of pension rights in the event of divorce and on the granting of pension entitlements for career breaks. The role of derived benefits can be reduced as the labour-market involvement of women and men becomes more similar.

Meeting the challenges

The German pension system has been gradually adapted since the 1990s to the challenges of demographic ageing. A major focus of the measures of 1992, 1997 and 2000 was to reduce the need for future increases in contribution rates, notably by raising the labour-force participation rate of older workers and hence the effective retirement age. The statutory retirement age is currently being raised to 65 years for all types of pensions except invalidity pensions. Early retirement is only possible at reduced pension levels. Thus, conditions for early retirement were tightened and financial incentives for working longer were introduced.

The latest major reform was adopted in 2001 with the aim of reducing the so-called standard pension level in the public scheme from 70 % to 67–68 % by 2030 and promoting the development of private pension savings. It set a maximum contribution rate of 20 % until 2020 and 22 % until 2030. The government is statutorily obliged to propose appropriate measures to Parliament should a risk of contribution rate increases emerge from the 15-year projections. In November 2002, an independent high level expert commission (Rürup-Commission) was set up to review the financial sustainability of the social security systems in Germany. This commission will present its proposals at the latest in the autumn of 2003.

The latest reform also improved the protection of older people against the risk of poverty. Although there is no guaranteed minimum pension, the granting of social assistance to older people is no longer subject to a means-test against their children's income (even if they were to have sufficient resources to support their parents), nor is the income of household members other than the partner taken into account. Statutory pension insurance institutions are obliged to inform older people of their rights. This should increase the rate of benefit take-up and reduce a phenomenon known as 'shameful poverty'.

In order to compensate for the planned reduction in replacement levels under the statutory scheme, massive support for the development of private pension provision has been made available not only in the form of tax deductibility, but also through direct grants for people on lower incomes and families with children who could not take advantage of the tax deductions. Depending on the take-up of these government-supported pension arrangements, the total cost of this measure could rise to more than EUR 12 billion annually. Financial support is available for a wide range of second and third-pillar pension arrangements.

The development of occupational pensions, which were traditionally voluntary benefits provided by the employer, will be boosted by the granting of the right to employees to demand that part of their earnings be converted into pension contributions (*Entgeltumwandlung*). Such contributions are generally not subject to income tax nor, for a limited period, to social insurance contributions. Pension rights based on such employee contributions are vested immediately. The legal limits for vesting periods applying to employer-financed pensions were reduced from 10 to five years and the minimum age for acquiring a vested pension right was cut from 35 to 30. This will be beneficial for people who interrupt their careers or change jobs and should improve occupational pension benefits for women. This improved framework for occupational pensions is likely to lead to the creation of more pension schemes based on collective agreements, including at the level of sectors where some agreements have already been concluded.

The 2001 pension reform also sought to further improve pension rights for women. In view of the fact that bringing up children often leads to reduced earnings (e.g. through part-time working or career breaks), pension entitlements are awarded by assuming average earnings during the first three years after the birth of a child. After that and up to the 10th year, low pension entitlements due to part-time working can be topped up. If there are at least two children, this further increase is granted even in the case of a career break. Survivors' pensions have been lowered from 60 % to 55 % of the deceased spouse's pension, but the survivors' pension is raised for each child. Individual pension rights of women could be strengthened as a result of the newly introduced option of splitting pension rights acquired during married life. Previously, splitting could only take place in the event of a divorce. Splitting would have the advantage that these individualised rights are not means-tested (as survivors' pensions) and are not lost in case of re-marriage.

The information made available to insured people about their prospective pension entitlements is also to be improved. As from 2003, statutory pension insurance institutions have to provide annual statements about the pension entitlements that an individual (over the age of 27) has built up. Moreover, these institutions can provide guidance on how to build up additional, funded pension rights.

Conclusion

The 2001 pension reform made progress in terms of adequacy, financial sustainability and modernisation of the pension system. While some progress in raising the employment rates, particularly of older workers, can be expected, this cannot be relied upon to guarantee the financial balance of the pension system. Further efforts are needed to ensure the long-term financial sustainability in the context of the ongoing process to modernise and adapt the pension system to changing circumstances. The government's initiative to review the financing and further development of social security schemes with the help of an independent expert group is therefore to be welcomed. Finally, it is important that the social partners ensure an extensive development of occupational pension schemes so that the newly introduced government support can benefit the largest possible number of workers. They should also ensure that such schemes do not penalise mobility.

Background statistics

	D						EU-15					
Recent income situation (1999 ECHP data)												
	Total		Men		Women		Total		Men		Women	
	0–64	65+	0–64	65+	0–64	65+	0–64	65+	0–64	65+	0–64	65+
At-risk-of-poverty rate (1) (at 50 % of median)	6	6	6	5	6	6	10	9	9	7	10	10
At-risk-of-poverty rate (1) (at 60 % of median)	11	11	10	9	11	13	15	17	15	15	16	19
Inequality of income distribution (1)	3.5	3.6					4.6	4.1				
Income of people aged 65+ as a ratio of income of people aged 0–64 (1)	0.97		0.98		0.96		0.89		0.92		0.86	

	D				EU-15			
Long-term projections of public pensions spending (EPC 2001)								
	Level			% increase 2000–50	Level			% increase 2000–50
	2000	2020	2050		2000	2020	2050	
Old-age dependency ratio (2)	23.8	33.5	49.0	101.0	24.2	32.2	49.0	102.5
Public pensions expenditure. % of GDP (3)	11.8	12.6	16.9	43.2	10.4	11.5	13.3	27.9
Updated projection (8)	10.8	12.1	14.9	34.7				
Factors determining the evolution of public pensions expenditure (2000–50) (3)	Contribution to change in percentage points of GDP				Contribution to change in percentage points of GDP			
Demographic dependency	6.5				6.4			
+ Employment	– 0.8				– 1.1			
+ Eligibility	1.1				0.6			
+ Level of benefits	– 2.7				– 2.8			
= Total (including residual)	4.1				3.1			
Esspros pensions expenditure (4) (1999)	13.0				12.7			

	D			EU-15		
Scope for policies to ensure sustainable pensions						
Employment (2001)	Total	Men	Women	Total	Men	Women
Employment rate (15–64) (5)	65.8	72.6	58.8	64.1	73.0	55.0
Employment rate (55–64) (5)	37.7	46.1	29.3	38.8	48.3	28.7
Effective labour-market exit age (6)	60.7	60.9	60.4	59,9	60,5	59,1
Public finances (2001) (7)						
Public debt. % of GDP	59.5			63		
Budget balance. % of GDP	– 2.8			– 0.8		

Notes:

(1) *Source:* ECHP–UDB, Eurostat, version December 2002. The weights for the Spanish data will be revised. Data for Sweden only cover persons aged less than 85; see methodological note preceding the country summaries and the box ‘European income data: methodology and limitations’ in Section 3.1.2 for a full discussion of the survey methodology and its limitations.

(2) *Source:* Eurostat, demographic projections. Number of people aged 65 years and over as a percentage of people aged 15–64.

(3) *Source:* Economic Policy Committee, report on ‘Budgetary challenges posed by ageing populations’, 24 October 2001. Public pension expenditure (including most public replacement incomes to people aged 55 or over), before taxes. See methodological note.

(4) *Source:* Esspros, Eurostat. Includes expenditure by certain private social protection schemes; see methodological note.

(5) *Source:* European labour force survey, 2001.

(6) *Source:* European labour force survey, 2001. Calculation method still under discussion.

(7) *Source:* European Commission, Directorate-General for Economic and Financial Affairs.

(8) *Source:* New projections submitted by Germany to take account of the latest pension reform. Germany indicated that the projections are based on the same population scenario and the same employment and economic assumptions as those used in the EPC projections. The coverage of pension expenditure has been slightly redefined.

GREECE

Main characteristics of the pension system

The first pillar consists of a variety of pay-as-you-go financed schemes which are dispersed across industrial sectors and provide varying levels of pension. The largest funds are IKA (private sector) and OGA (farmers); a separate scheme also exists for the self-employed. Employees' pensions are defined-benefit in type and are also payable to the self-employed. These primary insurance funds typically offer replacement rates of up to 80 %. However, pensions are subject to an upper limit. Primary pensions represented 10.6 % of GDP (84 % of total pensions) in 2001.

A second tier of the first pillar consists of occupation-based auxiliary funds which provide supplementary pensions. They cover all employees and a small percentage of the self-employed and typically offer additional replacement rates of up to 20 %. In 2001, they accounted for 1.8 % of GDP (14.5 % of total pensions expenditure), a proportion which is growing. Finally, in the public sector, lump-sum severance payments are also common.

All funds are financed through the pay-as-you-go system and benefits levels are implicitly guaranteed by the State. The implicit rates of return (taking into account contributions, age limits and benefits) differ among funds. Moreover, within a fund, various occupational categories may be subject to different conditions.

Second-pillar occupational pensions are not widespread. Third-pillar pensions are subject to legislation governing life insurance and benefits typically come in the form of a lump sum and only rarely as an annuity.

Means-tested benefits are paid to those without an insurance record; a large number of pensioners receive contributory pensions at a guaranteed minimum level. For pensioners, with total income from pensions below a minimum (which exceeds minimum pensions) and whose other income and household situation fulfil additional criteria, a pension supplement (known as EKAS) is also paid.

Over the past 20 years, there have been frequent rule changes resulting in significant differences in treatment depending on the time of first affiliation to the system.

Challenges

The Greek national strategy report states that the main challenge is to restore the trust of citizens in the system and its prospects. It summarises the problem as follows:

— Despite expenditure of over 12 % of GDP on pensions, the elderly remain one of the socially vulnerable groups.

— Fragmentation and legislative complexity result in similar cases being treated in different ways. These inequities undermine the social acceptance of the system.

— Frequent revisions of the legislative framework created feelings of flux and insecurity.

Notwithstanding this, huge financial challenges will build up from the coming decade onwards. According to the national strategy report, public pensions expenditure is projected to rise steeply — from 12.4 % of GDP in 2000, to 17.3 % in 2030 and to 22.6 % by 2050, the largest projected increase among EU Member States in 2050. This increase in expenditure is also due to the maturation of the pension system which leads to higher pensions in the medium to long term; as a consequence, the Greek projections are the only ones where the average pension per person relative to GDP per employed person (the 'benefit ratio') will significantly raise expenditure by the year 2050. In comparison with the EPC projections, the reform undertaken in 2002 and the revised population and employment figures included in the latest national projection would reduce the expected increase in 2050 by only two percentage points. As a consequence of the steep rise in expenditure, tax financing of pensions by the State budget would, in the absence of payouts from the announced reserve fund, have to increase from the current 4.8 % of GDP to 8.7 % in 2030 and to 15.5 % of GDP in 2050, if current contribution rates are assumed (in fact, the national strategy report rules out such increases).

Without taking into account the impact of the 2002 reform, which took measures to increase the minimum pension level, the income situation of older people contrasts with that in other EU countries in a number of ways. Unlike other Member States, old age was still the most important factor in determining risk of poverty as measured by ECHP data of the late 1990s. When interpreting this data, it should be borne in mind that older people were much less likely than elsewhere in the EU to live in old peoples' homes, hospitals or other communal institutions (less than 3 % of the pensioner population). They also had higher rates of home ownership. Both of these factors lead to an over-estimation of poverty risks. Partly due to the fact that a large proportion of pensioners live with their children, pensions constituted a smaller share of their household income than elsewhere: tax returns showed that other significant sources of income for people in pension ages include farming, commercial activity, rents and employment. Nevertheless, a large number of pensioners rely on the protection of minimum pensions and of the means-tested pension supplement EKAS. The introduction, in 1992, of a considerably less generous system for new entrants, notably in providing radically curtailed minimum income protection, raises concerns of inter-generational equity in terms of entitlements.

The adequacy of pension provision is seen as an important structural weakness of the Greek system. Tackling the issues of adequacy and modernisation is regarded as a precondition for successfully addressing the financial sustainability problem posed by demographic ageing. Greece, along with other MS, faces the prospect of a worsening of the demographic dependency ratio, although the 2001 census shows that the impact will be postponed and somewhat mitigated by recent high levels of net migration of people in the economically active age group.

Overall employment rates are still low (55.4 % as against the EU average of 63.9 % in 2001). The national strategy report also anticipates that there will be a weakening of traditional family solidarity, so that pensions are likely to have to play a greater role in securing the wellbeing of older people in Greece in the future.

Meeting the challenges

The Greek strategy is based on two premises:

- The effect of increased participation in pension schemes during the 1980s and 1990s is that there should be an improvement in the level of pensions paid to future pensioners.

- There exists a 'window of opportunity' between now and 2015 during which pressure on the social security system and on public debt will fall and when there is good scope to accelerate economic and employment growth and to pursue the modernisation of the social insurance system.

The adopted Greek reform aims at addressing the structural weaknesses of the pension system, as described above, and to create the institutional framework needed to meet the further challenges stemming from demographic ageing. The further pension reform strategy will have to address the issue of financial sustainability in particular, simultaneously with the issues of adequacy and good governance. The 2002 reform bill should be seen as a starting point for such a long-term reform strategy, providing a road map for future changes. The main aim is to increase confidence in the pension system, to promote structural change and, hence, face the challenge of the ageing population, by:

- promoting pension adequacy and improving the quality of services;

- consolidating the system to ensure uniform treatment and to curtail evasion;

- securing the financial autonomy of the main public fund (IKA) until 2030, through the creation of a reserve fund which exploits the current 'window of opportunity' in order to secure the payment of benefits after 2015;

- creating a stable legislative framework for first-pillar pensions;

- distinguishing auxiliary pensions more clearly from primary pensions and transforming auxiliary funds gradually into funded occupational schemes managed by the social partners;

- promoting the institutional and regulatory environment to allow the emergence of second-pillar pension schemes, so as to diversify the system and reduce public expenditure in the medium term;

- securing reforms via social dialogue;

- creating a national actuarial authority as a regulatory body for all pension providers and as a mechanism for timely and accurate actuarial projections of pension scheme finances.

The Greek national strategy report places a lot of emphasis on increasing economic growth and achieving the Lisbon targets for employment rates. It also presents measures that are already being implemented to increase gradually the retirement age and to combat contribution evasion. However, the recent labour-market performance has not been particularly good: the overall employment rate was only marginally higher than in 1995 and the employment rate of older workers had decreased by three percentage points, which is contrary to the development in almost all other EU Member States. Major labour-market reforms are required in order to raise the employment rates significantly.

While the 2002 reform addresses a large range of issues with the aim of making the system more credible and socially sustainable, the still-large projected increase in expenditure, despite the high starting level, suggests that significant further efforts will be required. Many of the recent measures are aimed at tackling the existing problems to clear the path for further reform measures needed in order to prepare for the ageing problem. The reserve fund, for example, has been established with the double aim of managing the cash flow of the main pension fund (IKA) over the medium-term but also of transferring resources for the use of the fund for the period from now to 2030.

Conclusion

Implementing the reforms enacted in 2002 and set out in the national strategy report will be crucial for rebuilding confidence in the pension system and for laying the groundwork for further reform efforts. In order to meet the huge financial challenge of ageing, the process of pension reform needs to continue with financial consolidation in due course, building on the modernisation that is currently being undertaken. There is substantial scope for improving the viability of the pension system in the medium term by increasing employment rates and curbing contribution evasion, while the gradual development of second-pillar schemes will ease pressures on public finances. Nevertheless, significant further efforts will be needed to stabilise expenditure growth in order to ensure the continuity and the long-term financial sustainability of the pension system. In addition, considerable labour-market improvements are needed in order to raise employment rates as required by the Lisbon and Stockholm quantitative targets.

Background statistics

	GR						EU-15					
Recent income situation (1999 ECHP data)												
	Total		Men		Women		Total		Men		Women	
	0–64	65+	0–64	65+	0–64	65+	0–64	65+	0–64	65+	0–64	65+
At-risk-of-poverty rate (1) (at 50 % of median)	12	25	12	24	12	25	10	9	9	7	10	10
At-risk-of-poverty rate (1) (at 60 % of median)	18	33	17	34	18	33	15	17	15	15	16	19
Inequality of income distribution (1)	5.8	7.0					4.6	4.1				
Income of people aged 65+ as a ratio of income of people aged 0–64 (1)	0.74		0.74		0.74		0.89		0.92		0.86	

Long-term projections of public pensions spending (EPC 2001)	GR				EU-15			
	Level			% increase 2000–50	Level			% increase 2000–50
	2000	2020	2050		2000	2020	2050	
Old-age dependency ratio (2)	25.5	32.9	54.0	110.0	24.2	32.2	49.0	102.5
Public pensions expenditure, % of GDP (3)	12.6	15.4	24.8	96.8	10.4	11.5	13.3	27.9

Factors determining the evolution of public pensions expenditure (2000–50) (3)	Contribution to change in percentage points of GDP (GR)	Contribution to change in percentage points of GDP (EU-15)
Demographic dependency	9.9	6.4
+ Employment	– 3.6	– 1.1
+ Eligibility	1.4	0.6
+ Level of benefits	4.0	– 2.8
= Total (including residual)	11.7	3.1
Esspros pensions expenditure (4) (1999)	12.7	12.7

Scope for policies to ensure sustainable pensions	GR			EU-15		
Employment (2001)	Total	Men	Women	Total	Men	Women
Employment rate (15–64) (5)	55.4	70.9	40.9	64.1	73.0	55.0
Employment rate (55–64) (5)	38.0	54.6	22.7	38.8	48.3	28.7
Effective labour-market exit age (6)	59.6	61.2	57.7	59,9	60,5	59,1
Public finances (2001) (7)						
Public debt, % of GDP	107.0			63		
Budget balance, % of GDP	– 1.2			– 0.8		

Notes:

(1) *Source:* ECHP–UDB, Eurostat, version December 2002. The weights for the Spanish data will be revised. Data for Sweden only cover persons aged less than 85; see methodological note preceding the country summaries and the box 'European income data: methodology and limitations' in Section 3.1.2 for a full discussion of the survey methodology and its limitations.

(2) *Source:* Eurostat, demographic projections. Number of people aged 65 years and over as a percentage of people aged 15–64.

(3) *Source:* Economic Policy Committee, report on 'Budgetary challenges posed by ageing populations', 24 October 2001. Public pension expenditure (including most public replacement incomes to people aged 55 or over), before taxes. See methodological note.

(4) *Source:* Esspros, Eurostat. Includes expenditure by certain private social protection schemes; see methodological note.

(5) *Source:* European labour force survey, 2001.

(6) *Source:* European labour force survey, 2001. Calculation method still under discussion.

(7) *Source:* European Commission, Directorate-General for Economic and Financial Affairs.

SPAIN

Main characteristics of the pension system

The first pillar of the Spanish pension system consists of a general earnings-related scheme financed through contributions and special schemes for civil servants working for the central government or the justice system and for people working for the armed forces. The general scheme is mandatory for all employees and self-employed and provides pension entitlements after a minimum contribution period of 15 years. The contribution rate is 28.3 % of earnings (4.7 percentage points paid by the employee and 23.6 by the employer).

Benefits are calculated as a percentage of a so-called 'base pension' which takes into consideration the earnings-related contributions paid during the 15 years (previously eight years) before retirement. The percentage of the base pension that is paid out depends on the number of years a person contributed to the system and on the retirement age: a full pension is reached after 35 contribution years and retirement at age 65. Pensions are, in principle, adjusted annually in line with the consumer price index, but, in practice, they have increased in real terms over the last five years, particularly the guaranteed minimum pensions which raise low contributory pension entitlements to the guaranteed level. The number of pensioners needing a top-up to reach the guaranteed level fell from 25 % in 1995 to 20 % in 2001 in the general scheme as a result of higher pension entitlements of new retirees.

Supplementary pension schemes of the second or third pillar cover nearly six million people, but only 10 % of these are members of an occupational scheme established by a collective agreement. Pension plans tend to be more often adhered to on an individual basis or through membership in a group (association, trade union, etc.). The benefits can be drawn in the form of regular or lump-sum payments covering retirement, invalidity, death and survivors' benefits. The book reserve financing system traditionally used for occupational pension plans is being abolished (except in the financial services sector) in favour of external funds to enhance the safety of pensions in the event of bankruptcy.

Non-contributory pensions provide a means-tested guaranteed minimum income for those without contributory pension benefits (e.g. because of insufficient contribution periods or lack of contributions).

Challenges

Spain faces one of the largest increases in the old-age dependency ratio in the EU over the coming 50 years. However, as a consequence of low birth rates during the Spanish Civil War, the increase in the number of pensioners over the coming years will be reduced, whereas the age group 20–64 is expected to increase until 2013 before starting to decline. Spain will, therefore, experience the impact of ageing somewhat later than most other Member States. Future demographic developments and hence the old-age dependency ratio will also depend on migratory flows which are difficult to predict. In 2000, Spain experienced an influx of 360 000 immigrants. The latest financial data for the social security system take into account the fact that the number of foreigners covered by the system increased from 332 000 in 1999 to 792 000 in 2002.

According to the EPC projections, public pension expenditure is expected to rise from 9.4 % to 17.3 % of GDP between 2000 and 2050, i.e. by 7.9 percentage points of GDP (6.7

percentage points under the more favourable employment assumptions of the 'Lisbon scenario'). Almost all of this rise is expected to occur between 2020 and 2050.

The national strategy report presented new projections for pension expenditure under the contributory social security system up to 2040. Later (in December 2002), the 2002 stability programme extended these projections to the year 2050. According to these figures, pension expenditure was 8.4 % of GDP in 2000; this is projected to decrease to 8.0 % in 2010 and thereafter to rise gradually to 13.0 % in 2050. The differences in the share of pension expenditure in 2000 is explained by the fact that the national calculations exclude civil servants' pensions (1.0 % of GDP in 2000, projected to be 0.6 % of GDP in 2050). The expected increase between 2000 and 2050, 4.6 percentage points of GDP, is significantly lower than the increase projected by the EPC. This difference is partly due to a different population scenario and partly to different macroeconomic assumptions. The population scenarios in these two exercises differ mainly with regard to assumptions on the influx of immigrants. The national projection assumes 360 000 immigrants in 2000, decreasing to 160 000 by 2005, and thereafter remaining at this level up to 2050. The EPC projection assumed 31 000 immigrants in 2000, increasing to 60 000 by 2010 and thereafter remaining at this level up to 2050. According to the Economic Policy Committee's sensitivity analysis, a high population scenario of 42.4 million people in 2050, which is close to the national projection of 41.4 million people in 2050, would yield a 1.5 percentage points lower increase in pension expenditure between 2000 and 2050. An additional (partial) explanation for the difference is that the national projection assumes that pension entitlement accrues only at about half the speed of the increase in wages, thereby resulting in significantly lower levels of pensions in the future than in the EPC projections, which assumed that pension entitlement accrues in line with the growth in wages ([29]).

The Spanish employment rates for older workers and women are among the lowest and the unemployment rate the highest in the EU, thus providing considerable potential for employment growth and hence a stronger contribution base for financing pensions. Limited availability of part-time jobs seems to constrain the increase in female labour-market participation. The large increase in the number of foreign workers is expected to continue to sustain the relatively fast employment growth in Spain.

The pension system appears to be effective in reducing poverty risks among older people (which are lower than for the rest of the population). Relative living standards of older people are high and the gap between men and women appears to be small in terms of living standards and poverty risks, albeit not in terms of individual pension entitlements. The government nevertheless wishes to strengthen occupational pension provision which currently is only available to a small proportion of employees.

Meeting the challenges

Spain is trying to tackle the issue of adequate and sustainable pensions on the basis of a large political consensus. The so-called Toledo Pact concluded in 1995 and put into law in 1997 represented an important step forward in facilitating the management of the financing of the social security system by separating contributory from non-contributory benefits, the latter being financed through the general budget. It was also agreed that the surplus of the social security system that is expected until 2015 will be transferred to a newly established

([29]) The Ageing Working Group of the EPC has not yet had an opportunity to evaluate the comparability of the national projections with those of the EPC.

reserve fund to help to cover increased future pension expenditure. In 2002, the assets of the fund amounted to 1 % of GDP. Although the accumulation of funds will continue as long as the social security system produces surpluses, this period of time is limited, involving a risk that the fund may not grow sufficiently to make a major contribution to financing the pensions of the large cohorts that will retire after 2015. Thanks to the discipline required by the budgetary stability law, Spain has made major efforts to achieve balanced budgets both at the level of the central government and in the sub-sectors of the general government (autonomous communities and local authorities).

Low participation rates and high unemployment, particularly among older people and women, are being addressed by a number of reform efforts. Measures to reduce female unemployment focus on promoting education and training and on reducing employers' social contributions if women are given open-ended contracts. Some steps have been made to facilitate the reconciliation of family and work responsibilities through measures such as the extension of the right to a reduced working day or leave for people who are caring for dependent people (not only children) and through the facilitation of paternity leave (as an alternative to maternity leave), so as to improve incentives for female labour-force participation. The integration of immigrants into the Spanish labour market is expected to continue to play a significant role in increasing total employment and, hence, the number of contributors to the social security system.

In recent years, some steps were taken with the aim of increasing the employment rate of older people notably through better possibilities for flexible and gradual retirement. Working beyond the age of 65 now allows an individual to accrue higher pension entitlements. It is also possible to draw a (partial) pension while continuing to work after 65. Furthermore, Spain seeks to promote the employment of people over 45 through considerable reductions of social security contributions.

Legislation introduced in January 2002 tries to promote the development of occupational pension schemes, particularly in small and medium-sized companies, through collective bargaining.

Conclusion

The Spanish pension system appears to perform well in terms of adequacy, but faces a major challenge with regard to financial sustainability. While the reorganisation of the financing of the social security system, including the establishment of a reserve fund, as well as some adjustments to the parameters of the pension system are steps in the right direction, the reform efforts up to now appear to fall short of what is required to meet the challenge of financial sustainability. Significant reforms for ensuring the financial sustainability of the pension system are in preparation and will be necessary. Given the low female employment rate and the low participation rate of older people, further efforts are also necessary in order to enable these people to actively participate in the labour market and to offer them the right incentives to do so.

Background statistics

	E						EU-15					
Recent income situation (1999 ECHP data)												
	Total		Men		Women		Total		Men		Women	
	0–64	65+	0–64	65+	0–64	65+	0–64	65+	0–64	65+	0–64	65+
At-risk-of-poverty rate (1) (at 50 % of median)	14	7	14	7	15	7	10	9	9	7	10	10
At-risk-of-poverty rate (1) (at 60 % of median)	19	16	19	16	20	16	15	17	15	15	16	19
Inequality of income distribution (1)	6.0	4.2					4.6	4.1				
Income of people aged 65+ as a ratio of income of people aged 0–64 (1)	0.91		0.94		0.88		0.89		0.92		0.86	

Long-term projections of public pensions spending (EPC 2001)	E				EU-15			
	Level			% increase	Level			% increase
	2000	2020	2050	2000–50	2000	2020	2050	2000–50
Old-age dependency ratio (2)	24.5	30.6	60.0	146.0	24.2	32.2	49.0	102.5
Public pensions expenditure, % of GDP (3)	9.4	9.9	17.3	84.0	10.4	11.5	13.3	27.9
Factors determining the evolution of public pensions expenditure (2000–50) (3)	Contribution to change in percentage points of GDP				Contribution to change in percentage points of GDP			
Demographic dependency	8.2				6.4			
+ Employment	– 2.4				– 1.1			
+ Eligibility	2.0				0.6			
+ Level of benefits	– 0.3				– 2.8			
= Total (including residual)	7.5				3.1			
Esspros pensions expenditure (4) (1999)	9.9				12.7			

Scope for policies to ensure sustainable pensions	E			EU-15		
Employment (2001)	Total	Men	Women	Total	Men	Women
Employment rate (15–64) (5)	57.7	72.4	43.0	64.1	73.0	55.0
Employment rate (55–64) (5)	39.2	57.9	21.4	38.8	48.3	28.7
Effective labour-market exit age (6)	60.6	60.7	60.2	59,9	60,5	59,1
Public finances (2001) (7)						
Public debt, % of GDP	57.1			63		
Budget balance, % of GDP	– 0.1			– 0.8		

Notes:

(1) *Source:* ECHP–UDB, Eurostat, version December 2002. The weights for the Spanish data will be revised. Data for Sweden only cover persons aged less than 85; see methodological note preceding the country summaries and the box 'European income data: methodology and limitations' in Section 3.1.2 for a full discussion of the survey methodology and its limitations.

(2) *Source:* Eurostat, demographic projections. Number of people aged 65 years and over as a percentage of people aged 15–64.

(3) *Source:* Economic Policy Committee, report on 'Budgetary challenges posed by ageing populations', 24 October 2001. Public pension expenditure (including most public replacement incomes to people aged 55 or over), before taxes. See methodological note.

(4) *Source:* Esspros, Eurostat. Includes expenditure by certain private social protection schemes; see methodological note.

(5) *Source:* European labour force survey, 2001.

(6) *Source:* European labour force survey, 2001. Calculation method still under discussion.

(7) *Source:* European Commission, Directorate-General for Economic and Financial Affairs.

FRANCE

Main characteristics of the pension system

The French pension system is based on compulsory pay-as-you-go schemes, which cover 98 % of total pension expenditure and are financed by social security contributions and taxes.

The architecture of the schemes varies according to the sector of activity. Pension schemes for private sector employees cover 63 % of total pension expenditure. Alongside a basic, general scheme with strong solidarity elements, mandatory supplementary pension schemes are established by collective agreements and financed on a pay-as-you-go basis. The benefit formula of these supplementary schemes is based on a point system and ensures a close link between contributions and benefits paid. Financial equalisation mechanisms exist between these different schemes. Compulsory schemes for farmers and the liberal professions have a comparable two-tier structure.

Civil servants and State enterprise employees are covered by a variety of special schemes that are organised in one pillar only and cover 28 % of total pension expenditure. These special schemes are generally more generous than those for private sector employees.

Finally, a guarantee of a minimum level of resources for old people and the households to which they belong is provided through a means-tested complement to pensions received from other schemes.

The extensive role of compulsory pay-as-you-go schemes in the French pension system leaves little room for the development of other voluntary occupational or individual plans which nevertheless benefit from fiscal incentives.

Pension income accounts for more than three-quarters of all income of people aged 65 and more. When all sources of income are taken into account, the living conditions of retired people are very close to those of the active population. In particular, retired households are at no higher risk of poverty than other households.

Challenges

In France, because of the early onset and the magnitude of the baby-boom, the number of new retirees will increase sooner and more significantly than in other Member States (already in 2007, although the financial implications will not materialise until 2010). Maintaining financial sustainability in the face of an expected rise of the old-age dependency ratio over the coming decades is seen as the main challenge ([30]). The government has, therefore, announced its intention to start discussions with the social partners early next year with a view to defining a program of reform that will start being implemented in the second half of the year.

([30]) According to Eurostat projections, the old-age dependency ratio will rise by 89 % between 2000 and 2050. National projections are based on a greater rise in life expectancy and foresee an increase in the old-age dependency ratio of 112 %.

According to the estimates reported in the national strategy report, public pension expenditure, is expected to increase rapidly over the coming decades, from a level of 12.6 % of GDP in 2000 to 16.3 % in 2040. This confirms the order of magnitude of the increase presented in the earlier Economic Policy Committee projection (12.1 % of GDP in 2000 rising to 15.8 % in 2040). Under current regulations, the balance of the pension system would, therefore, pass from a surplus of 0.6 % of GDP in 2005 to a deficit of 1.8 % in 2020 and 3.8 % in 2040, unless the contribution rate is raised by 10 percentage points. Using more favourable variants to the demographic and economic assumptions underlying these estimates only partially corrects the financing needs of the system. For example, a slightly higher fertility rate, or a shorter life expectancy or, still, a reduced unemployment rate by one percentage point would each lead to a reduction of the financing need of the pension system of only about 0.2–0.4 percentage points of GDP.

Raising the effective age of withdrawal from the labour market (without increasing pension rights) is estimated to have a relatively large impact: adding one extra year to the average age of retirement from now until 2040 would allow the financing need of the pension system to be cut by 0.6 percentage points of GDP. Currently, the employment rate of older workers is still very low and the estimated labour-market exit age is, at 58.1 years, one of the lowest among EU countries. There is, therefore, large scope for increasing the labour supply of older people. The government does not intend to raise the minimum legal age of retirement, which is now at 60, but rather aims to introduce incentives to postpone the effective withdrawal from the labour market. The current retirement system provides weak incentives to contribute beyond the age at which a full pension entitlement is acquired, i.e. after age 60 and after 40 contribution years (37.5 in the public sector). Once these conditions are fulfilled, there are hardly any incentives for working longer: an extra year of work implies foregoing one year of pensions as there are restrictions for the accumulation of pension and earnings and paying pension contributions with no or little increase in acquired pension rights.

The government's strategy to cope with the financial challenge also relies on increasing employment among other groups, so as to strengthen the contribution base. There is scope for lowering unemployment and raising the employment rates of young people and women. However, the strategy to raise the employment rate of young people entails significant costs as it relies strongly on subsidies notably in the form of reduced social security contributions.

Building the required consensus for reforming the French pension system is made difficult by its fragmented nature and notably the existence of special and more generous schemes in the public sector. This represents a major challenge and explains, to some extent, why progress in pension reform has been uneven.

The large variety of pension schemes with somewhat different entitlement conditions and pension formulae also makes it important to improve the transparency of the pension system as a whole. While it can be said that the French pension system has been able to ensure adequacy in terms of allowing people to maintain their living standards after retirement, there is still some way to go to meet the objective of intra-generational solidarity. The latter would require ensuring better equality between workers belonging to different schemes, in particular between workers in the public and private sectors. In this respect, the social partners have emphasised the need to give more visibility to the likely evolution of replacement ratios for private sector employees.

Meeting the challenges

The present government intends to propose a new reform of the pension system during the first half of next year. A driving principle of the forthcoming reform is to safeguard of the compulsory schemes financed on a pay-as-you-go basis, which the national strategy report regards as an essential condition for inter- and intra-generational solidarity. The government wants to engage in the reform process through dialogue with the social partners and within the framework of the existing fragmented system of pension schemes.

The forthcoming reform will build on previous reforms steps of the French pension system. The most notable one was the Simone Veil reform of the general scheme for private sector employees which came into force in 1993. It increased, gradually over a ten-year period, the number of years of service required to get the full pension rate before 65 years of age from 37.5 years to 40 years. Next, the period of earnings on which pensions are calculated was increased from the best 10 to the best 25 years, at the rhythm of one year per year, starting from 1 January 1994. The pension adjustment was changed to prices instead of wages, although leaving scope for some additional adjustments in the case of favourable economic performance. Finally, in order to reinforce the insurance character of the system, a 'solidarity fund' financed out of taxes was created with the purpose of funding certain solidarity elements (minimum old-age allowance, benefits awarded on the basis of the number of children, periods of national service, old-age contributions for the unemployed). These measures responded to the social partners' claim that such expenses should be a responsibility of the State.

As a result of the 1993 reform, the replacement ratio provided by the general scheme is estimated to fall until 2020. In 1996, changes have also been introduced in the complementary schemes for private sector employees (AGIRC and ARRCO) in order to reinforce their insurance character. In contrast, public sector employees' schemes have so far remained unaffected by reforms.

A pension reserve fund was created in 1999 with a view to smoothing contribution rates during the retirement of the baby-boom cohorts. However, assets of the reserve fund currently amount to less than 1 % of GDP and will be difficult to boost as ageing will begin already from 2007 onwards. The government estimates that reserves should rise to EUR 150 billion by the year 2020 (around 7 % of GDP), but this will not be sufficient to cover future pensions imbalances. Finally, an orientation committee on retirement (COR) has been set up with representatives from the Parliament, the social partners and experts to promote dialogue and provide reports and advice on pension matters.

Conclusion

The financing of the pension system for the decades ahead is currently not secured and significant further reform efforts are needed. The national strategy report envisages a major reform in 2003; specific measures are not presented, but it is made clear that this will not change the basic architecture of the current system. However, further significant reforms are needed in order to put the pension system on a financially sustainable footing. Given the complexity of the current system, this will require a strong political consensus. The fragmentation of the pension system into a large quantity of schemes and the discussions between the government and the social partners within each of these schemes should not slow down the reform process. A crucial issue concerns the extent to which it will be possible to ensure an equitable treatment of members of different schemes, and, in particular, of public and private sector employees. It will also be important for the government to develop an effective and sustainable strategy to guarantee a greater participation of older workers in the labour market and to raise employment in general.

Background statistics

	F						EU-15					
Recent income situation (1999 ECHP data) ([8])												
	Total		Men		Women		Total		Men		Women	
	0–64	65+	0–64	65+	0–64	65+	0–64	65+	0–64	65+	0–64	65+
At-risk-of-poverty rate ([1]) (at 50 % of median)	8	10	8	8	8	12	10	9	9	7	10	10
At-risk-of-poverty rate ([1]) (at 60 % of median)	14	19	14	16	15	21	15	17	15	15	16	19
Inequality of income distribution ([1])	4.4	4.1					4.6	4.1				
Income of people aged 65+ as a ratio of income of people aged 0–64 ([1])	0.90		0.94		0.88		0.89		0.92		0.86	

	F				EU-15			
Long-term projections of public pensions spending (EPC 2001)								
	Level			% increase 2000–50	Level			% increase 2000–50
	2000	2020	2050		2000	2020	2050	
Old-age dependency ratio ([2])	24.4	32.6	46.0	89.0	24.2	32.2	49.0	102.5
Public pensions expenditure, % of GDP ([3])	12.1	15.0	15.8	30.6	10.4	11.5	13.3	27.9

	F	EU-15
Factors determining the evolution of public pensions expenditure (2000–50) ([3])	Contribution to change in percentage points of GDP	Contribution to change in percentage points of GDP
Demographic dependency	7.7	6.4
+ Employment	– 0.9	– 1.1
+ Eligibility	0.7	0.6
+ Level of benefits	– 3.6	– 2.8
= Total (including residual)	3.9	3.1
Esspros pensions expenditure ([4]) (1999)	13.5	12.7

	F			EU-15		
Scope for policies to ensure sustainable pensions						
Employment (2001)	Total	Men	Women	Total	Men	Women
Employment rate (15–64) ([5])	62.8	70.3	56.0	64.1	73.0	55.0
Employment rate (55–64) ([5])	31.9	35.4	26.7	38.8	48.3	28.7
Effective labour-market exit age ([6])	58.1	58.2	58.0	59,9	60,5	59,1
Public finances (2001) ([7])						
Public debt, % of GDP	57.3			63		
Budget balance, % of GDP	– 1.4			– 0.8		

Notes:

([1]) *Source:* ECHP–UDB, Eurostat, version December 2002. The weights for the Spanish data will be revised. Data for Sweden only cover persons aged less than 85; see methodological note preceding the country summaries and the box ‘European income data: methodology and limitations’ in Section 3.1.2 for a full discussion of the survey methodology and its limitations. In the case of France, due to differences in the scope of surveys, sample attrition and sampling errors in the ECHP, national survey results using ECHP income definitions indicate different at-risk-of-poverty rates: 4.2 % for people aged 65+ at 50 % of median income (7.5 % for people aged 0–64) and, at 60 % of median income, 10.2 % for people aged 65+ (13.5 % for people aged 0–64).

([2]) *Source:* Eurostat, demographic projections. Number of people aged 65 years and over as a percentage of people aged 15–64.

([3]) *Source:* Economic Policy Committee, report on ‘Budgetary challenges posed by ageing populations’, 24 October 2001. Public pension expenditure (including most public replacement incomes to people aged 55 or over), before taxes. See methodological note.

([4]) *Source:* Esspros, Eurostat. Includes expenditure by certain private social protection schemes; see methodological note.

([5]) *Source:* European labour force survey, 2001.

([6]) *Source:* European labour force survey, 2001. Calculation method still under discussion.

([7]) *Source:* European Commission, Directorate-General for Economic and Financial Affairs.

([8]) The statutory pensionable age in France is 60. Using age the age groups 0–59 and 60+ would result in observing lower poverty risks and higher relative living standards of older people.

IRELAND

Main characteristics of the pension system

The first pillar provides for flat rate payments and is financed through pay-related contributions from employers, employees and the self-employed. Supplements are payable for dependants, for those living alone and to pensioners over 80. Similarly structured social assistance pensions are payable on a means-tested basis to those without a sufficient social insurance record.

The old-age (insurance-based) pension currently pays an amount equivalent to approximately 31 % of gross average industrial earnings; the means-tested pension pays slightly less. Rates of payment have increased significantly in recent years and the government has committed itself to a policy of ongoing real increases to the basic pension rates until 2007. At the same time, the share of the population dependent on means-tested pensions is falling and should continue to do so.

The second pillar consists of voluntary occupational pensions usually provided by individual employers. The third pillar is made up of individual pensions. The State facilitates and encourages second- and third-pillar pensions through favourable tax treatment of contributions and investment returns and by a regulatory system designed to safeguard pension entitlements.

Approximately 68 % of members of occupational pension schemes are of the defined-benefit type with the remainder being defined-contribution schemes. The membership of second- and third-pillar schemes has been increasing by an average of 5 % in each of the last five years as the workforce expanded rapidly. Currently, just over 50 % of workers have supplementary pension coverage.

Non-cash benefits-in-kind are substantial: they include free travel paid to all of pension age; free healthcare, telephone rental and TV licences, electricity/gas/fuel allowances are paid to all at age 70 and subject to a means-test before that.

Challenges

Regarding demographic developments, Ireland stands out in that it has the lowest proportion of older people in the EU; 11.2 % are aged 65 or over. This proportion will remain at roughly the same level for the next 10 years, after which it is projected to increase steeply to 15 % in 2021, 19 % in 2031 and 28 % in 2056. However, ageing presents challenges for Ireland of at least the same magnitude as for other Member States; the only difference is that this challenge, reinforced by increased longevity, will appear later.

According to ECHP data from the late 1990s, poverty risks were high for elderly women, and the living standard of older people relative to the population below 64 was rather low. However, the national strategy report points out that in the period 1994 to 2000 the percentage of households headed by a person aged over 65 in consistent poverty fell from

12.5 % to 7.2 % ([31]). The current government target is to reduce this to 2 % by 2007 and, if possible, to eliminate consistent poverty for this group.

The relative income situation of older people reflects notably the fact that Ireland is currently the only Member State without some form of compulsory income-related pension provision for a majority of workers. Moreover, the expansion of occupational pensions coverage — and employment in sectors that are well covered — will take some time before producing its full impact on pensioner incomes.

Public spending on first-pillar pensions (including public service pensions) is projected to rise from 4.6 % of GNP in 2000 to 6.7 % in 2020 and 9 % in 2050. These projections assume a very high participation rate of 80 % by 2050 (68 % in 2001). If the participation rate were to rise to about 75 %, the pension expenditure increase would be 0.7 percentage points higher. Current contribution rates to the Social Insurance Fund are deemed to be sufficient. However, an increased contribution to the Fund will be needed if benefits are indexed to wages or if the lowest pensions are to be increased in real terms.

As a means both to allow people to maintain an appropriate living standard in retirement and to contribute to spreading the future financial burden, raising the coverage of supplementary pensions is seen as crucial. Currently, occupational and private pension plans cover about 50 % of employees and there are particularly low rates of coverage in certain sectors (e.g. 'hotels and restaurants' and 'wholesale and retail trades'). The government is seeking an increase in coverage to 70 % of employees.

In view of the important role of occupational schemes in the Irish pension system, it will be important to ensure not only improved access for all workers, but also greater portability of pension rights, particularly under defined-benefit schemes. The Pensions (Amendment) Act 2002 reduced maximum vesting periods to two years and also improved transfer, preservation and the revaluation of entitlements for members of occupational pension schemes.

Meeting the challenges

As a result of the progressive extension of compulsory insurance between the mid-1970s and the mid-1990s, 86 % of pensions will be social-insurance-based by 2016. The absence of a means test and the fact that these contributory pensions are paid at a higher rate than social assistance pensions should reduce the number of pensioners on very low incomes. Moreover, the government has declared its intention to raise basic pensions and supplements for dependent spouses and partners significantly, so that the lowest pension will reach EUR 200 per week by 2007.

The government has also set a target for supplementary pension coverage which should reach 70 % of the workforce. To this end, the government will introduce personal retirement savings accounts (PRSA) from 2003 onwards as the main vehicle for increasing coverage. PSRAs will be subject to statutory limits on administrative charges, and pension entitlements can be maintained without penalty when an account holder changes or ceases employment. However, participation in a PRSA will be voluntary for an individual, but employers will be obliged to facilitate this unless they already operate an occupational

([31]) A person in consistent poverty lives on less than 60 % of average income and lacks basic items such as a hot meal, a warm coat and adequate housing.

pension schemes. There will also be a public information campaign. Recently enacted legislation requires that progress be reviewed within three years. The quarterly national household survey has been improved to allow the monitoring of pension coverage.

The national strategy report announces a consultation document that should cover two measures which would improve opportunities for earning adequate pension rights: the elimination of the retirement condition at age 65 (at 66 the combined receipt of a pension and earned income is again possible) and the possibility to postpone retirement in return for improved benefits.

A key element of the Irish strategy is to build up a reserve fund to partially pre-finance public pensions to be paid out after 2025. The assets of the Reserve Fund will be drawn down by future Ministers for Finance commencing in 2025 until at least 2055. The size of these drawdowns will increase in line with the growth in the percentage of over 65s in the population. The government is required by law to contribute 1 % of GNP to the fund each year. The current amount of assets, at 8 % of GNP, is estimated to reach a level of 43 % by 2025. Additional contributions may also be added (the fund was launched with the proceeds from privatisation of the public telecommunications company).

Recognising the need to monitor the sustainability of the Irish pension system, the government decided in 1998 to carry out regular actuarial reviews of the financial situation of the Social Insurance Fund (SIF); the capacity of the National Pension Reserve Fund to meet future pension liabilities is also to be assessed regularly. The first and, to date, only review of the SIF covered the period 2001–56 and focused on the adequacy of current contribution rates under alternative scenarios for the indexation and target levels of pensions.

Conclusion

The Irish national strategy report presents a clear commitment to improving adequacy by raising the lowest pensions and rapidly extending voluntary supplementary pension coverage to 70 % of the workforce. This extended coverage is important for ensuring the effectiveness of the income replacement function of pension systems and it remains to be seen whether this can be achieved via the current purely voluntary approach.

Ireland has made good progress in ensuring the financial sustainability of the pension system while at the same time making provisions for increasing the adequacy of pensions. The government is committed to accumulating a considerable reserve fund in order to partially pay for future liabilities. The public system therefore appears to be, in broad terms, financially sustainable despite projected major increases in future pensions expenditure. However, if benefits were to be indexed to wages in the future, present levels of contributions would be insufficient. The commitment to monitoring the adequacy of contribution rates through regular actuarial reviews which should help to react to indications of a need for adjustments in case of a lower-than-projected increase in participation rates or the introduction of indexation or new targets for benefit levels and, thus, help to keep the system on a sustainable footing.

Background statistics

Recent income situation (1999 ECHP data)

	IRL						EU-15					
	Total		Men		Women		Total		Men		Women	
	0–64	65+	0–64	65+	0–64	65+	0–64	65+	0–64	65+	0–64	65+
At-risk-of-poverty rate (1) (at 50 % of median)	10	14	10	7	11	19	10	9	9	7	10	10
At-risk-of-poverty rate (1) (at 60 % of median)	17	34	16	26	17	41	15	17	15	15	16	19
Inequality of income distribution (1)	4.9	4.5					4.6	4.1				
Income of people aged 65+ as a ratio of income of people aged 0–64 (1)	0.69		0.74		0.65		0.89		0.92		0.86	

Long-term projections of public pensions spending (EPC 2001)

	IRL Level 2000	IRL Level 2020	IRL Level 2050	IRL % increase 2000–50	EU-15 Level 2000	EU-15 Level 2020	EU-15 Level 2050	EU-15 % increase 2000–50
Old-age dependency ratio (2)	16.8	22.1	40.0	139.0	24.2	32.2	49.0	102.5
Public pensions expenditure, % of GDP (3)	4.6	6.7	9.0	95.7	10.4	11.5	13.3	27.9
Factors determining the evolution of public pensions expenditure (2000–50) (3)	Contribution to change in percentage points of GDP				Contribution to change in percentage points of GDP			
Demographic dependency	4.5				6.4			
+ Employment	– 0.9				– 1.1			
+ Eligibility	1.4				0.6			
+ Level of benefits	– 0.7				– 2.8			
= Total (including residual)	4.3				3.1			
Esspros pensions expenditure (4)· (8) (1999)	3.8				12.7			

Scope for policies to ensure sustainable pensions

Employment (2001)	IRL Total	IRL Men	IRL Women	EU-15 Total	EU-15 Men	EU-15 Women
Employment rate (15–64) (5)	65.7	76.0	54.9	64.1	73.0	55.0
Employment rate (55–64) (5)	46.8	64.7	28.5	38.8	48.3	28.7
Effective labour-market exit age (6)	63.1	63.2	62.2	59,9	60,5	59,1
Public finances (2001) (7)						
Public debt, % of GDP	36.4			63		
Budget balance, % of GDP	1.5			– 0.8		

Notes:

(1) *Source:* ECHP–UDB, Eurostat, version December 2002. The weights for the Spanish data will be revised. Data for Sweden only cover persons aged less than 85; see methodological note preceding the country summaries and the box ‘European income data: methodology and limitations’ in Section 3.1.2 for a full discussion of the survey methodology and its limitations.

(2) *Source:* Eurostat, demographic projections. Number of people aged 65 years and over as a percentage of people aged 15–64.

(3) *Source:* Economic Policy Committee, report on ‘Budgetary challenges posed by ageing populations’, 24 October 2001. Public pension expenditure (including most public replacement incomes to people aged 55 or over), before taxes. See methodological note.

(4) *Source:* Esspros, Eurostat. Includes expenditure by certain private social protection schemes; see methodological note. For Ireland, no data are available on occupational pension schemes for private-sector employees with constituted reserves; these exenditure values could therefore not be included in this figure.

(5) *Source:* European labour force survey, 2001.

(6) *Source:* European labour force survey, 2001. Calculation method still under discussion.

(7) *Source:* European Commission, Directorate-General for Economic and Financial Affairs.

ITALY

Main characteristics of the pension system

While the first pillar remains fragmented into over 50 different schemes, the reforms of the 1990s have progressively unified the basic rules and most of the schemes are administered by the social security institution for the private sector (INPS) which accounts for two thirds of the expenditure and insures the majority of private sector employees and the self-employed. Public sector employees' pensions are administered by a separate institution (INPDAP). The five largest schemes cover about 80 % of total public pension expenditure.

This first pillar covers 100 % of the registered employed population in Italy and includes old-age, invalidity and survivors' pensions. Old-age pensions accounted for 70 % of public pension expenditure in 2000, disability pensions for 13 % and survivors' pensions for the remaining 17 %. The contribution rate for employees is 32.7 % and between 13.5 % and 17 % for the self-employed (due to be raised to 19 % over the coming years). The transfer from the general budget amounted to 0.8 % of GDP in 2001. An additional 2.2 % of GDP was used to finance benefits included in pension expenditure, but classified as social assistance and financed through general taxation.

Pensions and public welfare benefits represent the most important source of income for older people, especially among the less well-off segments of the population. They account for between 86.2 % and 54.5 % of the income of people aged 65+.

The 1995 reform of the first-pillar pensions is leading to a gradual shift from the current defined-benefit scheme to a notional defined-contribution scheme, to be applied fully to all entrants to the labour market after 31 December 1995. This implies that fully defined-contribution pensions will be paid out only from 2035 onwards. Meanwhile, during the transition period, older generations will maintain, at least partially, their entitlements according to the old scheme rules. Workers with at least 18 years of contributions at the end of 1995 remain under the defined-benefit method of the old system for the calculation of their benefits. The new system will result in significantly lower pension benefits if current career lengths and retirement ages are maintained: under the public pension scheme, the gross replacement rate for a typical employee retiring at 60 with 35 contribution years will fall from 67.1 % in 2010 to 56 % in 2020 and to 48.1 % in 2050. The fall is larger for the self-employed whose contribution rates to the public pension system are lower.

Under the new system, benefits are calculated on the basis of the amount of contributions paid throughout the entire career and capitalised at the average growth rate of GDP over the previous five years. The value of accumulated contributions is translated into a pension on the basis of actuarial equivalence, taking into account the remaining life expectancy at the retirement age. Retirement will be possible between 57 and 65 for both men and women, but workers may not retire before they have reached a pension level of at least 1.2 times the minimum guaranteed pension guaranteed from age 65 (old-age allowance). In order to counterbalance the impact of increased longevity, the coefficients used for converting contributions into a pension are reviewed every 10 years on an actuarial basis.

The pension reforms of the 1990s introduced a new legal framework for supplementary pension provision. Supplementary pension provision can now take one of three different forms: closed (negotiated) funds based on collective agreements; open funds managed by financial intermediaries; and, since 2000, individual pension plans via life insurance policies (third pillar). Open funds can be joined by workers individually or in groups. Participation in a pension fund is always voluntary for employees, and benefits are calculated, with a few exceptions, on a defined-contribution basis. In 2001, membership in closed and open funds was slightly below 10 % of the employed population; for the self-employed, the percentage is only 4 % and practically zero for civil servants.

Top-up benefits are available to raise the lowest pensions to a minimum level. Older people without sufficient income can claim social assistance.

Challenges

Italy will have the highest old-age dependency ratio among the current 15 EU Member States: more than 60 % in 2050, up from 26 % in 2000. The government started in the 1990s to work out solutions that could guarantee both financial sustainability and adequate benefits. It had been calculated that under the rules in force in 1990, pension expenditure would have risen to 23 % of GDP in 2040 as a result of demographic ageing.

The reforms during the 1990s have curbed and will curb further future pension expenditure growth. According to the EPC projections, pension expenditure is expected to increase from 13.8 % of GDP in 2000 to 16 % of GDP in 2033, where it peaks, and, thereafter, to decrease gradually to 14.1 % in 2050. The updated national projections, taking account of the latest reform measures presented in the national strategy report on pensions and the 2002 stability programme show slightly lower increases for the intermediate years: at the most, 0.3 percentage points less in 2020 compared to the Economic Policy Committee projections. The pension system currently runs a deficit: 0.8 % of GDP for the insurance system alone, despite a very high contribution rate for employees of 32.7 % of wages (lower, but rising to 19 % for the self-employed). If social assistance benefits are included in pensions expenditure, the transfers from the state budget rise to 3.0 % of GDP.

A major challenge — and an opportunity for ensuring future adequacy and financial sustainability — is the low employment rate in general (55 % in 2001) and of women (41 %) and older workers (28 %) in particular. As long as current older workers can take up early pensions under old rules, disincentives to continue to work are strong whereas under the reformed public pension scheme with its close link between contributions and benefits and its actuarial adjustment mechanisms, more and longer employment will give rise to higher benefit entitlements and hence help address potential adequacy issues. It will be necessary to be very strict in avoiding the recourse to early retirement as an instrument for adjustment in labour market and to improve employment opportunities for older workers. Moreover, it will be necessary to help large numbers of undeclared jobs — many of them held by pensioners — emerge from the shadow economy.

Preventing future adequacy problems will also require improvements in the social protection of workers in new flexible forms of employment, although only few people would spend much of their working life under such flexible contracts, so that the adequacy problems associated with them are somewhat mitigated. There is also a large number of workers with a special status of self-employment, mainly characterised by a close and continuous relation to a single company (*parasubordinati*). Their social protection was improved in 1996 through the creation of a special scheme.

Supplementary pension schemes currently play a minor role in pension provision, but they are developing, notably thanks to fiscal incentives. They could compensate for the lower replacement rate under the first pillar, but they have yet to be fully developed in many companies and sectors. About two million workers have so far enrolled in a supplementary pension scheme. Public sector employees are affected by the same reform measures as private sector employees, but for this category of workers supplementary pension schemes have yet to be established.

Meeting the challenges

Three major reforms during the 1990s (in 1992, 1995 and 1997) took on the challenge of securing financially sustainable pensions and radically transformed the Italian pension system. Among the cost-cutting mechanisms introduced in the 1990s, and already implemented, include the elimination of the index-linking of pensions to earnings, the raising of the retirement age, the tightening of the minimum eligibility requirements for retirement in the transition period, the tightening of the requirements for disability pension benefits and the application of rules to public sector schemes that are equivalent to those of the reformed private sector pension scheme.

The draft enabling act for a new pension reform (currently under discussion in the Parliament) does contain measures to promote second and third-pillar pension provision to compensate for the reduction in replacement rates under the first pillar. The measures envisaged include a favourable treatment of contributions to the second and third pillar with regard to income taxation and social insurance contributions and a possibility of diverting contributions to mandatory severance pay schemes (*TFR — Trattamento di fine rapporto*) into occupational pension schemes. TFR schemes are currently financed by a contribution rate of 6.91 % on gross earnings and managed as book reserves within the company with a low but guaranteed rate of interest. The reform will allow future contributions to severance pay schemes to be channelled into pension funds which are separate from the other assets of the companies. This will imply, however, that companies will lose a source of cheap finance. Some categories of workers are already diverting TFR into pension funds on a voluntary basis, and the government is taking actions to further extend this possibility to all private and public sector employees.

Conclusion

Italy undertook major reform efforts in the 1990s which have started to stabilise public pension expenditure and will control the future spending dynamics. The move towards a notional defined-contribution pension scheme represents a thorough modernisation of the first pillar, which is of critical importance also for its financial sustainability. However, the high overall level of contributions to the pension system and the need for transfers from the central government budget remain major challenges. Raising employment rates, particularly of women and older workers, will be crucial for meeting these challenges.

During the transition period to the new system, older workers will continue to retire under the old rules which offer weak incentives for working longer. For the new entrants to the labour market since 1995, the new pension system will offer appropriate incentives to work, thanks to actuarial neutrality, and should, therefore, lead to higher employment rates. At the same time, working longer will provide opportunities for earning adequate pension rights. Future adequacy will also depend on the development of supplementary pension provision. The transformation of the severance pay scheme into occupational pension schemes represents a major opportunity. Ensuring adequacy will also require tackling the issue of pension rights for atypical workers.

Background statistics

Recent income situation (1999 ECHP data)

	I						EU-15					
	Total		Men		Women		Total		Men		Women	
	0–64	65+	0–64	65+	0–64	65+	0–64	65+	0–64	65+	0–64	65+
At-risk-of-poverty rate (1) (at 50 % of median)	13	8	13	7	13	9	10	9	9	7	10	10
At-risk-of-poverty rate (1) (at 60 % of median)	19	14	19	12	19	16	15	17	15	15	16	19
Inequality of income distribution (1)	5.1	4.2					4.6	4.1				
Income of people aged 65+ as a ratio of income of people aged 0–64 (1)	0.96		0.98		0.94		0.89		0.92		0.86	

Long-term projections of public pensions spending (EPC 2001)

	I				EU-15			
	Level			% increase 2000–50	Level			% increase 2000–50
	2000	2020	2050		2000	2020	2050	
Old-age dependency ratio (2)	26.6	36.7	61.0	131.0	24.2	32.2	49.0	102.5
Public pensions expenditure, % of GDP (3)	13.8	14.8	14.1	2.2	10.4	11.5	13.3	27.9

Factors determining the evolution of public pensions expenditure (2000–50) (3)	I: Contribution to change in percentage points of GDP	EU-15: Contribution to change in percentage points of GDP
Demographic dependency	9.5	6.4
+ Employment	– 3.1	– 1.1
+ Eligibility	– 1.4	0.6
+ Level of benefits	– 4.9	– 2.8
= Total (including residual)	0.2	3.1
Esspros pensions expenditure (4) (1999)	15.1	12.7

Scope for policies to ensure sustainable pensions

	I			EU-15		
Employment (2001)	Total	Men	Women	Total	Men	Women
Employment rate (15–64) (5)	54.9	68.1	41.1	64.1	73.0	55.0
Employment rate (55–64) (5)	28.1	39.3	15.3	38.8	48.3	28.7
Effective labour-market exit age (6)	59.4	59.6	59.2	59,9	60,5	59,1
Public finances (2001) (7)						
Public debt, % of GDP	109.9			63		
Budget balance, % of GDP	– 2.2			– 0.8		

Notes:

(1) *Source:* ECHP–UDB, Eurostat, version December 2002. The weights for the Spanish data will be revised. Data for Sweden only cover persons aged less than 85; see methodological note preceding the country summaries and the box 'European income data: methodology and limitations' in Section 3.1.2 for a full discussion of the survey methodology and its limitations.

(2) *Source:* Eurostat, demographic projections. Number of people aged 65 years and over as a percentage of people aged 15–64.

(3) *Source:* Economic Policy Committee, report on 'Budgetary challenges posed by ageing populations', 24 October 2001. Public pension expenditure (including most public replacement incomes to people aged 55 or over), before taxes. See methodological note.

(4) *Source:* Esspros, Eurostat. Includes expenditure by certain private social protection schemes; see methodological note.

(5) *Source:* European labour force survey, 2001.

(6) *Source:* European labour force survey, 2001. Calculation method still under discussion.

(7) *Source:* European Commission, Directorate-General for Economic and Financial Affairs.

LUXEMBOURG

Main characteristics of the pension system

The first pillar of the Luxembourg pension system consists of a general scheme for private sector employees and the self-employed and a special scheme for civil servants. Pension benefits are related to earnings.

The general pension insurance scheme is financed through a contribution on wages of 24 % which is paid in equal shares by employers, employees and the state budget. The contribution rate is determined for a period of seven years on the basis of an actuarial evaluation of the scheme. This long-term commitment to stable contribution rates is made possible by a large reserve fund which must not be smaller than 1.5 times the annual amount of benefits. Currently, the reserve amounts to three times the yearly amount of benefits paid.

The net replacement rates for a full insurance career under the general scheme are high, reaching almost 100 % of the pre-retirement income for a worker on about average earnings after 40 years of insurance. A minimum pension of EUR 1 190 is guaranteed after 40 insurance years.

This leaves only a limited need for supplementary schemes. Occupational pension schemes have developed mainly in foreign or very large industrial and commercial companies, as well as in the banking sector. Individual pension provision benefits from fiscal incentives.

The means-tested guaranteed minimum income (RMG) scheme ensures a basic income for those without adequate pension entitlements or other resources. The monthly amount for a single person is EUR 942.

The living conditions of retired people are very close to those of the active population, and old people are at no higher risk of poverty than other people.

Challenges

Demographic ageing is projected to be somewhat less pronounced in Luxembourg than on average in the EU. However, the Luxembourg pension system is very much affected by the high level of employment of non-residents. Due to the low level of unemployment, most new jobs — 75 % of jobs created in 2001 — are taken up by residents of the neighbouring countries. Provided current employment growth rates can be maintained, Luxembourg does not expect to face difficulties in financing public pensions up to 2050. However, this is based on the assumption of an annual rate of economic growth of 4 % and hence a continuing influx of workers. At half this growth rate, the contribution rate would have to be raised from the current 24 % to 46 %. The management of the reserve fund will have to play an important role in preparing for the increase in pensioner numbers.

Within the domestic labour market, there is scope for raising employment rates so as to widen the contribution base. In spite of a very low rate of unemployment, the employment rate of residents aged between 15 and 64 years was 62.9 % in 2001, which is below the EU average. Employment rates of women were also comparatively low at 50.9 %. Fewer than one quarter of residents between 55 and 64 are in employment — half the target rate set at the Stockholm European Council.

Meeting the challenges

A round table discussion on pensions was launched in 2001 with the participation of trade unions, employers' representatives and political parties. This round table analysed issues of pension minima and convergence of the level of pensions paid out by the social security schemes for private and public sector employees. Some of the measures decided at the round table discussion include a rise in the amount of minimum old-age and survivors' pensions and a proportional increase of 3.9 % in the amount of pensions. However, the participants at the round table agreed that some of the improvements could be reversed if the next actuarial assessment showed that the reserve fund could shrink to less than the statutory minimum of 1.5 times annual expenses, but this should not affect the lowest pensions.

Two recent reforms try to address the problem of the low employment rates of older workers. One is the reform of the disability pension system with the aim of promoting rehabilitation instead of retirement. The new law envisages several steps for helping a worker who becomes unable to perform his or her current job. First, examinations are conducted to ascertain whether the worker can return to the previous job. If this is not the case, there should be a reassignment of the worker which should be internal in all companies with more than 25 employees. If an internal reassignment is not possible, the worker is registered as unemployed and entitled to unemployment benefits while the search for other suitable employment opportunities continues. If the disabled person cannot be placed in alternative employment during the legal duration of unemployment benefit payments, the worker is entitled to a waiting allowance, which corresponds to the level of a disability pension.

The other measure is the introduction of a new mechanism of staggered pension increments, based on age and contribution history, for workers aged at least 55 years and with a contribution history of 38 years. This measure should encourage people to extend their working lives.

The government is committed to defining a legal framework for a more dynamic, albeit prudent, investment policy for the reserve fund. A study on this issue was launched in 2001 and a bill is being prepared. The national strategy report notes that the conservative investment strategy followed in the past has protected the reserve fund against the recent downturn on financial markets.

A law of 8 June 1999 establishes a legislative framework for supplementary retirement schemes organised by employers. Whilst leaving companies free to choose whether or not to introduce a supplementary pension scheme, the law defines the rights of employees and ensures equal treatment with regard to taxation of different types of occupational schemes (book reserves, external funds, group insurance). The introduction of a new type of personal pension plan is envisaged by the government. Such plans could pay out up to 50 % of the accumulated savings as a lump sum.

The national strategy report presents a number of measures to improve the pension rights of parents — mostly mothers — who interrupt their career to care for their children. This should reduce the gap between average pensions for men and women. A working group was established following the round table on pensions to examine how individual pension rights of women could be strengthened.

Conclusion

The Luxembourg pension system is based on a strong political consensus and ensures a high level of adequacy. Its financial sustainability hinges, however, not only on the contribution of relatively high rates of economic growth in the future, but also on the major contribution of non-resident workers to the Luxembourg economy and the pension scheme. Fluctuations in the number of foreign workers could amplify the effects of demographic ageing of the resident population. For Luxembourg, the difference between the demographic dependency ratio (people aged 65+ in relation to people aged 15–64) and the economic dependency ratio (people receiving benefits relation to people in employment) could become much larger than elsewhere. In the event of a decline in the employment of non-resident workers, an ageing resident population would have to shoulder not only the pensions of resident pensioners, but also those of a large number of pensioners living outside Luxembourg. This risk should be taken into account in deciding on the amount of reserves that should be held by the general pension scheme. Financial sustainability would depend less on the availability of non-resident workers if the employment rates of residents were raised — and in particular those of women and people over 55.

Background statistics

	L						EU-15					
Recent income situation (1999 ECHP data)												
	Total		Men		Women		Total		Men		Women	
	0–64	65+	0–64	65+	0–64	65+	0–64	65+	0–64	65+	0–64	65+
At-risk-of-poverty rate (1) (at 50 % of median)	6	4	6	3	7	4	10	9	9	7	10	10
At-risk-of-poverty rate (1) (at 60 % of median)	14	8	13	6	14	10	15	17	15	15	16	19
Inequality of income distribution (1)	4.0	3.2					4.6	4.1				
Income of people aged 65+ as a ratio of income of people aged 0–64 (1)	0.99		1.01		0.98		0.89		0.92		0.86	

Long-term projections of public pensions spending (EPC 2001)	L				EU-15			
	Level			% increase 2000–50	Level			% increase 2000–50
	2000	2020	2050		2000	2020	2050	
Old-age dependency ratio (2)	21.5	28.2	38.0	76.0	24.2	32.2	49.0	102.5
Public pensions expenditure, % of GDP (3)	7.4	8.2	9.3	25.7	10.4	11.5	13.3	27.9
Factors determining the evolution of public pensions expenditure (2000–50) (3)	Contribution to change in percentage points of GDP				Contribution to change in percentage points of GDP			
Demographic dependency	NA				6.4			
+ Employment	NA				– 1.1			
+ Eligibility	NA				0.6			
+ Level of benefits	NA				– 2.8			
= Total (including residual)	NA				3.1			
Esspros pensions expenditure (4) (1999)	10.9				12.7			

Scope for policies to ensure sustainable pensions	L			EU-15		
Employment (2001)	Total	Men	Women	Total	Men	Women
Employment rate (15–64) (5)	62.9	74.9	50.9	64.1	73.0	55.0
Employment rate (55–64) (5)	24.4	35.3	14.4	38.8	48.3	28.7
Effective labour-market exit age (6)	56.8	57.5	55.3	59,9	60,5	59,1
Public finances (2001) (7)						
Public debt, % of GDP	5.6			63		
Budget balance, % of GDP	6.1			– 0.8		

Notes:

(1) *Source:* ECHP–UDB, Eurostat, version December 2002. The weights for the Spanish data will be revised. Data for Sweden only cover persons aged less than 85; see methodological note preceding the country summaries and the box 'European income data: methodology and limitations' in Section 3.1.2 for a full discussion of the survey methodology and its limitations.

(2) *Source:* Eurostat, demographic projections. Number of people aged 65 years and over as a percentage of people aged 15–64.

(3) *Source:* Economic Policy Committee, report on 'Budgetary challenges posed by ageing populations', 24 October 2001. Public pension expenditure (including most public replacement incomes to people aged 55 or over), before taxes. See methodological note.

(4) *Source:* Esspros, Eurostat. Includes expenditure by certain private social protection schemes; see methodological note.

(5) *Source:* European labour force survey, 2001.

(6) *Source:* European labour force survey, 2001. Calculation method still under discussion.

(7) *Source:* European Commission, Directorate-General for Economic and Financial Affairs.

THE NETHERLANDS

Main characteristics of the pension system

The first pillar of the Dutch pension system consists of a basic state old-age pension scheme that provides flat-rate benefits to all residents over the age of 65. It is financed by contributions levied on earnings at a rate that is statutorily limited to a maximum of 18.25 %, but the entitlement to the basic pension accrues through residence in the Netherlands between the ages of 15 and 65. The current value of the basic pension for a single person is around EUR 825 per month which almost completely eliminates the risk of poverty for people over 65. The amount of the basic pension is linked to the minimum wage which, in turn, follows average earnings. In 1999, for more than three quarters of the over-65s, the basic pension represented more than half of the total gross income.

The second pillar of occupational pension schemes is more developed than anywhere else in the EU, thanks to collective agreements that ensure mandatory coverage of at least 91 % of all employees in 2001. These schemes are all fully funded, including those for civil servants and teachers, and the funding level at the end of 2001 stood at almost 120 % of liabilities (108 % of GDP in 2001), although this figure is likely to have come down since then because of the recent stock market decline. The schemes are usually of the defined-benefit type; only 4 % of employees with a supplementary pension belong to a pure defined-contribution plan. However, the percentage of pure final salary schemes has fallen from 14 % of employees covered by an occupational scheme in 1995 to 7 % in 2001. Most defined-benefit schemes disregard salary increases in the last few years before retirement. 30 % of pension scheme members belonged to career average schemes.

Third pillar, individual pension provision is tax-favoured. Contributions are deductible up to the level that is required to build up total pension rights equivalent to 70 % of final earnings. Assets held by third-pillar schemes amounted to 58 % of GDP in 2001.

Challenges

If the (indirect) link between earnings and the basic State pension is maintained and in view of the increasing benefit payments by the still maturing occupational schemes, adequacy will not be problem in the Dutch pension system. However, the gap between older men and women in terms of relative living standards is likely to remain fairly large, due to the fact that the importance of occupational pension schemes is still rising and benefits from such schemes reflect past employment and earnings patterns. Moreover, until 1994, it was possible to exclude part-time workers — mostly women — from occupational pension schemes.

The Dutch national strategy report presents estimates according to which ageing will result in an increase in public spending of approximately 9 % of GDP at the peak in 2040: 4.3 % for basic old-age pensions, 3.6 % for healthcare, 0.7 % for invalidity benefits and 0.4 % for other items. The projections carried out for the Economic Policy Committee point to a rise of 6.2 % of GDP (this covers all public replacement incomes for people aged 55 and over, including invalidity benefits), one of the highest increases in the EU, although the projected level in 2050 will be close to the EU average.

There is some scope for raising employment in the Netherlands. The overall employment rate and the rate for women are above the targets set at Lisbon and Stockholm, but the proportion of women working part-time is very high (69 % in 2000). The employment rate of older workers also remains low at just under 40 % in 2001. This requires in particular a review of how the invalidity pension scheme operates and of the incentive structures in occupational pension schemes.

The Dutch report also points to increasing international influences on the national pension system as important challenges. The system has to be adapted to the growing mobility of labour and capital across borders. Moreover, the financial situation of pension funds and their ability to provide adequate benefits will depend on inflation in the euro zone, and, more generally, on developments in financial markets. The national strategy report therefore insists on the importance of maintaining stability-oriented macroeconomic policies, including strict compliance with the Stability and Growth pact. Finally, at the peer review held in October 2002, the Netherlands also expressed concern about legal uncertainty caused by challenges, based on EU competition rules, to mandatory membership in occupational pension schemes. So far, these challenges have never been successful, but it was confirmed that the dominant position of occupational schemes benefiting from mandatory membership must be justified by solidarity elements.

Meeting the challenges

The government and the social partners are committed to raising participation rates in occupational pension schemes even further. The social partners at the central level issued recommendations on this matter for the decentralised collective bargaining processes in spring 2001. A further step towards a participation rate of 100 % (in 2001 it stood at 91 %) would be compulsory membership in the occupational pension scheme for the temporary employment agency sector which is currently under discussion. The government will decide, on the basis of a review in 2006 of the results achieved by the social partners, whether it is necessary to enact legislation which would make it impossible to exclude individuals or groups of employees from pension schemes. The social partners also reached an agreement on recommendations regarding the index-linking of occupational pensions.

In spite of the significant increase in public spending caused by ageing, the Netherlands is committed to maintaining the basic State pension scheme in its present form. The financing is to be secured through transfers from the general budget as soon as the maximum contribution rate of 18.25 % is no longer sufficient to cover expenditure. This can be expected to be the case around 2010. The government expects that sufficient budgetary resources will be available. This is to be ensured by a further reduction of public debt. A virtual old-age pensions savings fund is being built up in which these savings will be earmarked to be used for financing pensions from 2020 onwards. As this is not a real fund, the use of these earmarked resources implies a possible increase in public debt after 2020. The need for government borrowing will be mitigated by the fact that deferred taxation of supplementary pensions will lead to increased revenues at the time when more public benefits are paid out. The government expects that this extra tax revenue will represent some 5 % of GDP in 2040.

Raising employment rates will also have to make a significant contribution to securing the future funding of pensions. Expressed in full-time equivalents, employment rates in the Netherlands are close to the European average which means that there is scope for improvement through more full-time employment opportunities particularly for women.

This would help to create the necessary budgetary margin as increased earnings do not create additional entitlement to public flat-rate pension benefits. It is estimated that a five percentage point rise in employment rates creates a budget margin of 1.2 % of GDP.

Regarding the employment of older workers, the government aims for an increase in the participation rate of older workers of 0.75 percentage points per year. This is to be achieved through various measures: the favourable tax treatment for early retirement schemes is being phased out; and the social partners have already reformed early retirement schemes covering 83 % of older employees. Members who postpone their retirement under a pre-pension scheme will be entitled to a higher supplementary pension from the age of 65. The number of older people claiming unemployment benefit is to be reduced by obliging employers to contribute to unemployment benefit expenditure for employees aged 57.5 and over, and by reintroducing the obligation to seek work for people aged 57.5 and over. The 2002 budget law introduced direct subsidies and contribution rebates as financial incentives for the employment of older workers.

Further legislation that will have positive effects on the employment of older workers is envisaged. The government will introduce legislation to prohibit age discrimination in employment and training. Legislation will also ensure that older workers who finish their careers at reduced pay will not be penalised disproportionately in terms of their pension rights under final salary schemes. Finally, a reform of the disability benefit scheme is also envisaged; this should bring down the number of people who are currently classified as totally or partially incapable of working from the current high level of nearly one million.

The strategy to cope with the challenge for the public pension system and for public finances as a whole relies on the abolition of the public debt within one generation (i.e. by around 2025). This will require average annual surpluses of over 1 % of GDP. Given that the effects of ageing will still be relatively moderate until 2010, this window of opportunity should be used explicitly for debt reduction. This will reduce interest payments, which will allow funds to be earmarked for a notional pension reserve fund. In addition, an increase in tax revenues paid by future pensioners, in particular from pensions paid out from second-pillar funds, will help to cope with the financial challenge, notably from 2020 onwards. Nevertheless, the withdrawals from the notional reserve fund will imply increased debt levels.

The financial sustainability of the second-pillar schemes depends largely on the stability of macroeconomics developments and on low inflation, which are important objectives in the overall economic policies. In addition, requirements concerning the level of funding in these schemes are high and, thus, provide a useful safety margin in the face of stock market declines. Notwithstanding this, recent declines have reduced the value of assets in some funds below the required level. A further decline in asset values could lead to adjustments in contribution levels or a suspension of the index-linking of benefits for a substantial number of pension funds.

Conclusion

The Dutch strategy for the first pillar relies (NL) on an ambitious goal of achieving budgetary surpluses over a long period of time, supported by intensified employment policies and a reform of disability pension schemes, in order to eliminate public debt. This should make it possible to achieve the substantial increase in public resources that will be required for financing public pensions. However, public finances are moving into deficit in

2002. This gives rise to some concern over the likelihood of success of this policy. Regarding second-pillar pensions, the strategy relies on conducting sound macroeconomic policies and safe funding margins.

The Dutch pension system performs well in terms of adequacy, as it is based on a universal flat-rate public pension and on earnings-related supplementary pensions which cover a very large share of the population. However, it remains to be seen whether increased labour-force participation and the inclusion of part-time workers in occupational pension schemes will allow women to catch up with men in terms of incomes in old age, but differences in pension levels will remain between men and women as long as women earn less than men, notably as a result of voluntary part-time work.

Background statistics

	NL (8)						EU-15					
Recent income situation (1999 ECHP data)												
	Total		Men		Women		Total		Men		Women	
	0–64	65+	0–64	65+	0–64	65+	0–64	65+	0–64	65+	0–64	65+
At-risk-of-poverty rate (1) (at 50 % of median)	6	4	6	4	6	5	10	9	9	7	10	10
At-risk-of-poverty rate (1) (at 60 % of median)	11	7	11	7	12	7	15	17	15	15	16	19
Inequality of income distribution (1)	3.7	3.7					4.6	4.1				
Income of people aged 65+ as a ratio of income of people aged 0–64 (1)	0.93		0.98		0.89		0.89		0.92		0.86	

Long-term projections of public pensions spending (EPC 2001)	NL (8)				EU-15			
	Level			% increase 2000–50	Level			% increase 2000–50
	2000	2020	2050		2000	2020	2050	
Old-age dependency ratio (2)	20.0	29.5	41.0	103.0	24.2	32.2	49.0	102.5
Public pensions expenditure, % of GDP (3)	7.9	11.1	13.6	72.2	10.4	11.5	13.3	27.9
Factors determining the evolution of public pensions expenditure (2000–50) (3)	Contribution to change in percentage points of GDP				Contribution to change in percentage points of GDP			
Demographic dependency	5.4				6.4			
+ Employment	– 0.6				– 1.1			
+ Eligibility	0.5				0.6			
+ Level of benefits	0.2				– 2.8			
= Total (including residual)	5.5				3.1			
Esspros pensions expenditure (4) (1999)	13.3				12.7			

Scope for policies to ensure sustainable pensions	NL (8)			EU-15		
Employment (2001)	Total	Men	Women	Total	Men	Women
Employment rate (15–64) (5)	74.1	82.7	65.2	64.1	73.0	55.0
Employment rate (55–64) (5)	39.6	50.5	28.0	38.8	48.3	28.7
Effective labour-market exit age (6)	60.9	61.1	60.3	59,9	60,5	59,1
Public finances (2001) (7)						
Public debt, % of GDP	52.8			63		
Budget balance, % of GDP	0.1			– 0.8		

Notes:

(1) *Source:* ECHP–UDB, Eurostat, version December 2002. The weights for the Spanish data will be revised. Data for Sweden only cover persons aged less than 85; see methodological note preceding the country summaries and the box 'European income data: methodology and limitations' in Section 3.1.2 for a full discussion of the survey methodology and its limitations.

(2) *Source:* Eurostat, demographic projections. Number of people aged 65 years and over as a percentage of people aged 15–64.

(3) *Source:* Economic Policy Committee, report on 'Budgetary challenges posed by ageing populations', 24 October 2001. Public pension expenditure (including most public replacement incomes to people aged 55 or over), before taxes. See methodological note.

(4) *Source:* Esspros, Eurostat. Includes expenditure by certain private social protection schemes; see methodological note.

(5) *Source:* European labour force survey, 2001.

(6) *Source:* European labour force survey, 2001. Calculation method still under discussion.

(7) *Source:* European Commission, Directorate-General for Economic and Financial Affairs.

(8) In the Netherlands, the second pillar is well developed. This has a direct positive impact on the public pension scheme by reducing the burden of ageing populations on the first pillar. However, there is also an important indirect implication: taxes on future pension benefits (which are drawn from the private funds) are expected to be quite high and may partially counterbalance the rise in public pension benefits.

AUSTRIA

Main characteristics of the pension system

The first pillar consists of a general scheme for private sector employees and special schemes for the self-employed, for farmers and for civil servants. In 2001, around 95 % of the active population were covered by compulsory pension insurance.

The schemes are predominantly funded through contributions. The current rate of contribution is 22.8 % of pensionable earnings and has been kept stable at that level over recent years. Employees pay 10.25 percentage points and employers 12.55. Civil servants contribute 12.55 % of their salary to their pension scheme. It is interesting to note that retired civil servants also have to contribute 2.3 % of their pension income to the scheme. The State budget contributes 21.5 % of total pensions expenditure of the statutory social security system in Austria.

The standard retirement age is 65 for men and 60 for women. Early retirement is possible from age 61.5 for men and 56.5 for women. The pension level depends on the length of the insurance career (including certain assimilated periods such as national service or periods during which certain social benefits were paid) and on the level of insured earnings (which are limited by a ceiling of EUR 3 270 per month in 2002). The pension is based on the average earnings during the 15 best years of the entire insurance career. Pension rights accrue at the rate of 2 % of this average for every insurance year. The maximum pension amount that can be achieved under the general scheme is EUR 2 309 (paid 14 times per year).

The second pillar is voluntary. It is estimated that 300 000 people have already acquired pension entitlements under occupational schemes, although this figure does not include the more traditional direct benefit promises by employers (book reserves).

The third pillar has been boosted by the tax reform in 2000 which introduced tax credits for individual retirement savings plans and employee contributions to a second-pillar scheme. Benefits from such favoured schemes are tax free.

A minimum pension of EUR 630 for singles and EUR 900 for a couple (to be paid 14 times per year) is guaranteed through a means-tested top-up benefit.

Challenges

For people with sufficient insurance records, the first pillar of the Austrian pension system provides adequate benefits with net replacement rates in excess of 80 %. However, in mid-2002, more than 11 % of pensions needed to be topped-up to raise pensioner incomes to the minimum pension level. Reliance on this means-tested support is high among pensioners under the farmers' scheme and also among recipients of survivors' benefits. Poverty risks in old age are significantly higher for women than for men.

The Austrian pension system relies almost completely on the first-pillar public pension scheme. This is reflected in public pension expenditure as a share of GDP: 14.5 % in 2000, the highest expenditure level in the EU and well above the EU average of 10.4 %. The old-age dependency ratio will rise faster than the EU average in Austria to about 2.3 times the current level by 2050. However, the projected increase in public pensions expenditure appears moderate compared to the extent of demographic ageing, notably thanks to the fact that the employment rates of women and older workers are expected to increase in the calculations due to raising the pensionable age of women and the minimum age for early retirement. According to the EPC projections, e expenditure in 2050 will amount to 17 % of GDP, 2.5 percentage points higher than today, but at its peak around 2035, expenditure will be up by 4.2 percentage points.

Austria provided revised national projections in their comments on the Commission draft of the joint pension report. These projections show a smaller increase in public pension expenditure from 14.7 % in 2000 to 16.5 % of GDP in 2050. At its peak around 2035, the level of pension expenditure is estimated to be 17.6 % of GDP (i.e. an increase of 2.9 percentage points), more than one percentage point lower than in the EPC calculations. The national projections assume a more favourable population scenario, consequently leading to more favourable employment developments and higher economic growth ([32]).

Austria has more or less reached the Lisbon employment targets for all people of working age and for women. Employment rates of older workers, by contrast, are amongst the lowest in the EU at 28.6 % in 2001. Moreover, they fell slightly between 1995 and 2001 whereas most other Member States managed to raise them. The low employment rate of older workers is to a large extent due to early exit from the labour market for reasons of invalidity. However, Austria has gradually raised the statutory early retirement age and abolished early retirement on grounds of partial invalidity.

Austria is one of the few remaining countries with different pensionable ages for women and men — except in the special scheme for civil servants. Equalisation is planned by raising the pensionable age for women by five years to the same age as for men, but this will only be phased in between 2019 and 2029 for early retirement and between 2024 and 2033 for standard retirement. An earlier equalisation could help raise the employment rates further.

Individual pension rights for women will continue to be significantly lower than those for men, reflecting lower earnings and labour-market participation which in turn is a reflection of the assignment of roles within families. This challenge can be addressed by awarding pension rights for childcare periods. However, it is also necessary to ensure that women obtain a fair share of a couple’s combined pension entitlements in the event of a family breakdown.

Meeting the challenges

Austria is trying to fill the adequacy gap for women by granting better pension rights in respect of childcare periods. Parental leave allowance are available during 36 months per child (if both parents claim their entitlement), of which up to 18 months are recognised as genuine contributory periods; up to 48 months are recognised as assimilated periods. This makes it easier for women to achieve the 15 years required for a pension entitlement.

While replacement rates under the first pillar are expected to remain high, the government wishes, nevertheless, to strengthen the second pillar. Since 1 July 2002, severance pay can be invested under favourable conditions in a life insurance contract. This benefit is financed

([32]) The Ageing Working Group of the EPC has not yet had an opportunity to evaluate the comparability of these projections with those of the EPC.

through a contribution of 1.53 % of earnings and is to be managed by separate employee welfare funds (*Mitarbeitervorsorgekassen*). Worker will have the choice between receiving the payment of severance pay or the investment of their capital in pension provision. The latter option benefits from a total exemption from taxes. Moreover, in 2003 the new premium based and tax privileged private pension savings scheme (*Zukunftsvorsorge)* is being introduced and expected to boost the third pillar.

Austria is currently working on the consolidation of all first-pillar pension schemes, including the civil servants' scheme, into a single scheme. The special scheme for civil servants was more favourable in that it provided 80 % of final earnings (rather than 80 % of earnings during the best 15 years of the career) and insured earnings were not subject to a ceiling. Currently, the earnings base for calculating pension entitlements is being progressively extended to 15 years in all schemes.

The average retirement age for men is about 60 years and for women nearly 59. Austria has started to address this problem through a series of measures adopted in 2000. They included the raising of the minimum age for early retirement, the abolition of early retirement for reasons of diminished ability to work, higher deductions for retirement before the standard age and higher increments for postponed retirement. These adjustments for anticipated or delayed retirement are, however, not yet actuarially neutral.

Pensioners were also allowed to earn income while receiving their pension, thus facilitating a gradual transition into retirement. Gradual retirement is also facilitated by the possibility from age 50 (women) or 55 (men) to work part-time for a period of 6.5 years and to receive a compensation for reduced earnings. However, it is likely that this is leading, in fact, to reduced rather than increased labour-market participation of older worker (the alternative would not be earlier full withdrawal from the labour market, but continued full-time work). Moreover, it is possible to concentrate the reduced working time during the first part of the 6.5 year period and, hence, to retire completely before the minimum early retirement age. This instrument will therefore be reviewed.

Invalidity pensions are currently under review. Under the present system, partial invalidity is not recognised with the effect that older workers withdraw completely from the labour market rather than opting for a more limited labour-market involvement that would be compatible with their health status. An expert committee was established to review all aspects of the Austrian pension system and to elaborate proposals for further reforms. This committee presented its proposals in December 2002. They include measures to enhance actuarial fairness of pension benefits and to increase transparency with regard to contributions and benefits. Moreover, the committee proposed a reform of invalidity pensions, including a clearer distinction between the old-age and invalidity risks and foreseeing a possibility of receiving benefits for partial invalidity in a way that promotes increased labour-market participation of partially invalid persons.

The government's strategy to cope with the financial challenge of the pension system is based on increasing the employment rate in general and that of older workers in particular, thereby strengthening the contribution base. A proposal for further reform of the pension system is envisaged in 2003. The national strategy report outlines some general principles for the reform, such as strengthening actuarial principles and promoting supplementary private pension provision, while not questioning the importance of the first-pillar scheme.

Conclusion

The Austrian national strategy report presents a detailed description of the various measures already taken to strengthen the financial sustainability of the pension system, but an overall estimation of the impact of these measures was not presented. The high level of spending and a projected significant increase therein pose considerable challenges for public finances. The declared intention of the Austrian government to reform the pension system is therefore welcome.

Background statistics

	A						EU-15					
Recent income situation (1999 ECHP data)												
	Total		Men		Women		Total		Men		Women	
	0–64	65+	0–64	65+	0–64	65+	0–64	65+	0–64	65+	0–64	65+
At-risk-of-poverty rate (1) (at 50 % of median)	6	10	5	8	6	12	10	9	9	7	10	10
At-risk-of-poverty rate (1) (at 60 % of median)	10	24	9	15	11	29	15	17	15	15	16	19
Inequality of income distribution (1)	3.6	4.1					4.6	4.1				
Income of people aged 65+ as a ratio of income of people aged 0–64 (1)	0.84		0.90		0.81		0.89		0.92		0.86	

	A				EU-15			
Long-term projections of public pensions spending (EPC 2001)								
	Level			% increase 2000–50	Level			% increase 2000–50
	2000	2020	2050		2000	2020	2050	
Old-age dependency ratio (2)	22.9	30.0	54.0	133.0	24.2	32.2	49.0	102.5
Public pensions expenditure, % of GDP (3)	14.5	16.0	17.0	17.2	10.4	11.5	13.3	27.9

	A	EU-15
Factors determining the evolution of public pensions expenditure (2000–50) (3)	Contribution to change in percentage points of GDP	Contribution to change in percentage points of GDP
Demographic dependency	10.5	6.4
+ Employment	– 2.2	– 1.1
+ Eligibility	– 3.0	0.6
+ Level of benefits	– 2.9	– 2.8
= Total (including residual)	2.4	3.1
Esspros pensions expenditure (4) (1999)	14.0	12.7

	A			EU-15		
Scope for policies to ensure sustainable pensions						
Employment (2001)	Total	Men	Women	Total	Men	Women
Employment rate (15–64) (5)	68.4	76.7	60.1	64.1	73.0	55.0
Employment rate (55–64) (5)	28.6	40.9	18.4	38.8	48.3	28.7
Effective labour-market exit age (6)	59.6	60.0	58.6	59,9	60,5	59,1
Public finances (2001) (7)						
Public debt, % of GDP	63.2			63		
Budget balance, % of GDP	0.2			– 0.8		

Notes:

(1) *Source:* ECHP–UDB, Eurostat, version December 2002. The weights for the Spanish data will be revised. Data for Sweden only cover persons aged less than 85; see methodological note preceding the country summaries and the box 'European income data: methodology and limitations' in Section 3.1.2 for a full discussion of the survey methodology and its limitations.

(2) *Source:* Eurostat, demographic projections. Number of people aged 65 years and over as a percentage of people aged 15–64.

(3) *Source:* Economic Policy Committee, report on 'Budgetary challenges posed by ageing populations', 24 October 2001. Public pension expenditure (including most public replacement incomes to people aged 55 or over), before taxes. See methodological note.

(4) *Source:* Esspros, Eurostat. Includes expenditure by certain private social protection schemes; see methodological note.

(5) *Source:* European labour force survey, 2001.

(6) *Source:* European labour force survey, 2001. Calculation method still under discussion.

(7) *Source:* European Commission, Directorate-General for Economic and Financial Affairs.

PORTUGAL

Main characteristics of the pension system

The first pillar of the Portuguese pension system consists of a general scheme that is mandatory for all employed and self-employed in the private sector. A special scheme exists for civil servants, police and military force. There is also a voluntary scheme that is open to residents in Portugal who are not covered by the Portuguese social security system; Portuguese nationals who reside or work abroad can also enrol in this scheme.

Pension contributions to the general first-pillar scheme are not separated from contributions for other benefits provided by the general social security scheme which covers sickness, maternity, occupational diseases, unemployment, invalidity, old-age, survivors and family allowances. The contribution rate is 34.75 % of earnings (11 percentage points paid by the worker and 23.75 by the employer) for employees and varies between 25.4 % and 32 % for the self-employed. The voluntary social insurance scheme is financed by the payment of a contribution of 16 % of an amount to be covered by pension insurance; this amount can be selected by the insured person. In the banking and telecommunications sector, occupational schemes exist as a substitute for the general scheme.

Since 2000, the retirement age is 65 for both men and women. To be entitled to an old-age pension, beneficiaries need to have completed a qualifying period of 15 years of insurance, with at least 120 days per year of registered earnings. Since 1994, old-age and invalidity pensions are calculated on the basis of the average income of the best 10 years over the last 15 (instead of the average monthly income of the best five years over the past 10 years, which applied before) ([33]). The rate of accrual of pension rights is 2 % (previously 2.2 %) for each insurance year.

The second pillar is practically non-existent, and membership in such schemes has even declined slightly over recent years. It is regulated by the framework law on social security. Pension funds are administered by private institutions, essentially insurance companies and pension funds management companies.

Third-pillar provision can take different forms including the subscription of life insurance policies or voluntary membership in a pension fund. Individual pension provision is encouraged through tax incentives.

A tax-financed non-contributory scheme provides means-tested benefits to persons aged 65 and over without adequate benefits from other sources. People with incomes below 30 % of the national minimum wage (50 % for a couple) are entitled to an income supplement under this scheme.

Challenges

The Portuguese pension system is confronted with two major challenges: to improve the adequacy of old-age pension provision (so as to guarantee decent living standards after

([33]) Since the latest social security reform in 2000, the earnings over the whole insurance career will be taken into account for the calculation of the pension level (subject to a maximum of 40 years).

retirement to all low-wage earners) and to guarantee at same time the financial sustainability of the system.

A significant proportion of the population have short insurance careers or with very low insured earnings. According to ECHP data from the late 1990s, many older people were at risk of poverty and in particular the oldest pensioners. However, these data do not reflect the impact of increased minimum pensions in the latest reform. The relative income of people over 65 compared to younger people was also among the lowest in the EU, at 72 % of the income of people below the age of 65 years, in spite of the fact that the first pillar can achieve a maximum replacement rate of 80 % at average earnings ([34]). Over time, as cohorts with better insurance records reach retirement age, the adequacy situation should improve automatically.

The old-age dependency ratio in Portugal is projected to double approximately between now and 2050 to a rate of 46 %. A recent national projection, which took account of the pension reform of this year, forecasts a rise in public pension expenditure from 9.7 % of GDP in 2001 to 12.1 % in 2050, while the Economic Policy Committee projected a rise from 9.8 % in the year 2000 to a peak of 13.8 % in 2040 (13.2 % in 2050). An important factor in the expenditure increase (accounting for one third of the rise) is public sector employees' pensions which are more generous than pensions in the private sector for those who started working in the public sector before September 1993.

If second-pillar pension schemes are to develop in Portugal, it will be crucial to guarantee the vesting of pension rights and to make them portable.

Meeting the challenges

Over the last few years, a major priority has been to improve the level of the minimum old-age pension. Minimum guaranteed levels for old-age and invalidity pensions under the contributory scheme were introduced for the first time in 1998 ([35]); the minimum levels depend on the number of contributions years. Under the new 2002 framework law, this level will be made to converge towards the minimum wage over the period 2003–07. The non-contributory minimum pension will be raised to 50 % of the national minimum wage minus the employees' social insurance contribution (11 %). The possibility to work after retirement and to combine a pension with earned income should contribute to improving the living standards of the elderly in the short run. In the longer run, the maturing of the pension system (more pensioners with full careers) and, possibly, the development of supplementary pension schemes should also have a positive impact.

During the 1990s, a number of adjustments were made to reduce the future increase in public pension expenditure. In 1993, the rules for calculating pension entitlements under the special scheme for new civil servants became the same for the new entrants to this scheme as in the general social security scheme. In 1994, the conditions for entitlement to an old-age pension and the coefficient for calculating pension benefits were both tightened.

([34]) Under the social security reform of 2000, the maximum replacement rate can rise to 92 % at average earnings for beneficiaries with 21 and more contributions years.

([35]) Previously, a social supplement was paid to people whose statutory pension did not reach the minimum amount of 30 % of the average income.

Since the latest social security reform in 2000, the earnings over the whole insurance career will eventually be taken into account for the calculation of the pension amount (subject to a maximum of 40 years). The new measures will be phased in and convergence to the benefit formula that uses the entire contribution history will start in 2016. The new benefit formula will only be applied in full to those who started working form 2002 onwards. The social security law of 2002 introduces a ceiling on insured earnings which will also cap pension benefits for future generations of pensioners, with a consequent reduction of spending in the long term but also a reduction in revenues already in the short term.

In 1999, retirement was made more flexible. All workers who have completed the qualifying period of 15 contribution years during 30 calendar years are allowed to retire from the age of 55 at a reduced pension. Workers may also postpone their retirement up to the age of 70 and receive an increased pension. Moreover, old-age pensions can be freely combined with earned income. Insured persons who claim an early retirement pension and who have ceased to work can make voluntary contributions in order to increase their amount of old-age pension. The possibility to cumulate part-time work with partial pension has also been introduced.

A reserve fund for social security was created in 1989. According to the social security reform law of 2000, the aim is to constitute, in the medium term, a reserve that is equivalent to two years of pension expenditure, approximately 12 % of GDP. In addition to receiving the surpluses of the social security scheme, which are expected to continue up until about 2015, the fund will receive two percentage points of the employees' social security contributions. In December 2001, the fund held assets worth EUR 3.8 billion, thus amounting to 3 % of GDP. Social security deficits are expected to emerge between 2015 and 2020; the fund should then be used for a period of 15–20 years to cover increased expenditure and to fill the revenue gap. Thereafter, from 2029 onwards, a deficit of between 1 and 2 % of GDP will emerge.

In order to promote the development of supplementary pension schemes, a comprehensive legal framework was introduced in 2000 covering management and investment rules, as well as the tax regime for such private provision. In 2002, further tax benefits were introduced and a supervisory framework was defined for supplementary pension schemes. The introduction of the above-mentioned ceiling on earnings covered by the social security pension insurance should create greater scope for private pension provision. With a view to improving the access to supplementary pension provision, the new framework social security law improves the conditions for the acquisition of supplementary pension rights and establishes the principle of portability.

Conclusion

While adequacy remains a major challenge, recent measures to raise minimum pensions should soon alleviate poverty risks. The more flexible retirement options and the possibility to raise one's pension entitlement by postponing retirement should increase the adequacy of retirement income for those with employment opportunities. Also, more complete insurance careers in better-paid employment will result in higher pensions for new generations of pensioners.

The latest pension reform has also made some progress in meeting the financial challenge of the pension system and the national strategy report explains how Portugal will deal with this challenge up to around 2030, but leaves it open how the social security deficit is to be financed thereafter. In view of the minor effect of recent reforms on the estimated increase in public pension expenditure, there is scope for further reform, while taking account of the fact that the balancing of the central government budget remains difficult. In this context, there also seems to be scope for the development of private pension provision. It remains to be seen whether the modernisation of the legal framework for private pensions (including rules on vesting and portability) will be sufficient to allow occupational pension schemes to play a significant role.

Background statistics

	P						EU-15					
Recent income situation (1999 ECHP data)												
	Total		Men		Women		Total		Men		Women	
	0–64	65+	0–64	65+	0–64	65+	0–64	65+	0–64	65+	0–64	65+
At-risk-of-poverty rate (1) (at 50 % of median)	12	22	12	18	12	25	10	9	9	7	10	10
At-risk-of-poverty rate (1) (at 60 % of median)	18	33	18	30	19	36	15	17	15	15	16	19
Inequality of income distribution (1)	6.4	5.8					4.6	4.1				
Income of people aged 65+ as a ratio of income of people aged 0–64 (1)	0.76		0.80		0.73		0.89		0.92		0.86	
Long-term projections of public pensions spending (EPC 2001)												
	Level			% increase 2000–50			Level			% increase 2000–50		
	2000	2020	2050				2000	2020	2050			
Old-age dependency ratio (2)	22.6	27.5	46.0	104.0			24.2	32.2	49.0	102.5		
Public pensions expenditure, % of GDP (3)	9.8	13.1	13.2	34.7			10.4	11.5	13.3	27.9		
Factors determining the evolution of public pensions expenditure (2000–50) (3)	Contribution to change in percentage points of GDP						Contribution to change in percentage points of GDP					
Demographic dependency	6.7						6.4					
+ Employment	– 1.1						– 1.1					
+ Eligibility	– 2.4						0.6					
+ Level of benefits	0.1						– 2.8					
= Total (including residual)	3.3						3.1					
Esspros pensions expenditure (4) (1999)	10.1						12.7					
Scope for policies to ensure sustainable pensions												
Employment (2001)	Total		Men		Women		Total		Men		Women	
Employment rate (15–64) (5)	68.7		76.9		61.0		64.1		73.0		55.0	
Employment rate (55–64) (5)	50.1		62.2		40.7		38.8		48.3		28.7	
Effective labour-market exit age (6)	62.0		62.0		61.5		59,9		60,5		59,1	
Public finances (2001) (7)												
Public debt, % of GDP	55.5						63					
Budget balance, % of GDP	– 4.1						– 0.8					

Notes:

(1) *Source:* ECHP–UDB, Eurostat, version December 2002. The weights for the Spanish data will be revised. Data for Sweden only cover persons aged less than 85; see methodological note preceding the country summaries and the box 'European income data: methodology and limitations' in Section 3.1.2 for a full discussion of the survey methodology and its limitations.

(2) *Source:* Eurostat, demographic projections. Number of people aged 65 years and over as a percentage of people aged 15–64.

(3) *Source:* Economic Policy Committee, report on 'Budgetary challenges posed by ageing populations', 24 October 2001. Public pension expenditure (including most public replacement incomes to people aged 55 or over), before taxes. See methodological note.

(4) *Source:* Esspros, Eurostat. Includes expenditure by certain private social protection schemes; see methodological note.

(5) *Source:* European labour force survey, 2001.

(6) *Source:* European labour force survey, 2001. Calculation method still under discussion.

(7) *Source:* European Commission, Directorate-General for Economic and Financial Affairs.

FINLAND

Main characteristics of the pension system

The mandatory statutory pension provision comprises a basic national pension scheme that aims at guaranteeing a minimum income for all pensioners and an earnings-related pension scheme that enables workers to maintain their standard of living to a reasonable degree after retirement. The two schemes form the first pillar which can be complemented with voluntary pension arrangements. The national pension scheme provides a residence-based minimum pension that can reach EUR 488 per month (subject to 40 years' residence). The national pension decreases as the person's other pension income increases. In 2001, a full national pension was paid to 10 % of all pensioners, while a means-tested portion supplemented the earnings-related pension of 55 % of pensioners. The share of pensioners receiving only the national basic pension is on a declining trend.

The earnings-related pension provides insurance-based pensions and covers all wage and salary earners and self-employed persons without any income ceiling. Old-age pensions for private sector employees currently start to accrue from the age of 23 at the rate of 1.5 % per year up to the age of 60 when it accrues at the rate of 2.5 %, for a maximum of 40 years (these rules will change in 2005). The target (maximum) replacement rate is 60 %. The pension is calculated on the basis of average earnings over the last 10 years in each different employment relationship (to be based on the entire working career as of 2005). At the end of 2000, the average total pension for old-age pensioners (including survivors' pensions) was approximately EUR 962 per month, corresponding to 47 % of the average earnings for wage earners. There is a gender difference (EUR 1 151 for men, EUR 841 for women) due to the lower average pay level of women (80 %), a lower labour-market participation in the past and more breaks in women's careers. While national pensions are adjusted in line with consumer prices, earnings-related pensions are linked to a weighted index based on consumer prices and earnings.

At present, it is possible to retire on an unemployment or early old-age pension at the age of 60 and on a part-time pension at the age of 56 (to be raised to 58 in 2005 for those born in 1947 or later). Various disability, unemployment, early and part-time retirement benefits are payable before the age of 65. Incapacity for work is the most common reason for early retirement. In 2000, Finland spent about 1 % of GDP on rehabilitation measures to maintain and develop work ability.

Earnings-related pensions are partially funded. For private sector employees, these funds are managed by private pension institutions which compete on the basis of customer service and return on investments. They must, however, comply with a detailed regulatory framework. A guarantee scheme ensures the payment of benefits in the event of insolvency of a pension institution. Also, for local government and State pensions, reserve funds have been established with the aim of raising funding to the same level as for the private sector pension schemes. Altogether, the reserves of the first pillar amounted to 60 % of GDP in 1999 and are projected to rise to almost 80 % of GDP by 2030.

Due to the comprehensive coverage of the statutory scheme, the demand for voluntary supplementary pension provision is very small. The benefits paid out from the second and third-pillar schemes amounted to 4 % of all pension benefits and the contributions to these schemes to 6 % of all pension contributions in 1999.

Challenges

In general, the risk of poverty among older people is kept low by the statutory pension system. The income level of pensioners is comparable to the rest of the population, and the at-risk-of-poverty rate for older people in Finland was, at the end of the 1990s, one of the lowest in the EU. However, some risks of poverty seem to persist especially among very old women. Owing to the design of the pension system, pension entitlements of people on low incomes increase only slightly through their contributions to the earnings-related pension scheme, since the amount of their national pension diminishes with rising earnings-related pensions.

The main challenges to financial sustainability are stem from population ageing, due to the baby-boom generation reaching retirement age, increased life expectancy and low fertility rates. The number of people above retirement age will rise rapidly after 2020, and in 2030 one in four Finns will be at least 65 years old. Insufficient employment creation would add to the demographic problem. The current overall employment rate is 68.2 %, but only 45.8 % for those aged between 55 and 64. 86 % of Finns retire before the statutory pensionable age and the effective labour-market exit age is as low as 61.6 years. In order to reduce early retirement, it is necessary to strengthen incentives and to maintain the individuals' ability to work. Unless the ratio between working people and pensioners can be improved by adequate efforts to promote employment for the unemployed and older age groups, there will always be a risk that the fiscal burden becomes unsustainable.

Expenditure on social security pensions amounted to 11.3 % of GDP in 2000 and was projected by the Economic Policy Committee to rise to 16 % by 2040, where it will remain relatively stable until 2050. Expenditure on earnings-related pensions was estimated to increase by six percentage points of GDP, implying an increase in contribution rates by 10 percentage points; expenditure on national pensions will decrease by about one percentage point of GDP, mainly due to the maturation of the earnings-related scheme which will reduce the need for means-tested guarantee pensions. The indexation of the national pension to prices should also mitigate the rise.

The latest reforms of the private sector pension schemes in 2001 and 2002 are estimated to reduce significantly the rise in pension expenditure relative to GDP. This is, to a large degree, thanks to the strengthening of the contribution base through tightened access to early pensions and an improvement of incentives to continue in work. Consequently, the degree to which the contribution rate (relative to wages) would have to be raised to maintain financial equilibrium is estimated to be five percentage points. Notwithstanding the progress made, there is a need to cope with the remaining financial challenge and to introduce corresponding reforms in the public sector schemes.

A succession of laws and amendments have, on one hand, made the earnings-related pension legislation very complex, but have, on the other hand, brought different schemes closer to each other, thus providing an opportunity for further streamlining and modernisation. Legislation would gain from being simplified and consolidated through the harmonisation of the internal operational principles of the pension schemes.

Meeting the challenges

A number of reform measures with the aim of curbing future pension expenditure were already taken since 1990: during the 1990s, measures were taken, *inter alia* to adjust survivors' pensions to individual pensions, to align public sector pensions to those of the private sector, to raise the lower age limit for early retirement, to extend the period of earnings considered for calculating the pension from four to 10 years, and to reduce the weight of earnings in the index used for pension adjustments. These measures, undertaken in public pension schemes during the 1990s, are estimated to reduce pension expenditure by almost one fifth of the expenditure level projected for 2040 under an unchanged policies scenario with the rules in force in 1990.

Further measures under the 2001 reform package have just been finalised: the 2001 reform of the private sector earnings-related pension schemes is aimed at discouraging early retirement and at increasing incentives to continue in work. Measures include: the introduction of flexible retirement between age 62 and 68, accompanied by higher accrual rates of pension rights for the later years in work; a rise of the part-time pensionable age from 56 to 58 years, accompanied by a reduced accrual rate; a reduction of the lower age limit for the accrual of pension rights from 23 to 18; the gradual abolition of the unemployment pension scheme (from 2009 to 2014); and the abolition of the individual early (disability) retirement scheme in 2003.

In November 2002, the government presented a bill based on an agreement between the government and the social partners, on supplementary measures to the 2001 pension reform, mostly to be introduced from 1 January 2005. The Finnish Parliament accepted this bill in February 2003. The calculation of pension benefits will be based on earnings during the entire career, adjusted using an improved weighted index (80 % wages, 20 % prices instead of the earlier equal weights); pension accrual is further raised for older workers (1.9 % per year between 53 and 62 years of age and 4.5 % between 63 and 68 instead of the normal accrual rate of 1.5 %); early retirement before age 62 will no longer be possible; the contribution rate for employees over 53 will be raised by 27 %; the replacement rate ceiling of 60 % is to be abolished; benefits will be adjusted in line with life expectancy (as of 2009); pensions will accrue during periods without earnings due to childcare, unemployment, training, sickness, and rehabilitation; and, finally, the funding level of the pension scheme will be increased to smooth out the evolution of contributions. The national pension, though means tested against other pension income, will not be diminished by the earnings-related pension rights accrued from age 63. The pensionable age for national pensions will remain at 65 years.

An objective has been set to raise the employment rate of older workers from 46 % in 2001 to 55 % in 2010, which would involve a rise in the effective retirement age by two years. However, the new projections of the impact of the latest reforms foresee only an increase in the effective retirement age by three years by 2050, emerging mainly after 2015. This would be insufficient in view of the objectives set by the government regarding both the effective retirement age (to be raised by two to three years in the long term) and the employment rate of older workers and would call for a faster implementation of the reforms, including measures to reduce the overall high unemployment rate.

The government's overall strategy to cope with significant pressures in pension expenditure is built upon the elements of ensuring economic growth, reducing public debt and increasing pension reserves (beyond the statutory funding requirement), as well as increasing labour productivity and employment rates, notably among older workers, thereby raising the effective retirement age. The strategy will notably require high and continuous surpluses in general government finances for several decades.

Conclusion

Finland has made significant progress in meeting the strong challenge of financial sustainability of its pension system, while ensuring an adequate level of pensions, accompanied by a low risk of poverty among older people, and adjusting the system to changing societal circumstances.

The reforms of 2001 and 2002 represent major steps, but the long implementation period of the measures will delay the impact on pension expenditure somewhat beyond the moment when the baby-boom cohorts will start retiring, allowing most of the baby-boom cohort to still benefit from current early retirement options. Expenditure on social security pensions is expected to grow further. In addition, the overall strategy hinges critically on economic and productivity growth as well as on rising employment rates which will have to contribute to maintaining surpluses in general government finances and to accumulating pension funds.

Background statistics

	FIN						EU-15					
Recent income situation (1999 ECHP data)												
	Total		Men		Women		Total		Men		Women	
	0–64	65+	0–64	65+	0–64	65+	0–64	65+	0–64	65+	0–64	65+
At-risk-of-poverty rate (1) (at 50 % of median)	5	6	5	1	6	8	10	9	9	7	10	10
At-risk-of-poverty rate (1) (at 60 % of median)	10	17	9	9	10	23	15	17	15	15	16	19
Inequality of income distribution (1)	3.4	2.9					4.6	4.1				
Income of people aged 65+ as a ratio of income of people aged 0–64 (1)	0.78		0.86		0.74		0.89		0.92		0.86	
Long-term projections of public pensions spending (EPC 2001)												
	Level			% increase 2000–50			Level			% increase 2000–50		
	2000	2020	2050				2000	2020	2050			
Old-age dependency ratio (2)	22.1	35.5	44.0	98.0			24.2	32.2	49.0	102.5		
Public pensions expenditure, % of GDP (3)	11.3	12.9	15.9	40.7			10.4	11.5	13.3	27.9		
Factors determining the evolution of public pensions expenditure (2000–50) (3)	Contribution to change in percentage points of GDP						Contribution to change in percentage points of GDP					
Demographic dependency	6.6						6.4					
+ Employment	– 0.1						– 1.1					
+ Eligibility	– 1.3						0.6					
+ Level of benefits	– 0.1						– 2.8					
= Total (including residual)	5.0						3.1					
Esspros pensions expenditure (4) (1999)	11.2						12.7					
Scope for policies to ensure sustainable pensions												
Employment (2001)	Total		Men		Women		Total		Men		Women	
Employment rate (15–64) (5)	68.2		71.6		65.4		64.1		73.0		55.0	
Employment rate (55–64) (5)	45.8		45.8		45.2		38.8		48.3		28.7	
Effective labour-market exit age (6)	61.6		61.6		61.4		59,9		60,5		59,1	
Public finances (2001) (7)												
Public debt, % of GDP	43.4						63					
Budget balance, % of GDP	4.9						– 0.8					

Notes:

(1) *Source:* ECHP–UDB, Eurostat, version December 2002. The weights for the Spanish data will be revised. Data for Sweden only cover persons aged less than 85; see methodological note preceding the country summaries and the box 'European income data: methodology and limitations' in Section 3.1.2 for a full discussion of the survey methodology and its limitations.

(2) *Source:* Eurostat, demographic projections. Number of people aged 65 years and over as a percentage of people aged 15–64.

(3) *Source:* Economic Policy Committee, report on 'Budgetary challenges posed by ageing populations', 24 October 2001. Public pension expenditure (including most public replacement incomes to people aged 55 or over), before taxes. See methodological note.

(4) *Source:* Esspros, Eurostat. Includes expenditure by certain private social protection schemes; see methodological note.

(5) *Source:* European labour force survey, 2001.

(6) *Source:* European labour force survey, 2001. Calculation method still under discussion.

(7) *Source:* European Commission, Directorate-General for Economic and Financial Affairs.

(8) In the Netherlands, the second pillar is well developed. This has a direct positive impact on the public pension scheme by reducing the burden of ageing populations on the first pillar. However, there is also an important indirect implication: taxes on future pension benefits (which are drawn from the private funds) are expected to be quite high and may partially counterbalance the rise in public pension benefits.

SWEDEN

Main characteristics of the pension system

The new first-pillar scheme introduced in 1999 consists of an earnings-related (contributory) scheme and an old-age guarantee pension scheme (non-contributory). The income-related scheme is contribution-defined and financed from a contribution rate 18.5 % pensionable earnings during the entire career. Sixteen percentage points of the contribution are used for pay-as-you-go financing and are accumulated at a given interest rate as a notional pension capital (which accumulates roughly in line with earnings); 2.5 percentage points are invested in one or several funds chosen by the scheme member (the so-called premium pension scheme). The earnings-related pension system is separate from the government budget and financed only by contributions which are to be held constant at 18.5 %. The notional pay-as-you-go capital and the capital accumulated under the premium pension scheme are converted at the time of retirement into a pension the amount of which depends on the average life expectancy at the age of retirement.

The old-age guarantee pension provides a minimum pension for people over 65 years after 40 years of residence in Sweden. It tops up the pension entitlements from the statutory earnings-related pension scheme to the guaranteed amount and is financed by taxes. A new form of means-tested support for elderly people not entitled to the guarantee pension (mainly immigrants) will be introduced in 2003. In addition, means-tested housing allowances contribute significantly to many pensioners' incomes.

The second pillar consist of large occupational pension schemes based on collective agreements and covering around 90 % of employees. The contributions are typically between 2 and 5 % of wages. Traditionally, these pensions were defined benefit, but are becoming increasingly defined-contribution schemes. In 2000, pensions paid out of these schemes accounted for 17 % of total pension disbursements.

Third-pillar schemes contributed around 4 % to total pension disbursements in 2000. Such voluntary individual pension insurance is tax deductible.

Challenges

The projected increase in the old-age dependency ratio is much smaller in the case of Sweden than for the EU as a whole. Moreover, the design of the new pension system will limit the future growth of pensions expenditure. Spending on old-age pensions under the public scheme is expected to increase from 9 % of GDP in 2000 to 11.4 % in 2040, decreasing thereafter. This rise is comparatively small and should not represent a major financial challenge.

The employment rate of older workers is the highest the EU. Early retirement is not a major problem. However, the number of older workers on sick leave has been rapidly increasing during recent years, thus raising issues regarding the working environment of older workers.

As the guarantee pension is linked only to the price index, real income growth will lead to a rising income gap between wage earners and pensioners with earnings-related pensions above the guarantee level, on the one hand, and pensioners who are only entitled to the guarantee pension on the other hand. In the long run, this could lead to increased relative poverty risks, unless dependence on the guarantee pension can be reduced by rising entitlements to earnings-related pensions. Women might be particularly affected by such an evolution as their earnings generally tend to remain lower than those of men. As survivors' benefits are being reduced, persons with low individual pension incomes will be particularly exposed to a sharp fall in their living standards upon the loss of their partner. However, at present older women are still entitled to widow's pensions under transitional rules.

Meeting the challenges

The response to the challenge of ageing and certain inequitable aspects of the previous defined-benefit scheme (higher pensions for people with irregular earnings profiles, but the same contribution effort) was a comprehensive redesign of the pension system in 1999 which will fully come into effect in 2003. The earnings-related scheme aims for actuarial neutrality. Redistributive elements include: pension credits for the unemployed or for parents during the first four years of their child; and the guarantee pension. These mechanisms are financed out of the general budget.

The challenge of financial sustainability is addressed through an automatic balancing mechanism built into the earnings-related pension scheme. It is designed to maintain the contribution rate constant at 18.5 % of earnings and operates through an adjustment of the index applied to the notional pension capital of the pay-as-you-go part. If the contribution base of the system deteriorates due to an economic slowdown or unfavourable demographic developments, then the index is revised downwards. Moreover, the conversion of the notional pensions capital takes account of life expectancy at the age of retirement and, thus, neutralises a major cause of rising pensions expenditure.

Meeting the financial sustainability challenge will also be made easier thanks to the large buffer fund which was established as early as 1960 to smooth out fluctuations in the flow of pension contributions and disbursements. This buffer fund is expected to contribute to the long-term financing of the pension system. Its assets amounted to 26 % of GDP in 2001.

All financial risks under the new earnings-related pension scheme (longevity, falling contribution base) are borne by beneficiaries. However, the systems provides for a high degree of flexibility, both in terms of the choice of retirement age and in terms of the possibility of combining income from work with a full or partial pension. Actuarial neutrality will allow individuals to plan their working life in such a way as to obtain an adequate pension and, thus, offers strong incentives for increased labour-market participation of older workers (already the highest in the EU). This requires, however, that employability and the ability to work are maintained. Currently, the government tries to address the problem of a rise in sick leave through a comprehensive programme aimed at promoting better health in working life. If a large number of people are unable to earn adequate pension entitlements, financial risks are shifted to the general budget (through the guarantee pension).

The Swedish reform is based on a broad political consensus and is accompanied by a major effort to improve the information of pension scheme members. They receive an annual statement of pension capital and forecast of their future pension under different assumptions (growth rate, rate of return, retirement age).

Conclusion

The reformed Swedish pension system should be able to deliver adequate pensions in a financially sustainable way, thanks to its design and the built-in mechanisms aimed at adjusting to economic and demographic developments. It also results in a fair sharing of the financial responsibility between generations and responds to the requirements of modernisation by being well adapted to flexible employment patterns. Tax-financed solidarity elements are currently strong, including guarantee pensions, disability and survivors' pensions and pension credits to the earnings-related scheme during career breaks such as unemployment, parental leave or sick leave). However, it can be expected that the level of the guarantee pension will fall relative to earnings. Occupational pension schemes based on collective agreements are well developed and can make a significant contribution to income maintenance after retirement.

Background statistics

	S						EU-15					
Recent income situation (1999 ECHP data)												
	Total		Men		Women		Total		Men		Women	
	0–64	65+	0–64	65+	0–64	65+	0–64	65+	0–64	65+	0–64	65+
At-risk-of-poverty rate (1) (at 50 % of median)	5	3	6	2	5	3	10	9	9	7	10	10
At-risk-of-poverty rate (1) (at 60 % of median)	10	8	10	6	9	10	15	17	15	15	16	19
Inequality of income distribution (1)	3.2	2.9					4.6	4.1				
Income of people aged 65+ as a ratio of income of people aged 0–64 (1)	0.83		0.92		0.78		0.89		0.92		0.86	

	S				EU-15			
Long-term projections of public pensions spending (EPC 2001)								
	Level			% increase 2000–50	Level			% increase 2000–50
	2000	2020	2050		2000	2020	2050	
Old-age dependency ratio (2)	26.9	34.5	42.0	58.0	24.2	32.2	49.0	102.5
Public pensions expenditure, % of GDP (3)	9.0	10.7	10.7	18.9	10.4	11.5	13.3	27.9
Factors determining the evolution of public pensions expenditure (2000–50) (3)	Contribution to change in percentage points of GDP				Contribution to change in percentage points of GDP			
Demographic dependency	3.9				6.4			
+ Employment	– 0.5				– 1.1			
+ Eligibility	0.8				0.6			
+ Level of benefits	– 2.6				– 2.8			
= Total (including residual)	1.7				3.1			
Esspros pensions expenditure (4) (1999)	12.2				12.7			

	S			EU-15		
Scope for policies to ensure sustainable pensions						
Employment (2001)	Total	Men	Women	Total	Men	Women
Employment rate (15–64) (5)	74.1	76.1	72.4	64.1	73.0	55.0
Employment rate (55–64) (5)	66.8	68.9	63.5	38.8	48.3	28.7
Effective labour-market exit age (6)	62.0	62.1	61.9	59,9	60,5	59,1
Public finances (2001) (7)						
Public debt, % of GDP	56.6			63		
Budget balance, % of GDP	4.8			– 0.8		

Notes:

(1) *Source:* ECHP–UDB, Eurostat, version December 2002. The weights for the Spanish data will be revised. Data for Sweden only cover persons aged less than 85; see methodological note preceding the country summaries and the box 'European income data: methodology and limitations' in Section 3.1.2 for a full discussion of the survey methodology and its limitations.

(2) *Source:* Eurostat, demographic projections. Number of people aged 65 years and over as a percentage of people aged 15–64.

(3) *Source:* Economic Policy Committee, report on 'Budgetary challenges posed by ageing populations', 24 October 2001. Public pension expenditure (including most public replacement incomes to people aged 55 or over), before taxes. See methodological note.

(4) *Source:* Esspros, Eurostat. Includes expenditure by certain private social protection schemes; see methodological note.

(5) *Source:* European labour force survey, 2001.

(6) *Source:* European labour force survey, 2001. Calculation method still under discussion.

(7) *Source:* European Commission, Directorate-General for Economic and Financial Affairs.

UNITED KINGDOM

Main characteristics of the pension system

The first pillar of the UK pension system consists of a flat-rate basic pension and an earnings-related additional pension, the State second pension that replaces the previous State earnings-related pension scheme (SERPS, introduced in 1978). These two tiers of the first pillar are financed through earnings-related National Insurance contributions. The pensionable age is 65 for men and 60 for women. Legislation is in place to equalise State pension age at 65 by 2020. A full flat-rate pension requires 44 years of national insurance contributions for men and 39 for women. Pensions cannot be taken up before these ages, but may be deferred in return for higher benefits later (7.5 % per year of deferral).

A unique feature of the UK pension system is the possibility to contract out of the earnings-related tier of the pay-as-you-go financed first pillar. This requires coverage by an occupational or personal pension scheme providing equivalent or better benefits than the earnings-related component of the statutory scheme. About 60 % of the employed are in such contracted-out schemes and are entitled to a national insurance contribution rebate.

Occupational pension schemes tend to be established by a single employer and are generally of the defined-benefit type, providing pensions based on years of service and final pay. However, there is a trend towards defined-contribution schemes. Around 44 % of the working-age population were contributing to an occupational or personal pension scheme in 2000/01 and 60 % of pensioner households had income from an occupational pension scheme and 71 % had investment income (including personal pensions).

Personal pensions were introduced in 1988 to offer a private second pension to people without access to an occupational scheme or who change jobs frequently (although retirement annuity contracts, similar to personal provisions, were available prior to 1988). 12 % of employees and 44 % of the self-employed are building up personal pensions. To make private second pensions more attractive, stakeholder pensions were introduced in April 2001. Stakeholder pensions have simple, low charges (maximum 1 % of fund value per annum), flexibility for participants to vary contributions or move between schemes without any financial penalty, simplified tax arrangements with a GBP 3 600 p.a. contribution limit and are open to non-earners for the first time. 1.15 million stakeholder pensions had been sold by September 2002.

The non-contributory minimum income guarantee (MIG) provides means-tested support to people over 60, depending on their income and capital. For a single person who meets the test, the guarantee secures a weekly income of at least GBP 98.15, which is about 30 % more than the full flat-rate basic State pension of GBP 75.50.

In 1999/2000, 57 % of pension income came from state sources and 43 % from the private sector.

Challenges

Between 1979 and 1996, average net income of pensioner households rose by 64 % while average earnings grew by 36 %; however the income of the poorest fifth of pensioners grew only by 30 %. This discrepancy is due mainly to the growth in occupational and private pension income which benefited all but the poorest pensioners. The minimum income guarantee was introduced to raise the incomes of this group. This scheme raised the income of the poorest older people, but the pound-for-pound withdrawal meant that savings efforts of many people on low incomes would not translate into higher living standards after retirement.

SERPS offered a pension of 20 % of average revalued lifetime earnings to employees only, and lower earners only built up very small entitlements to it. Around 60 % of employees contracted out from SERPS into occupational/private schemes tend to have significantly better income replacement rates. A major challenge will be to ensure that more people have access to, and make use of, opportunities to provide for a higher living standard after retirement.

Whereas adequacy had developed into a major challenge over the 1980s and 1990s, financial sustainability appears to be secured well into the future. Public pension expenditure was 5.5 % of GDP in 2000 and was projected by the Economic Policy Committee to **fall** to 4.4 % by 2050, reflecting a smaller increase in old-age dependency ratios than in the rest of the EU and, most of all, indexation of basic pensions to prices so that their value in relation to earnings will decline. The projections were carried out without taking into account the new pension credit and the State second pension which will result in public pension expenditure remaining broadly at its current level.

In view of the importance of private provision, the current diversity and complexity of private pension schemes pose particular challenges. Individuals are faced with a range of choices when they start or change employment. The large number of schemes raises issues of the feasibility of close supervision. Many pension schemes have significant holdings of equities which have produce high returns historically but do introduce an element of volatility. Many pension schemes and life insurers appear to have badly suffered from the recent downturn on world stock markets. For employers backing a defined-benefit scheme, this increases the potential future costs of providing such benefits and may have contributed to a switch to defined-contribution schemes where the investment risk lies more with beneficiaries.

Although the UK already meets the Lisbon and Stockholm employment targets, there is still room for improvement. The average age of effective labour-market withdrawal is 63.1 for men and 61 for women. 55 % of men and one third of women retire before the State pension age; 10 % of early retirement was linked to retirement conditions in an occupational pension scheme, 30 % to ill-health and 14 % was employer-instigated. While there is no early retirement option under the State pension scheme, the minimum income guarantee can be claimed from age 60 by both men and women. Men aged 60–64 who claim the minimum income guarantee are not required to seek work. Occupational pension funds have often arranged early retirement packages.

Meeting the challenges

During the past few years, a number of measures have been taken to address the adequacy challenges. From 2003, the new pension credit will replace the minimum income guarantee. This new entitlement should reach not just the poorest households but nearly half of all households over 60. It will entitle single persons aged 60 or more to an income of at least GBP 102.10 per week (GBP 155.80 per week for couples), and will ensure that those over

65 can receive additional amounts from other pensions/savings up to a certain limit above the minimum guarantee level without losing their pension credit entitlements. The income test for the pension credit is also less severe than that for traditional income-related benefits, From age 60, people do not have to report any savings they have under GBP 6 000 and from age 65 most will not have to report any changes in income during fixed periods of five years. The UK Government has made a commitment to index the guarantee element of pension credit to earnings for the rest of its term.

The introduction of the State second pension in April 2002 will enable people on lower earnings to build up more pension entitlements. In addition, individuals will be credited second pension rights for periods when they cannot work due to caring responsibilities or disability. People earning between the lower earnings limit (GBP 3 900 a year) and GBP 10 800 will accrue pension rights as if they had earned GBP 10 800. From 2002, low and moderate earners who contract out in favour of an occupational scheme will receive a top-up to ensure that they will also benefit from the improvements resulting from the State second pension.

With regard to the employment of older workers, the national strategy report presents several initiatives that should have a positive impact. The integration of benefit and employment agencies will make it possible to reach people on invalidity or sickness benefits. Disabled people can be offered specialist support to help them stay in the labour market ('New deal for disabled people'). Job seekers over the age of 50 can receive an income top-up ('Employment credit') for up to 52 weeks if they take up a job or become self-employed; training grants are also available under the 'New deal 50 plus'. There is also a policy of encouraging people to work beyond the pensionable age. People may delay claiming their pension or even 'de-retire' when they have claimed, and earn increments. Currently, the maximum period for deferral is five years. It is proposed that from 2006, there will be no time limit and the incremental rate will increase to about 10.4 % for each full year of deferral. The wider active ageing strategy seeks to promote age-positive employment practices among employers in the run up to age legislation in 2006.

The challenges posed for private pension provision by longer life expectancy are currently being put on the political agenda. Two government-commissioned report were recently presented (the Pickering and Sandler reviews) with proposals concerning the simplification of pension products and of pensions legislation, better advice to consumers, improved access to savings products for lower income consumers and the reduction of administrative burdens on schemes and employers. The Pickering report also suggested a change to the function of the regulator. In December 2002, the government published a Green Paper on pensions which addressed a wide range of pension issues including simplification, greater protection for scheme members, promoting employment among older people, and tailored information to help individuals plan for their retirement. It also established an independent commission to monitor progress and report on how effectively the voluntary approach is working. An independent review of the role of the Occupational Pensions Regulatory Authority has now been published and the Green Paper has proposed a new more proactive pensions regulator focusing its efforts on schemes in which there is a higher risk of fraud, bad governance or maladministration.

As the level of public expenditure on pensions is low and will, in the future, remain around the same level while the level of spending will rise in other Member States, the financial sustainability of the public schemes does not pose a problem. The strategy for ensuring the financial sustainability of the whole pension system is focusing public pensions expenditure on lower income groups and encouraging more pension provision to be funded by private savings. The UK seeks to ensure the stability of pension investment in funded schemes by following appropriate macroeconomic policies and is considering improvements in the legislative and supervisory framework.

Conclusion

The UK has made significant progress in addressing the adequacy challenges, but it remains to be seen to what extent access to occupational and personal pension provision can be maintained and increased and people encouraged to save enough to meet their expectations in retirement. The UK Government has identified the importance of increasing private savings and simplifying private pension provision to achieve that goal. For those who are reaching retirement age in the near future, working longer remains the most efficient way to raise their living standard; the recent reforms have considerably improved the incentives to do so.

Financial sustainability appears to be well under control, but depends to a larger extent than in other countries on the performance of private pension providers. The national strategy report does not allow to draw conclusions about the financial sustainability of these private schemes. If private provision produces significantly less than the anticipated coverage or level of pensions, future governments may face increased claims of means-tested benefits.

Background statistics

Recent income situation (1999 ECHP data)

	UK						EU-15					
	Total		Men		Women		Total		Men		Women	
	0–64	65+	0–64	65+	0–64	65+	0–64	65+	0–64	65+	0–64	65+
At-risk-of-poverty rate (1) (at 50 % of median)	12	11	11	7	12	13	10	9	9	7	10	10
At-risk-of-poverty rate (1) (at 60 % of median)	19	21	18	17	20	25	15	17	15	15	16	19
Inequality of income distribution (1)	5.4	4.1					4.6	4.1				
Income of people aged 65+ as a ratio of income of people aged 0–64 (1)	0.78		0.81		0.75		0.89		0.92		0.86	

Long-term projections of public pensions spending (EPC 2001)

	UK				EU-15			
	Level			% increase 2000–50	Level			% increase 2000–50
	2000	2020	2050		2000	2020	2050	
Old-age dependency ratio (2)	23.8	29.2	42.0	76.0	24.2	32.2	49.0	102.5
Public pensions expenditure, % of GDP (3)	5.5	4.9	4.4	– 20.0	10.4	11.5	13.3	27.9
Factors determining the evolution of public pensions expenditure (2000–50) (3)	Contribution to change in percentage points of GDP				Contribution to change in percentage points of GDP			
Demographic dependency	2.4				6.4			
+ Employment	0.0				– 1.1			
+ Eligibility	– 0.1				0.6			
+ Level of benefits	– 3.4				– 2.8			
= Total (including residual)	– 1.0				3.1			
Esspros pensions expenditure (4) (1999)	11.5				12.7			

Scope for policies to ensure sustainable pensions

	UK			EU-15		
Employment (2001)	Total	Men	Women	Total	Men	Women
Employment rate (15–64) (5)	71.8	78.2	65.1	64.1	73.0	55.0
Employment rate (55–64) (5)	52.3	61.6	43.2	38.8	48.3	28.7
Effective labour-market exit age (6)	62.1	63.1	61.0	59,9	60,5	59,1
Public finances (2001) (7)						
Public debt, % of GDP	39.1			63		
Budget balance, % of GDP	0.7			– 0.8		

Notes:

(1) *Source:* ECHP–UDB, Eurostat, version December 2002. The weights for the Spanish data will be revised. Data for Sweden only cover persons aged less than 85; see methodological note preceding the country summaries and the box 'European income data: methodology and limitations' in Section 3.1.2 for a full discussion of the survey methodology and its limitations.

(2) *Source:* Eurostat, demographic projections. Number of people aged 65 years and over as a percentage of people aged 15–64.

(3) *Source:* Economic Policy Committee, report on 'Budgetary challenges posed by ageing populations', 24 October 2001. Public pension expenditure (including most public replacement incomes to people aged 55 or over), before taxes. See methodological note.

(4) *Source:* Esspros, Eurostat. Includes expenditure by certain private social protection schemes; see methodological note.

(5) *Source:* European labour force survey, 2001.

(6) *Source:* European labour force survey, 2001. Calculation method still under discussion.

(7) *Source:* European Commission, Directorate-General for Economic and Financial Affairs.