SGI Sustainable Governance Indicators 2009

Social Affairs

Pensions report

Bertelsmann Stiftung

Indicator

Pension policy

Question

Do pension policies prevent poverty while retaining intergenerational equity and fiscal sustainability?

30 OECD countries are sorted according to their performance on a scale from 10 (best) to 1 (lowest). This scale is tied to four qualitative evaluation levels:

10-9 = Policies prevent old-age poverty, and are sustainable and equitable.

8-6 = Pension policies fail to realize one of these three principles.

5-3 = The pension policy fails to realize two of these three principles.

2-1 = Policies are fiscally unsustainable, inequitable, and do not prevent poverty.

Canada

value 9

Pension policy in Canada relies on three pillars: the Old Age Security program (OAS), the Canada Pension Plan (CPP) and tax expenditures for Registered Retirement Savings Plans (RRSPs) and Registered Pension Plans (RPPs). OAS is financed from the Canadian government's general tax revenues and provides monthly benefits, including a taxable pension and a nontaxable, income-tested Guaranteed Income Supplement (GIS). These benefits are adjusted quarterly to the cost of living. Contributions or premiums to the CPP, the second tier of the pension system, are based on the earnings of workers at a rate of 4.95 percent for both the employee and the employer up to the level of maximum pensionable earnings.

The CPP is a fixed-contribution rate with defined benefits, which means that the government, rather than pension beneficiaries, bears the investment-related risks. As of 2006, the CPP was on a sound financial footing, and significant changes to benefit levels or premiums are not expected in the future.

Finally, the third pillar of Canada's pension policy is made up of RRSPs and RRPs. These contributions are deductible from taxable income, thereby allowing taxpayers to defer the payable income tax. Together, these three pillars provide a good social safety net and effectively prevent poverty among senior citizens. Moreover, Canada is one of the few OECD countries for which the fiscal sustainability of the public pension system is not an issue.

Denmark

value 9

In 2006, to respond to significant demographic changes, a large welfare reform package was approved and enacted. The reform stipulates a gradual and gentle increase in the age of eligibility for early retirement and the so-called "people's pension." Between 2019 and 2022, the early retirement age will increase from 60 to

62 years. Between 2024 and 2027, the age of eligibility for the people's pension will increased from 65 to 67. Thereafter, the retirement age will be adjusted according to developments in the average life expectancy.
In addition to the people's pension, large groups in the Danish labor market are covered by labor market pension arrangements, which are individually mandatory but negotiated. Under these circumstances, a significant proportion of the population can look forward to a reasonable pension package in the form of a public pension, a labor market pension and an eventual individual pension. Nevertheless, a non-trivial group (about 25 percent) of the working population has no significant pension savings. As a result, a growing inequality among pensioners can be expected, and a large group will be dependent on what the public pension scheme can offer. Thus, despite recent reforms in pension and retirement policies, a number of issues related to pension policy have yet to be solved.

Finland

value 9

As in most European countries, demographic aging presents a challenge to the Finnish pension system's financial sustainability. The pension system is based on two pillars, a residence-based national pension and an employment-based earnings-related pension. Private pension schemes exist, but are not very popular due to the good coverage of the two other provision types.
An extensive pension reform took hold at the beginning of 2005, introducing the most sweeping changes since the pension system's inception. Regulations governing the age when pensions can be received were made more flexible, and age limits for pre-retirement pensions were raised in order to give incentives for older employees to stay in the labor force longer. Since that time, the employment rate of older individuals has been increasing. The pension reform also included provisions taking retirees' earnings across their whole work histories into account in calculating pensions, and adjusting pension amounts to increased longevity. The fact that unpaid periods in the course of life are now accounted for when calculating pension levels has especially benefited women. Since pension levels have been increasing only marginally for years, retirees' purchasing power has been decreasing relative to that of wage-earners in recent years. Nevertheless, age-related poverty remains uncommon.

Netherlands

value 9

The comprehensive pension system in the Netherlands guarantees all citizens a decent minimum income. The system's first pillar is a basic old-age pension that provides all citizens 65 and older with a flat-rate pension benefit that, in principle, guarantees 70 percent of the net minimum wage. This benefit is financed by means of a pay-as-you-go system, whereby today's contributions finance today's pensions.

The aging of the general population will most likely put pressure on this system of financing in the future.
The system's second pillar – and the largest in terms of the overall Dutch pension system – entails the occupational, non-statutory pension schemes supplementing the state pension. Although employers are under no obligation to make pension commitments to their employees, the vast majority (over 90 percent) of employees in the Netherlands participate in a job-based pension scheme. Occupational pensions are subject to negotiation between the social partners and must be financed by means of capital funding. If an individual has contributed fully to the system for 35 to 40 years, the total pension benefit – including first pillar benefits – will be around 70 percent of his or her final salary. In 2002, 93 percent of all active members of the workforce were participating in a pension benefit scheme, one-third in a career-average pay scheme and two-thirds in a final-salary pay scheme. Thus, for the time being at least, it can be said that the Dutch pension system is rather effective at preventing old-age poverty.
The third pillar of the Dutch pension system comprises individual pension provisions financed by payments to private insurance providers.

Annotation: Dutch Government, Ministry of Social Affairs and Employment, "Old Age Pension Provisions,"

http://internationalezaken.szw.nl/index.cfm?fuseaction=dsp_rubriek&rubriek_id=13017 (accessed June 28, 2008).

New Zealand

value 9

New Zealand's pension system is tax-based. It is highly efficient, as it effectively prevents senior citizen poverty with a relatively low level of public spending, measured as a percentage of GDP. In order to prepare for an aging society, without burdening future budgets too much, the cabinet decided in 2001 to pre-fund a part of its future obligations. This took the form of the so-called Superannuation Fund, designed to contribute to future pension costs.
Over the next 20 years, the government plans to devote NZD 2 billion annually to the fund, drawn from budget surpluses. Pensions related to this fund are not very generous and are subject to income taxation. However, it offers a universal benefit for all individuals – residents as well as citizens – and there is no means test. As a benchmark, its level net of tax should not fall short of 32.5 percent of the national average weekly income level of households in the pensioner's former income bracket. It is indexed on an annual basis. In addition, the government introduced "Kiwisaver," a publicly subsidized, voluntary private pension plan, in 2007.
A worker reaching the age of eligibility on the public pension program (currently 65) will also gain access to these private retirement savings. Hence, the government has aimed both at encouraging employees to increase retirement savings and at easing the burden faced by future generations in supporting an increasing number of pensioners.

Annotation: Periodic Report Group, “Retirement Income Report 2003,” http://www.beehive.govt.nz/sites/all/files/Retirement%20Income%20Report%202003.pdf (accessed April 3, 2008)

Norway

value 9

Norway is in the process of reforming its pension system. The change has been driven by fears that the old system gave weak incentives to work and strong incentives to early retirement. Moreover, the old system was vulnerable to changes in the levels of aggregate wage growth and to increased longevity.

Under the new system, benefits will be closely tied to an individual’s lifetime earnings (in which all years of participation count), and stronger incentives to delay retirement will be put in place. Moreover, increased longevity for a particular age cohort will lead to proportional reductions in future pension benefits, as in the Swedish system. Like the old system, the new model has a strong redistributive component. First, the system guarantees a relatively generous benefit floor. Second, individuals accumulate pension rights even when unemployed, on sick leave, when disabled and when taking care of small children or the elderly.

There is no explicit fully funded pension system pillar based on individual compulsory savings. Instead, the government has opted to accumulate one large fund (the oil fund) which is supposed to finance various types of future government expenditure, including pension benefits. Incidentally, the government has recently renamed this the Government Pension Fund - Global (“Statens pensjonsfond – Utland”). This emphasizes the implicit commitment to use this fund to guarantee future pension benefits. Given the size of this fund and recent governments’ discipline in complying with the commitment to build up this fund, the new Norwegian pension system is solid and fiscally sustainable.

Slovakia

value 9

Slovakia introduced a three-pillar pension system in accordance with World Bank guidelines in 2004. With one-half of the overall pension contribution rate of 18 percent flowing into private funded accounts, the mandatory second pillar is quite large. Thanks to the robust development of capital markets, pension funds have performed well and have been quite popular. In addition to the new labor market entrants, who are obliged to contribute to the second pillar, about 1.5 million Slovak citizens have entered the second pillar voluntarily.

While the reforms have improved the system’s sustainability, the first pillar suffers from fiscal problems. Although the standard retirement ages were set to increase to 62 years in 2006 (men) and 2014 (women), they remain relatively low. The tightening of the contribution-benefit link is likely to increase future poverty among

retirees with irregular employment histories. The Fico government has aggravated the first pillar's fiscal problems by introducing a Christmas bonus for retirees. It has also announced plans to strengthen the first pillar, which will likely be to the detriment of the second pillar.

Sweden

value 9

The Swedish pension system was reformed approximately 10 years ago. Prior to these reforms, pensions were calculated based on the salary accumulated over the 15 best years of earnings. According to the current system, pensions are calculated based on the accumulated income of the individual's entire working life. At the same time, however, the state continues to be responsible for providing a minimum level of provision for all citizens, and this commitment has been strengthened by the new so-called "guarantee pension."

Since the general level of pensions appears to be decreasing, a growing number of people are signing up for private pension insurance. Although seniors are supported by welfare in any case if their pensions are too small, the fact that they would feel the need to turn to additional sources of pension income indicates some degree of failure on the part of the public pension system.

Another part of the reform made it possible for individuals to manage a small part of their retirement savings as an individual investment fund (known as a "premium reserve"). While this may help individuals feel more involved and in control of their retirement savings, it does nothing to compensate for modest pension levels. In the end, it would appear that the reformed public pension system has done little to improve the amount of pension funding individuals receive when compared with the previous system. Furthermore, changes in the financing structure and indexing mechanisms have reduced the pressure the pension system puts on the central government's finances. The new system also significantly increases work incentives by introducing a more actuarial benefit formula.

Australia

value 8

Historically, the dominant source of income for retirees in Australia has been a flat-rate, universal (but means-tested) and tax-funded social security payment, known as the Age Pension. There has never been an employment-related national pension plan in Australia. Private pensions (known in Australia as superannuation) were relatively uncommon prior to the 1990s, being largely confined to well-paid employees. Concerned by a low national savings rate and the implications of financing the retirement of the baby boom cohort, in 1992 the government legislated that employers must pay a percentage of their employees' earnings into an approved superannuation fund. Initially set at 3 percent of gross earnings, this mandatory contribution had risen by 2002 to its current level of 9 percent.

Currently, most retirees still depend on the Age Pension, which is set at a relatively low level and is not effective in preventing poverty. Dependence on the Age Pension will decline over time, which will both reduce financial hardship in retirement and reduce the program's fiscal demands. Nevertheless a significant part of the population will continue to rely on the Age Pension, existing on very limited resources. Indeed, the 9 percent superannuation contribution rate is widely regarded as inadequate for low-wage workers, failing to provide for a reasonable standard of living in retirement even in conjunction with Age Pension payments.

On introducing compulsory retirement saving in 1992, the Labor government then in power intended the contribution rate ultimately to reach 12 percent, but the Howard government subsequently preferred a "carrots over sticks" approach to increasing private retirement savings. Its emphasis was instead on providing tax concessions and other incentives to increase retirement savings. This approach has been ineffective in promoting self-reliance in retirement among low-to-middle income persons, almost all of whom contribute only at the compulsory minimum rate. Most of the response to the incentives has come from high-income persons.

Although this pension policy will in the long term tend to reduce intergenerational inequity, in the current transitional phase employees are being required to "pay twice," by simultaneously saving for their own retirement and paying the pensions of current retirees through taxation. The government is making its own contribution to pension sustainability through the sales of publicly owned assets, the proceeds of which are being set aside in a "Future Fund" designed to meet future public-sector employee pension commitments.

Austria

value 8

While Austria's expenditures on the elderly achieves the highest score of all OECD nations, the percentage of old people in poverty is relatively high. This discrepancy is due to restrictions regarding entitlement to the "minimum pension."

The need for pension reform was put on the political agenda owing to both the existing financial burden and changing demographic conditions, whereby the elderly constitute a growing proportion of the population, and a majority of the labor force is retiring before reaching the official pension age of 65. In 2003, an extensive reform introduced a uniform pension system for all workers that featured significant cuts in future pensions as well as incentives for prolonging the employment period. As an initial result, the average retirement age has risen. A complete reconciliation of the different pension systems, however, has not been achieved, and privileges still exist for civil servants, the self-employed and farmers. Additionally, private pension insurance and company pension insurance have been introduced to relieve the financial burden on the public budget. Nevertheless, both new pillars play only a minor role in complementing the public pension system.

Ireland

value 8

The Irish pension system rests on three pillars: the public old age pension funded on a pay-as-you-go basis through social insurance contributions; occupational pensions funded on a voluntary basis by contributions from employers and employees; and personal, individual pensions schemes. The adequacy of the first pillar – that is, the state pension – has increased in recent years, and the goal of raising it to one-third of pre-tax, average employment income has been endorsed by all the main political parties. This pension is not income-related; it is a flat amount currently equal to approximately €810 a month for an individual, with increases for dependants. There is some concern that too many people are dependent exclusively on this pillar, which will face funding difficulties as the population ages.

In April 2001, the minister for finance established a National Pensions Reserve Fund. This new fund represents a move away from complete reliance on the pay-as-you-go system to a partly pre-funded public pension system. It involves the statutory setting aside and investing of 1 percent of GNP annually. The fund aims to meet the costs of social welfare and public service pensions from 2025 onward as much as possible. In this way, the fund will mitigate the burden on the Exchequer arising from additional pension commitments over a very long time horizon. The fund's accumulated assets currently amount to approximately 12 percent of GDP.

Substantial tax incentives are provided to the second and third pillars of the national pensions system in order to encourage individuals to build up their individual pension entitlements. All employers must now either provide an occupational scheme or make provisions for a personal, individual pension plan. About 50 percent of all employees are covered by occupational schemes. Although gaps in coverage remain, Ireland ranks with the United Kingdom and the Netherlands at the top among European nations in terms of the size of private pension funds relative to GDP.

The current system's most important drawback is that it does not effectively prevent old age poverty. In fact, in 2000, Ireland had the highest level of relative income poverty in the European Union for people 65 and older.

In Ireland, the rate of increase in the state pension has been more rapid than that of average incomes in the same period. Data published by the Central Statistics Office indicates that levels of "consistent poverty" and "at risk of poverty" have both declined among older people during the period under review, as has the incidence of relative poverty among the elderly.

Annotation:

OECD, "Income Distribution and Poverty in OECD Countries in the Second Half of the 1990s," Michael Förster and Marco Mira d'Ercole, OECD Social, Employment and Migration Working Papers No. 22, 2005,

http://www.oecd.org/dataoecd/48/9/34483698.pdf (accessed February 1, 2008).

Luxembourg

value 8

According to the European Social Observatory (ESO), Luxembourg's pension system is a typical social insurance system with a Bismarckian influence, but with the addition of some private and voluntary components. The first mandatory public pillar provides a minimum personal pension to insured persons who have contributed to the system for at least 20 years. This flat-rate component, financed by social contributions shared equally between the employee, the employer, and the state, effectively prevents old age poverty. The second pillar is tied to earnings, with pension levels calculated on the basis of total contributions. In 2002, payments from the first and second pillar represented a gross replacement rate of almost 90 percent of workers' pre-retirement income and accounted for 97 percent of pensioners' net retirement income. Public pension spending totaled 7.4 percent of GDP in 2000. Given the generosity of these two pillars, the third component, consisting of supplementary private and voluntarily funded pensions, is of only marginal importance.

Policymakers are aware that the current social security equilibrium may be disrupted by future economic developments, including an increase in the population's average age. There are no plans yet for handling these risks. Additional criticism has focused on the difference between relatively high private sector pensions and their public sector counterparts. This differential gave rise to the Action Committee for Democracy and Pensions Justice, a political party founded 15 years ago pressing for pension equality. While the private-public pension gap has since been reduced, some difference – and some controversy – remains.

Annotation: David Natali, "Luxembourg - The Pension System," in research project: La Methode Ouverte de Coordination (moc) en Matiere des Pensions et de l'Integration Europeenne, Observatoire social européen, 2004.
http://www.ose.be/files/mocpension/LuxOMC.pdf (accessed February 29, 2008).

Switzerland

value 8

The Swiss pension system is based on three pillars: a public pension system, compulsory private pension plans and tax-exempted individual savings. The aim of this three-pillared structure is to create intergenerational equity and to prevent poverty amongst the elderly. The public pension system guarantees a basic annual income of €8000 to €9000 to every eligible Swiss citizen, which is funded by contributions made by employers and employees in the Swiss workforce. This first pillar is effective at redistributing wealth across the country, as contributions are proportionate to incomes, but the maximum benefit level is only 1.5 times larger than the minimum benefit.

The second pillar is also financed by employers and employees, although contributions as well as benefits are proportional to income. Low-income individuals

are excluded from this compulsory private pension system. Contributions are optional for those earning more than €45,000 per year and can be combined with an optional retirement provision. The third pillar consists of tax-deductible savings of up to €3,600 per year and is mainly used by high-income individuals. The Swiss tax system is currently fiscally sustainable, but will come under pressure in the future, as a result of predicted demographic change and the subsequent rise in the country's elderly population. The main challenge stems from the fact that the pension system is not financed by an accumulated capital stock, but rather by direct contributions made by the Swiss workforce. The demographic change therefore poses a threat to the country's intergenerational equity.

Belgium

value 7

Pension policy is still a federal prerogative. The pension system in Belgium is characterized by the coexistence of different schemes. The public mandatory pillar is still the most important pillar of the entire system, representing the main source of income for the elderly. The first pillar contains a tax-based, basic safety net of social assistance benefits. These payments aim to prevent poverty caused by old age, but payments do not always suffice and citizens above the age of 65 have an above-average likelihood of living in poverty. Also part of the first pillar is a contributions-based pension scheme.

The second (voluntary) pillar involves supplementary funded pensions that are supported by tax incentives. In 2002, these pensions covered about 35 percent of all employees, with assets totaling 17 percent of GDP. The third pillar consists of a private, individual and voluntary pension, which is financed through yearly individual contributions. The third pillar covers about 70 percent of the entire population, and in 2002, assets totaled roughly 20 percent of GDP.

There are a number of problems with the current pension system. Self-employed individuals who cannot afford a sufficient private pension plan are often left at retirement with very low-level pensions. The system's overall fiscal sustainability is threatened by an aging population. The dwindling labor market participation of older workers (55 years old or older) will put increasing pressure on the public pension system. Total public pension spending at the time of writing is 10 percent of GDP, and is expected to rise to 13 percent over the next few years. This expected development endangers inter-generational equity. Due to budget constraints, the required number of working years to collect a full pension will increase. This puts people who currently are of working age but who may be unemployed for extended periods of time at a disadvantage, as they are more likely to have to rely on the basic safety net in the future. This situation may increase the share of elderly people living in poverty 20 or more years from now.

Annotation: David Natali, "Belgium. The Pension System," 2004.

http://www.ose.be/files/mocpension/BelgiumOMC.pdf (accessed February 18, 2008)

David De la Croix, and Geraldine Mahieu, “Les générations futures: un souci pour la politique budgétaire?” Regards Economiques, no. 1 (2002)

Czech Republic

value 7

The existing pension system largely follows the principles of the pre-1989 system, according to which pensions are paid out of contributions to a state fund. The retirement age is being gradually increased and will become 63 for men and 61 for women in 2012, with earlier retirement offered for women who have bore children. Supplemental private pension funds have also been introduced, but they are far less important than the state system. The average pension remains slightly under half the average level of pay at retirement, and the figure is watched closely. Pressure on the government to reduce the budget deficit has caused pensions to fall in recent years, but the disparity among pension levels is relatively small, limiting the risk of pensioner poverty.

The center-left government initiated a discussion involving all parliamentary parties on possible comprehensive reforms to prepare for the effects of an aging population, but no definite conclusions were reached. The options put forward included a substantially greater private role with a much smaller guaranteed state pension (from the liberal-conservative Civic Democratic Party, or ODS) and an adaptation of the Swedish system that would allow greater dispersion of pension levels at the expense either of greater cost or of a relative reduction in the lowest pension levels (from the Czech Social Democratic Party, or ČSSD). In both cases, either poverty prevention or sustainability would be threatened. It was noted, however, that the current system will not necessarily face any significant financial difficulties for another 20 years, despite a rise in life-expectancy levels approaching those of countries in western Europe. With the urgency thus removed, no action was taken before the 2006 parliamentary elections. The center-right government has continued the tradition of cross-party consultations and announced some parametric changes of the existing system, most notably a gradual increase in the retirement age.

Germany

value 7

The German public pension system has experienced a financial crisis, and has been subject to major reforms in recent years. The Schröder government (1998 – 2005) introduced a new public-private mix, with state subsidies for voluntary participation in the second (private) pillar. Furthermore, a sustainability factor was introduced to adjust the system to changing conditions.

Angela Merkel’s government, which took office in 2005, introduced an increase in the statutory retirement age from 65 years to 67 years, which will take effect gradually until 2029. This is seen as a major step towards long-term fiscal sustainability. These reforms have brought the pension system much more in line

with its changing environment, and come close to balancing fiscal sustainability, intergenerational equity and the prevention of poverty.

Iceland

value 7

Iceland's pension policy is based on a tax-financed, means-tested public social security program, as well as occupational pension funds and voluntary savings encouraged with tax incentives. The pension funds, with worker contributions of 4 percent of total wages and a complementary employer contribution of 8 percent, aim at giving retirees a pension equivalent to 56 percent of their average working-life wages. Employees can opt to pay a further 4 percent of their wages, with a 2 percent employer contribution, into a voluntary savings program.
In this light, it appears that Iceland's pension policy is conducive to poverty prevention as well as to fiscal sustainability. Given that the occupational pension funds are largely fully funded (and currently amount to roughly 130 percent of Iceland's GDP), each generation provides for its own pensions (based on contributions and the accumulated return on these funds) rather than relying on pay-as-you-go transfers. Even so, many old people in Iceland have to get by on meager pensions. It also remains to be seen what the funds' long-term rate of return on investments (currently about 40 percent stocks and 60 percent bonds) will be.

Poland

value 7

Poland introduced a three-pillar pension system in line with World Bank recommendations in 1999. Owing to the favorable development of capital markets, private pension funds, which form the obligatory second pillar, have performed quite well. In contrast, the fiscal sustainability of the public, or first, pillar has suffered from the country's general high unemployment and low retirement age – which officially stands at 65 years for men and 60 years for women, but in practice, is much lower. Given the fiscal problems of the first pillar, public pensions have been cut and poverty among pensioners has increased as a result. The low retirement age will also limit future incomes sourced from the second pillar. This situation particularly applies to women, who not only tend to exit the labor market relatively early, but also who earn less and have a higher life expectancy than men. The PiS government failed to address these problems during the period under review.

United Kingdom

value 7

The mixed pension system has three pillars of support: the first being a general public system; the second a substantial reliance on occupational pensions; and the third being individual pension plans, which appear to play a limited role in the

overall system.
A glance at the first pillar shows that the United Kingdom has the lowest public pensions in the OECD, with a net pension of just 41 percent of pre-retirement net earnings, compared with an OECD-average of 70 percent. The main challenge for Britain in this area is to improve its poor record on poverty prevention: one in five pensioners lives below the poverty line.
A whole arsenal of policy measures have been employed, including significant increases made to the means-tested Basic State Pension, which has been rising above the rate of inflation. The introduction of so-called Stakeholder Pensions and the switch from the SERPS scheme to the State Second Pension in 2002 were designed to allow the accumulation of additional pension entitlements.
Aimed at improving fiscal sustainability, the shift from universal benefits to means-testing has yielded some success: the United Kingdom is one of only a few OECD countries that has been able to increase rather than cut pension entitlements – albeit from a low base. Future fiscal costs of state pension systems are not projected to rise significantly as the population ages and intergenerational equity seems to be ensured.
Private pension systems in Britain do not appear able to fill the gap left by the state sector. The proportion of the workforce covered by this system is not increasing and the average level of provision is declining. The Pensions Commission estimated in 2006 that up to 12 million people are not preparing properly for retirement.

France

value 6

France's pension policy has so far prevented any serious problems of poverty among its elderly citizens. Reforms introduced during the 1990s have not, however, managed to prevent poverty among the elderly, nor have they ensured the financial sustainability of elderly citizens. As a result, several key aims of France's pension policy have not been achieved.
The system, which is based almost exclusively on a "pay as you go" scheme, is not sustainable. For example, many people in the agricultural or commerce sectors have not been making sufficient contributions over the years to receive a decent pension. Privileges, such as retirement at the age of 50, which is traditionally provided for in public service occupations or other employment sectors, have pushed the pension system to its financial limit. While reform has been placed high on the current government's agenda, public protests point to considerable opposition to change in this area.

United States

value 6

Social Security, the main public pension system, is mainly a contributory "pay-as-you-go" program, with credits accumulated through employees' and employers' payment of a payroll tax. It also has a noncontributory component, Supplemental

Security Income (SSI), which serves the elderly poor. Social Security helps to make most retirees quite comfortable financially.
In comparison with other OECD countries, the U.S. poverty rate is significantly lower for retirees than it is for the general population. Nevertheless, since one's entitlement to sizable benefits is dependent on prior contributions, elderly people who have been chronically unemployed or underemployed or who have worked in low-paying jobs may receive minimal or no benefits, depend on SSI and live in poverty. In fact, 24 percent of retirement-age Americans do live in relative poverty.
The system performs even less well in terms of inter-generational equity. The reason for this potential inequity is that Social Security is not, in fact, fiscally sustainable over the life span of the younger generations of people currently working. In 2004, the Social Security trustees estimated that making the program solvent over the next 75 years would require a tax increase amounting to 1.8 percent of taxable payroll (i.e., an approximately 12% increase over the current rate of 15.3%), with even larger amounts being required the longer the adjustment is delayed.
In 2005, President Bush mounted a concerted six-month campaign to promote a major overhaul of the Social Security system, including a reduction in the rate of automatic increases in benefits (in addition to an ideologically divisive plan to establish private investment accounts for a portion of employees' contributions). The plan was attacked by congressional Democrats and abandoned by congressional Republicans – a reminder of the severe political obstacles to dealing with the long-term problems of Social Security.

Annotation: For the data on social security see, Congressional Budget Office, The Budget and Economic Outlook 2007: An Update, Washington D.C., p XI f., http://www.cbo.gov/ftpdocs/85x x/doc8565/08-23-Update07.pdf. On policy options, see: William G. Gale and Peter R. Orszag, "Private Pensions: Issues and Options," in Agenda for the Nation, edited by Henry Aaron et al. (Washington, D.C.: Brookings, 2003), 183–216.

Hungary

value 5

Hungary was one of the first European countries to introduce a three-pillar pension system in line with World Bank recommendations in the second half of the 1990s. However, subsequent measures were not sufficient to make the first pillar, the public-pension system, financially sustainable. Some new policies, like the introduction of a "13th month pension" in 2003 (in which pension disbursement levels were increased by the equivalent of an extra month) even worsened the situation.
In February 2007, the Gyurcsány government launched some first-pillar reforms aimed at increasing the fiscal sustainability of the scheme and intergenerational equity. These measures included an increase in retirement age, a tightening of eligibility criteria for early retirement and a change in the pension formula. While poverty rates have been relatively low among current pensioners, they are likely to

increase in the future when the tightened contribution-benefit link begins to be felt. One major group affected will be the many tax dodgers who are officially paid only the minimum wage.

Japan

value 5

Japan has a two-tiered pension system. The first tier is the National Pension, which in 1999 covered 96 percent of all Japanese citizens above the age of 65. About 60 percent of elderly individuals' households depended completely on public pension in 2003.The secondary tier of the system is comprised of two other pension programs, the Employees' Pension or Welfare Pension, and the Mutual Aid Associated Pension. The system divides people into three groups: (1) the self-employed and university students, (2) regularly salaried employees, and (3) housewives and dependents whose annual income falls below a certain level. The law requires the pension system to be examined in terms of sustainability every five years; the next such evaluation will take place in 2009.

Japan's fast-aging society threatens the pension system with serious problems, which governments have not yet been able to contain. Legislation passed in 2004 (but taking effect only in 2006) mandated that future payments will grow at 0.9 percent less than the inflation rate until 2023. In addition, after a short transition period, payments will commence at age 65 instead of 60. However, annual contributions to the system, shared between employers and employees, are capped at 18.3 percent of income, with benefit levels of 50 percent of a worker's average salary promised by the government. Given the current economic growth and birth rates, this promise cannot be kept, so further reform of the pension system is unavoidable.

Another problem concerns the efficiency of the system. Millions of data files have been lost, a major topic of public concern in early 2007. Moreover, only some 67 percent of the people are making contributions, not the expected 80 percent. Rich self-employed citizens seem to stay out of the system, raising issues of equity. By the end of this period of analysis, Prime Minister Abe´s reform proposals remained vague, and inadequate for the severe challenges ahead.

Portugal

value 5

Portugal faces a very significant fiscal deficit, which is partially due to an increase in social expenditures, including pensions. Increased pension expenses and the long-term challenge presented by Portugal's aging population will require its pension system to undergo very significant reforms in order to assure its long-term fiscal sustainability and inter-generational equity.

The most important measures of the 2005/2006 social security reforms are:

• a transition to a so-called "pension formula" for calculating pensions that considers contributions over the entire course of one's working life, while at the same time

increasing the accrual rate for lower wages;
• a new method for updating pensions that takes into consideration inflation, GDP growth and the pension's value;
• a bigger financial penalty for early retirement (although one should note that the average effective retirement age in Portugal is almost 64, which is the second highest in the European Union and just below the official retirement age of 65);
• several reforms of the civil service pensions system (including the 2005 closure of the separate public sector pension system, the Caixa Geral de Aposentações, or CGA, the enrolling of all new public employees after 2006 into the common system, and the progressive transformation of the CGA itself so as to make it more similar to the common system);
• the introduction of a "sustainability factor" that will peg the calculation of new pensions to the evolution of life expectancy at age 65.
Despite these changes, the incentives to remain at work continue to be insufficient. For example, retirement on an old-age pension is possible before the age of 60 after 30 years of contributions, which makes Portugal's system the most favorable one in the OECD. Moreover, cuts in benefits resulting from early retirement are also smaller in Portugal than in other OECD economies. At the same time, however, any cuts in benefits must also consider that, since a large percentage of less-qualified and older segments of the population already receive low wages, the prospects for increases in rates of old-age poverty are more likely to increase. The extent to which measures such as the "solidarity complement for old-age" (see "Social cohesion") can help address this problem remains uncertain.

South Korea

value 5

Old age remains a major poverty risk in Korea. The private-sector pension system was introduced only in 1988 and expanded in 1999. Thus, many of today's elderly are not yet covered by the system. The system's early state of development, with many new contributors and relatively few eligible recipients, also explains the relatively low expenditure. This will dramatically change when the first generation of contributors retires. Currently only 55 percent of the workforce contributes to the system, because many employers fail to register employees for the pension system, and because underreporting of income by the self-employed is widespread.
Currently the pension system is fiscally sustainable, but the future challenges from the changing dependency ratio are substantial. It is estimated that, in 2050, there will be two people under 64 years old for every one person over 64. New pension acts, allowing employers to create private investment-backed saving plans, have recently been passed as a reaction to the fast-aging population. Employees may choose to invest their retirement benefits through outside financial institutions or insurance companies. In addition, a new basic old-age pension plan was introduced, covering senior citizens over 65.
Starting in 2008, this covers about 60 percent of the elderly, depending on recipients' personal wealth. Though this is a step in the right direction, the current plans still do

not effectively prevent poverty caused by old age. Intergenerational equity cannot be assessed at this point due to the system's relative immaturity, and the low number of benefit recipients.

Spain

value 5

The Spanish pension system is not successful in preventing poverty. The poverty rate among Spanish citizens over 65 years old is 29.4 percent, ten points higher than the poverty rate for the population as a whole (19 percent). In 2000, this figure was 23.3 percent, which shows that there has been a dramatic increase over the last five years. The system does not entirely satisfy the inter-generational equity criterion, and the system's long-term fiscal sustainability is one of Spain's greatest fiscal challenges. Taking into account the fact that pensions currently represent the largest percentage of public social spending (8 percent of GDP) and that the average age of Spain's population is rising faster than in any other European country, it comes as no surprise that the Spanish government has been committed to address this issue.
Despite the growth of the pensioner population, expenditure levels for pensions decreased between 1998 and 2003. The pension reserve fund has been accumulating resources over the past three years and has increased from €15.2 billion in February 2004 to €31 billion in February 2006.
Some measures have been put forward to foster the redistributive effect of benefits, by increasing minimum pensions and non-contributory pensions (there are 500,000 non-contributive pensioners receiving less than €500 per month). As to fiscal sustainability, the system has benefited from a massive increase in immigration. Above all, it is worth mentioning that the agreement on social security issues that was signed July 2006 and includes important measures such as the extension of the contribution period required to qualify for a full pension; the rationalization of the categories of retirement prior to the normal retirement age; and incentives to support an active life.

Italy

value 4

Pension policy has been awaiting major reforms for more than ten years that, at the time of writing, have still not taken place. Current policy still tends to favor the current generation, offering rather generous retirement age levels to the disadvantage of future generations. Such decisions leave also significant groups of the population with thin pension coverage. The provision adopted by the former Berlusconi government to increase the retirement age was only partially maintained by the Prodi II government. Given the imbalance between a larger, elderly population and the smaller younger generation, further corrections of the retirement age will be needed to ensure a sustainable pension system and prevent old-age poverty.
In 2005 Italy paid €215 billion toward pensions, which is 15 percent of GDP.

Furthermore, according to research by Italy's National Institute of Statistics, families that live with pensioners suffer on average a significantly higher risk of poverty.

Mexico

value 4

Until 1993, all pension systems were based on collective, non-individual accounts, and repeated fiscal crises eroded them to the point of bankruptcy. The 1993 pension reform allowed all private sector workers to open an individual account, to which they could freely contribute above the legal obligation. However, many public sector workers and employees remained under the old system until 2007, when a reform creating individual accounts for newly hired public employees and those who wanted to change their pension system was introduced. These reforms have initiated the creation of a sound and viable pension system, but its expansion has been limited by the breadth of the large informal economic sector, as well as by public employees who have not yet opted for individual accounts. Furthermore, the fragmented pension subsystems cannot be considered financially sustainable. This challenge will grow as the age structure of Mexican society continues to change.

Mexico still has a fairly young population by OECD standards. Consequently, pension liabilities are still relatively low in absolute terms. Yet, this will naturally change as the population's average age increases. In fact, the share of retired people is relatively small but rapidly growing, with many retirees already living in poverty. Many think that Mexico needs to increase its mandatory retirement age beyond 65, or the 25 years of service mandated today. However, a successful congressional proposal of this kind seems unlikely due to trade union pressure, with no political party seeming willing to pay the electoral costs of such reform.

Turkey

value 4

Although the Turkish pension system covers every individual who has paid premiums for a certain period of time (the actual number of years keeps changing), except for higher-level civil servants, pension payouts are extremely low and fall even below poverty limits. It would be a miracle for a former blue-collar worker to survive only on his pension income during retirement. Nevertheless, the system suffers from large deficits (currently 4.8 percent of national income is transferred to the social security system) for two reasons. One, the retirement age is very low. For some time, it was possible for a 38-year-old woman, for example, to retire and draw pension income for the rest of her life. Two, the system offers extensive benefits. To give but one example, unemployed daughters (who are unemployed by choice) are entitled to a proportion of their father's pension, regardless of their age.

According to government statistics, 62 percent of pensioners (excluding white-collar public servants who have their own social security system) are below the age of 60. This situation, over the long term, is not financially sustainable.

With the aim of ensuring financial sustainability and achieving long-term actuarial balances in the retirement system, amendments were made in basic rules related to retirement with a law introduced in 2006. Changes include the increase, on a gradual basis, of the retirement age; the reduction of replacement rates; the linking of retirement salaries to premiums paid; the inclusion of all income elements in the base of a pension premium, especially for civil servants; the increase of the number of premium payment days for workers from 7,000 to 9,000 days, on a gradual basis following a transition period of 20 years; and the consideration of income statements rather than income levels in the calculation of the premium base for the self-employed and farmers. In addition, the principle of government contributions to disability, old age and death insurance premiums and health insurance premiums was established.

Additional pressure stemmed from the realization of the aging Turkish population and a demographic "window of opportunity" that presented the possibility for the government to collect additional resources for the social security fund. The new Social Insurances and General Health Insurance law, however, met with fierce resistance by the government opposition and labor unions.

Greece

value 2

Greek pension policy has not been able to prevent old-age poverty, since more than half a million (26.8 percent) citizens older than 65 are relatively poor. Nor has it been able to guarantee the fiscal sustainability of the pension system, although the country spends 11.5 percent of its GDP on pensions, one of the highest such levels of expenditure among all OECD countries. Greek pensions are funded by current employee contributions, state benefits and by the pension plans' capital yield. The use of state benefits has become inevitable in recent years. If this development continues, the current plans' sustainability will be endangered.

The pension system's funding difficulties result in part from the demographic problems of an extremely low birth rate and an aging population. However, contributions are also shrinking due to long-term unemployment, especially among young people and women. Additionally, the large number of insurance companies has led to a myriad of multifaceted, overly complex laws. This too is a heavy burden for the Greek pension system.

While a pension crisis is not imminent, governments since the mid-1990s have done little to prevent a medium- and long-term fiscal crisis, including the possibility of cash shortages. In the current period of analysis, the incumbent government changed only secondary aspects of the system, such as banking employees' pension funds, a reform which was the result of external, international pressures related to international banking standards.

This report is part of the Sustainable Governance Indicators 2009 project, which assesses and compares the reform capacities of the OECD member states.

More on the SGI 2009 at www.sgi-network.org

Contact

Andrea Kuhn, Dr. Leonard Novy, Daniel Schraad-Tischler

Bertelsmann Stiftung

Carl-Bertelsmann-Straße 256

33311 Gütersloh

www.bertelsmann-stiftung.de