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The Public-Private Mix of Retirement Income in Nine OECD Countries: Some Evidence from Micro-data and on Exploration of its Implications

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Bernard Casey and Atsuhiko Yamada

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**The public-private mix of retirement income in nine OECD countries:
some evidence from micro-data and an exploration of its implications**

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This chapter draws from work undertaken whilst the authors were working in the Social Policy Division of the OECD. Views expressed are, however, those of the authors and should not be taken to represent the position of the OECD

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**The public-private mix of retirement income in nine OECD countries:
some evidence from micro-data and an exploration of its implications**

Over the past three decades, the wellbeing of people over retirement age has improved, not only absolutely but also relatively. Being old is no longer synonymous with being poor. This improvement has occurred across almost all of the main OECD countries, and has occurred almost regardless of the type of pension system that is operating in the country concerned. This chapter seeks to illustrate the importance or other wise of the nature of the public-private mix in incomes in old age both in producing this improvement in wellbeing and in leading to differences in the level of wellbeing enjoyed by different types of person. It draws from a number of studies undertaken at the Social Policy Division of the OECD in the course of 2000 and 2001, many of which have been reported upon in OECD (2001) and Yamada and Casey (2002).

The findings presented and discussed here are drawn, largely, from special analyses of the “Luxembourg Income Study” (LIS). This brings together, on a standardised basis, the income and expenditure surveys of some 25 countries. The OECD’s study was limited to nine countries – Canada, Finland, Germany, Italy, the Netherlands, Sweden, the United Kingdom, the United States and Japan. All bar the last of these participate in LIS. Data protection laws prevent Japan contributing, but it was possible to gain access to special tabulations from an equivalent Japanese dataset.¹

The LIS and other data was used to provide descriptions of the situation at a moment in time – usually 1994 or 1995 – the most recent available years. Although LIS can provide information for earlier years, it cannot do so in the same detail. Thus, for the purposes of across time analysis, special analysis was made of a second dataset, the “OECD income distribution dataset”. This had been collected to study changes in the

income levels and equality over time and allows comparisons between the mid 1990s and the mid 1980s and, in some cases, between the mid 1980s and the mid 1970s (see Förster, 2000). Lastly, the OECD had put together data on wealth and assets of older people, mainly from the mid 1990s (see Disney and Mira D’Ercole, 1998). This information, coupled with that obtainable on age-related public spending for older people, was used to complement the income data.

The chapter is organised as follows. In succession, the relative improvement in older people’s wellbeing over the period since the mid 1970s and the changing make up of their incomes is considered. The section concerned shows the growing importance of private provision. The next section looks at recipients of private pensions within the income distribution. It shows that it is largely the better off of older people who are in receipt of private pensions. The next two sections tackle less frequently studied aspects of the public private mix. One looks at the contribution of private pensions to facilitating early retirement. That section shows they can be important, but so, too, are public pensions, and, equally, other public benefits. The other section looks at the impact of private pension receipt on the situation of women. It is well know that women are less frequently covered by private pension systems. The section illustrates what can occur when the death of a husband results in the lose to the surviving wife of his pension. Having looked at transfer payments, the chapter turns to two further determinants of the public-private mix. One section shows how labour incomes are stills an important part of the income package of older people in some countries. The older person him or herself might still be working or he or she might be living in a household where other people, especially adult children are. A further section considers how “in-kind” benefits provided by the state also have an impact on the overall public-private mix. Whether or not a universal health care system operates can have a major impact on the effective wellbeing of older people. A final

¹ This is the “Income Redistribution Survey”.

section draws some conclusions and discusses how the study of the public-private mix with respect to retirement might further be pursued.

The relative improvement in older people's wellbeing

Time series data shows the relative improvement of older people's wellbeing. Equivalizing to take account of differences in household size, the income of people over retirement age relative to that of people in their late forties and early fifties – a “quasi-replacement rate” – rose from about two thirds to about three quarters across the nine countries. With the exception of the United Kingdom, much of the improvement seems to have occurred between the mid 1970s and the mid 1980s: relative wellbeing was much more stable over the subsequent decade.

< Table 1: Quasi replacement rates over time >

It was not only that relative incomes rose, the composition of incomes of people over retirement age also changed over time. In all nine countries, the proportion of income derived from work – be it the work of the older individual or his/her spouse or of any adult living in the same household – fell. This reflects the continued fall in effective retirement ages and the fact that fewer and fewer people over retirement age still work. This meant that the proportion made up by transfers increased. However, depending on the country in question, the type of transfer that grew in relative importance differed. In almost all countries, income from capital – which is, to a very large extent, income from an individual or company pension – grew in importance, but in four countries, it not only grew substantially, it constitutes a substantial part of incomes in retirement. The four countries concerned are Canada, the Netherlands, the United States and the United Kingdom. This can be seen in Figure 1.

< Figure 1: Composition of gross income over time >

These four countries stand out as the countries in which private or company pensions are particularly important. The difference can be seen in four ways – the proportion of the current workforce that is enrolled in a private pension plan, the proportion of retirement age people who have income from a private pension, the relative importance of private pensions for those who receive them, and the relative importance of private pension income for all older people. Table 2 seeks to capture this.

< Table 2: Importance of private pensions >

The first column of Table 2 shows that private pension arrangements are relatively wide spread in more than four countries. Germany and Japan have to be added to the list, so to does Sweden, where almost all employees are covered by one of the four collectively agreed private pension arrangements. Amongst current retirees, however, column two shows that only in Sweden do a substantial number have some private pension income. Indeed, the nature of arrangements in that country means that the proportion is the highest in any of the nine countries. However, as far as the importance of private pensions are to those who receive them is concerned, column three shows that it is in the original four countries that private pensions are important, followed by Italy and, further behind, by Sweden. The last column sums up the previous three since it takes into account the share of retired people receiving pensions when assessing the importance of private pensions for the income of all retired people. On this basis, and despite their high value for those that do have them, private pensions are relatively unimportant in Italy. Canada, the Netherlands, the United Kingdom and the United States are the countries in which private pensions are an important source of income in old age. Sweden occupies an intermediate position.

Finland, Germany, Italy and Japan are countries in which private pensions are relatively unimportant.

Private pensioners in the income distribution

Although a substantial share of the retired population has some private pension income, it is well known that private pensions, other than in Sweden, tend to cover employees in the primary sector of the economy rather than employees across the whole economy. Thus, men are more likely to be covered than women, employees in large enterprise more likely to be covered than those in small enterprises, higher-paid workers are more likely to be covered than low-paid workers, and full-time workers are more likely to be covered than part-time workers. Of course, many of these categories overlap. It is not surprising, therefore, indeed it is almost inevitable, that private pensions reproduce inequalities in working life. Unlike public pension, they do not normally contain any redistributive provisions,² either in the form of thresholds or ceilings, or in the form of crediting times spent not in employment for reasons such as childcare or long-term sickness.

Amongst pensioners themselves, private pensions are important only for the better off. As Figure 2 shows, in all of the countries bar the United Kingdom, capital income makes up only about ten per cent – or less – of the gross income of low income pensioners in all of the countries bar the United Kingdom. On the other hand, it makes up about half of income for the best off pensioners in Canada, the Netherlands, the United Kingdom and the United States. Equally, for low income pensioners, public pensions make up well over 80 per cent of income in all countries bar Japan, but for the best off of pensioners, it is only in Finland, Germany, Italy and Sweden that public pensions make up half or more of gross income.

² Except in so far as defined benefit systems tend to redistribute from members who leave before retirement age to those who stay.

< Figure 2: Make up of income by income level >

Lastly, the role of labour income is to be noted. This is a further form of market income, but it is important for people over retirement age only in Japan. There, despite the fall in its importance, labour income still makes up nearly a quarter of income for the least well off people over pension age, and over two thirds for the best off ones.

The relative wellbeing of private pension recipients is further illustrated when they are compared with the generality of pensioners. This is done in Figure 3. It shows that recipients of private pensions are least likely to be found at the bottom of the income distribution and more likely to be found towards middle or even the top. This is particularly the case in Finland, Italy, Japan and Germany – countries in which, for the majority of people, private pensions are relatively unimportant.

< Figure 3: Private pensioners in the income distribution >

Private benefits and early retirement

Much of the concern of policy makers in the last decade has been with the high incidence of early retirement shown in the industrialised countries. Early retirement can be facilitated in many way – people can be offered early public age pensions, disability benefits, or extended unemployment benefits, often coupled with a lifting of the requirement to register as job seekers. Private pensions can also play an important part. Given the relatively small number of women who can be identified as

early retired,³ it is only with respect to men that cross sectional datasets allow any detailed study of early retirees.

Early retirees can be broken into two groups – those in their late fifties and those in their early sixties. Table 3 shows that private pensions are a considerably more important means by which early retirement is facilitated in the countries where private regular old age pensions are most prevalent – Canada, the Netherlands, the United Kingdom and the United States – and to a lesser extent, Sweden, than elsewhere. In the case of the Netherlands, the private pensions are private early pensions regulated by collective agreements and payable to those reaching 60, 61, or 62. These private benefits are separate from those granted under private age pension schemes, since the later do not allow pensions to be drawn until age 65 is reached. In the case of Sweden, special bridging payments are likely to be included alongside regular private pensions drawn early. Also to be noted in this respect is the case of Germany, where, like in Sweden, collectively agreed “social plans” regulating redundancies include private benefits that top up extended unemployment compensation or early public age pensions. In the case of Canada, the United Kingdom and the United States, private pensions might or might not be reduced when they are drawn before 65. They are less likely to be reduced when retirement is “at the request of the employer” (i.e., is part of a redundancy settlement). They can also be unreduced simply because some private pension schemes have a normal retirement age that is lower than that which applies under the public age pension system.

< Table3: Public-private mix of early pensions >

³ This is because, whilst most older non-working men can be presumed to have been in work during most of their previous adult lives, this is not the case with respect to women. Many of those who are currently in old age might have stopped working once they started to have

With respect to those countries for which the appropriate data was available, it can be seen that private pensions are a much more important facilitator of retirement for people in their late fifties in Canada and the United States than in the United Kingdom and the Netherlands. In the first two countries, disability pension systems are relatively strict in defining eligibility, and there are no provisions extending unemployment benefits for older unemployed people. In the United Kingdom and the Netherlands, eligibility for a public disability pension has been less strict, in so far as “social” as well as “medical” criteria can be, or are, taken into account. Moreover, in the Netherlands, although the collectively agreed early retirement provisions have had a minimum age of eligibility of 60 or higher, the unemployment insurance system can grant benefits to retirement age for those losing their jobs from the age of 57½.

It is not, however, only the relative importance of private and public pensions that determines the total public-private mix of early retirement provision. Also important are such public benefits as unemployment compensation and means-tested assistance. Early retirement through receipt of some kind of unemployment benefit is more important for people in their late fifties than for those in the early sixties, and is especially important in Canada, Finland and Germany. Data on receipt of means-tested assistance is more difficult to analyse, since the term is used to describe something other than normally understood in some countries and sample numbers are also too small in these or other cases. Also, means-tested benefits are awarded to households rather than individuals. Thus, the proportions in the final column cannot simply be added on to those in the other columns. However, the final column does indicate that in some countries means tested benefits are important. They are particularly so in Finland, where some older job-losers fail to qualify for the extended unemployment benefits and early pensions available to many. They are also

children and many of these did not return to work later or, if they did, did so on a part-time, casual or intermittent basis.

important in the United Kingdom and to a lesser extent Canada, where some older job losers benefit from early private pensions but where others have little to fall back upon once – or, or in the case of the United Kingdom, even before – unemployment benefit is exhausted.⁴ Once all public benefits are taken into account, even in those countries where private benefits are important, the public private-mix of early retirement support weighs heavily toward the public.

The gender unbalance of private pensions

An important feature of private pension arrangements that has already been noted is the way in which, amongst current employees, they are more likely to cover men than women. This has its impact on the relative importance they make up in the retirement income package of men and women. A simple illustration of this is provided in Table 4. In most countries, private pensions make up only half as much of the pension income of older women than as of older men; in Germany, yet less. Only in Sweden is the difference rather smaller.

< Table 4: Relative importance of private pensions for men and for women >

It is reasonable to assume that, in most households, income is shared. However, the death of one partner leads to the loss of that person's contribution to the household account. In so far as a man's private pension income is, on average, larger than that of his wife, widowhood can substantially lower her wellbeing. This is over and above the diminution of individual wellbeing resulting from the loss of economies of scale that two-person households enjoy. It is possible to make an estimate of the size of the diminution by comparing women living in couples with those who are widows.

⁴ The level of unemployment benefit in that country is so low that most recipients, particularly those with dependants, are eligible for complementary means-tested assistance.

Table 5 shows that, in three of the countries where private pensions are particularly important, widowhood results in a substantial loss of wellbeing due to a decline in the private pension income coming into the household. This decline is a consequence either of the total loss of the husband's pension or, at best, of its reversion to a lower survivors pension. On the other hand, in these same three countries, the public pension system, to a greater or lesser extent, compensates for the fall in private pension income.

< Table 5: Impact of widowhood where private pensions are important >

The impact of income from work

Studies of the role of the public and private contributors to wellbeing in old age have tended to concentrate upon pensions and the extent to which these are provided by the state or by company or individual savings plans. Private pensions can be regarded as a form of market income, public pensions as a form of non-market income. Another form of non-market income that should not be ignored, and that has been of some importance in the past for older people, is income from work. This, too, needs to be taken account of when assessing the nature of the public-private mix.

In Figure 1, some indications of the declining importance in labour incomes over the past quarter of a century were given. A fuller picture, for the mid 1990s, is given in Table 6. The very high contribution made by labour income to household income in Japan can be explained, in part, by the fact that, there, households “demerge” late – children stay with their parents until, and sometimes even after, marriage – and sometimes even “remerge” – older people go back to live with their children, as subordinates in their households. However, as the second line of the table shows, the contribution of the older person's own labour income is also important. The high contribution made by labour income to own income in the United States, and to a

lesser extent in Canada, can be explained by a tendency for older people to continue in some kind of paid employment – perhaps only part-time – after reaching normal retirement age and drawing a pension. Late “demerging” is common in Italy.

< Table 6: Labour income within total income >

The impact of income in kind

Studies of the role of the public and private contributors to wellbeing in old age have not only tended to concentrate upon pensions rather than earnings, they have also largely ignored the importance of in kind benefits. Such benefits are largely, indeed almost exclusively, provided by the state and, thus, are public. One reason for their being ignored is that micro-datasets seldom contain any relevant information. Even if they do record enjoyment of in-kind benefits, they do not do so in a consistent manner. An even greater hindrance to taking in-kind benefits into account is that it is difficult to place a value upon them.

Nevertheless, such benefits are important. Their importance can be seen by reference to macro data on expenditure on publicly provided services to the elderly and disabled – primarily day-centres, sheltered accommodation and domestic-help services – and health care services – visits to doctors, medicines and hospital stays. Table 7 shows the size of such expenditures relative to expenditures on public age, disability and survivors benefits – cash benefits primarily for older people. Results – particularly those for health care – are at best approximations and should be treated with care. However, in those countries for which full information is available, in-kind benefits seem to be worth between an half and three quarters of public cash benefits. Of course, this is an average across all older people and all years of old age.

Actual health utilisation will be much more “lumpy” and concentrated in the last years, or even months, of life.

< Table 7: Relative size of in-kind benefits >

The value of in-kind benefits is highest in Japan and Sweden, although in the first country it is the consequence of extensive health care provision and in the second country of extensive housing and home-help provision.⁵ Differences in the service mix are also apparent for the other countries and reflect very different cultures and institutions.

One further institutional difference that has to be taken into account when considering in-kind health services is how medical expenses are covered. It is well known that, unlike the other eight countries considered here, the United States does not have a universal health insurance system. Health insurance coverage is dependent upon whether an employer offers it or, in the absence of this, whether a person has purchased his or her own individual policy. The exception is people aged over 65 or in receipt of public disability benefits. However, whilst such people are covered by a form of public health insurance, the system concerned – Medicare – reimburses doctors fees and hospitalisation costs, but it does not reimburse the costs of prescription medicines. These can be high. Figure 4 below shows that, amongst the oldest Americans, expenditure on health related items accounts for an average of 16 per cent of all expenditures, compared with little over two per cent for amongst the oldest Germans and Swedes. Thus, if the provision of in-kind benefits swings the public-private balance in one direction in most countries, in the United States, the nature of the health insurance system swings it somewhat in the other direction.

< Figure 4: Share of private expenditure accounted for by health care >

⁵. In the case of Japan, some of the “health” expenditure might actually relate to services closer to long-term care. In this case, it should better have been placed in column two

Conclusions and matters arising

By the mid 1990s, older people had, on average achieved a reasonable level of wellbeing. However, in the last decade, many governments have made reforms to their retirement income systems that have sought to reduce the generosity of public pensions and encourage a greater reliance on private pensions. Other reforms, which have restricted access to early retirement and, in some cases, even raised the age at which regular age pensions can be drawn, mean, if successful, that labour incomes will increase in importance.

Such reforms might result in higher levels of wellbeing, if diversified packages bring the benefits often suggested. They might, however, bring lower levels of wellbeing, if people are left without the ability to access one income source – an early pension – and no opportunity to take advantage of another – a paid job. Such people might be forced back onto means-tested benefits. In this respect, a key to ensuring that reforms to pension systems do go hand in hand with increased wellbeing is an improvement in macro-economic performance. Only then are there likely to be sufficient employment opportunities for older people and, thus, for labour income to play a more important role in the income package of older people.

Private pension schemes are not, by definition, defined contribution pension schemes. The new public pension systems in Italy and Sweden have this characteristic, too. However, many private pensions do operate on a money purchase basis, and in those countries where employers sponsor pension plans, private, defined benefit schemes are being closed to new entrants and replaced with defined contribution schemes. Moreover, the sectors where defined contribution schemes tended to prevail are sectors that are shrinking, whilst new employers, if they offer pension plans at all, offer defined contribution plans. Money purchase or defined contribution scheme leave more people faced with planning how to use their accumulated savings. If people underestimate their remaining length of life, they could find their retirement

income depleted prematurely. In this case, they will become dependent upon some form of public assistance. In addition, and in so far as defined contribution schemes place a closer link between contributions and benefits, they tend to disadvantage women and they tend to increase the level of inequality in incomes amongst the retirement age population. They do this even if they do not lead to a greater proportion of the old having “low” incomes.

Having considered some of the policy implications of the changing public-private mix, this chapter concludes with a number of suggestions about how the mix itself should be studied in the future. It has argued that to concentrate upon pensions alone is insufficient. First, it is insufficient for a study of incomes in retirement because labour incomes remain, at least in some countries, of some import and because, if government reforms are successful, they might, in many countries, be of some import. Labour income can be considered a further element within the private part of the income package. Second, it is insufficient for a study of incomes in *early* retirement because, at least in some countries, unemployment benefits, and even means-tested assistance, are the functional equivalent of early pensions. Such benefits are a further component of the public part of the income package.

Third, such a concentration is insufficient because the size of the public component is determined, in part, by how benefits are provided. Some countries, particularly some of the Scandinavian ones, make considerable provision of benefits in-kind. These take the form of social care services for which no or little charge is made. Taking such benefits into account is important in assessing the overall contribution of the state to the wellbeing of people in old age. Last, it is insufficient because consumption as well as income has to be considered when assessing the public-private mix. The impact of a health insurance system that places considerable emphasis on co-payments or that excludes critical items from reimbursement can be seen with reference to the United States. It might also be noted that, where private

pension provision is voluntary rather than obligatory, contributions are not normally taken into account when disposable income is being assessed. Rather, they are only identifiable, if at all, through an analysis of consumption. A full assessment of the size of the public element within the public-private mix needs to take this into account.

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Table 1: Quasi-replacement rates over time (disposable income of people 65 and over as % of disposable incomes of people aged 18-64)

	mid 1970s	mid 1980s	mid 1990s
Canada	51%	87%	87%
Finland	68%	69%	72%
Germany	n/a	76%	78%
Italy	n/a	78%	78%
Japan	n/a	85%	82%
Netherlands	86%	85%	79%
Sweden	65%	74%	80%
U. K.	62%	60%	65%
U. S. A.	77%	84%	84%
unweighted average	68%	78%	78%

source: own calculations from OECD income distribution dataset

Table 2: The importance of private pensions

	% of retirement age people with private pensions	% of beneficiaries disposable income	% of retired men's gross income ^a	
Canada	33	58	38	44
Finland	15	*	*	*
Germany	46	16	18	6
Italy	5	3	33	7
Japan	50	5	10	4
Netherlands	91	75	54	53
Sweden	90	86	26	25
U. K.	46	76	40	55
U. S. A.	45	50	36	41

^a men aged 65-74

source: OECD 2001; own calculations from LIS and equivalent data

Table 3: The public-private mix of early retirement benefits

	prop with any private pension	prop with any public pension	prop with unemployment benefit	prop with any other public benefit (max)	prop of all households ^a with means- tested benefits
men aged 55-59					
Canada	32%	18%	18%	38%	15%
Finland	1%	64%	20%	16%	23%
Germany	2%	39%	25%	17%	9%
Italy	2%	72%	4%	22%	n/a
Japan	*	23%	13%	65%	n/a
Netherlands	*	19%	11%	70%	13%
Sweden	49%	64%	14%	6%	n/a
United Kingdom	46%	31%	1%	34%	18%
United States	34%	28%	5%	39%	12%
men aged 60-64					
Canada	44%	60%	5%	26%	18%
Finland	4%	95%	4%	2%	18%
Germany	15%	77%	6%	8%	10%
Italy	4%	84%	1%	14%	n/a
Japan	12%	78%	1%	20%	n/a
Netherlands	48%	4%	9%	13%	12%
Sweden	66%	71%	8%	2%	n/a
United Kingdom	66%	34%	0%	18%	20%
United States	48%	61%	2%	19%	12%

^a households containing someone in the relevant age range
source: own calculations from LIS and equivalent data

Table 4: Public-private mix of age pensions for men and for women (own private pension as % own gross income)

	men	women	women as % men
Canada	44%	21%	48%
Finland	*	*	not relevant
Germany	6%	1%	15%
Italy	7%	3%	46%
Japan	4%	2%	45%
Netherlands	53%	10%	18%
Sweden	25%	17%	68%
United Kingdom	55%	21%	39%
United States	41%	22%	53%

Note: data refer to married men and married women aged 65-74. The ratio used is the share of own private pensions within total own pensions

source: own calculations from LIS and equivalent data

Table 5: The impact of widowhood on wellbeing

	percentage point fall in wellbeing that is attributable to loss of		net pensions result
	public pensions	private pensions	
	aged 65-74		
Canada ^a	12	-13	-1
United Kingdom	13	-11	2
United States	5	-7	-3
	aged 65-74		
Canada ^a	12	-14	-2
United Kingdom	8	-13	-4
United States	3	-9	-6

^a Includes divorced and never married

Note: moving from a household of two persons to one of one person leads to a fall in wellbeing of 29 percent due to the loss of scale economies

source: own calculations from LIS and equivalent data

Table 6: The relative importance of labour income (labour income as % of gross income)

	Canada	Finland	Germany	Italy	Japan	N'lands	Sweden	U K	U S A
household income (65-75)	23%	15%	16%	21%	62%	9%	12%	17%	35%
own income (men 65-74)	14%	4%	6%	5%	38%	7%	8%	10%	28%

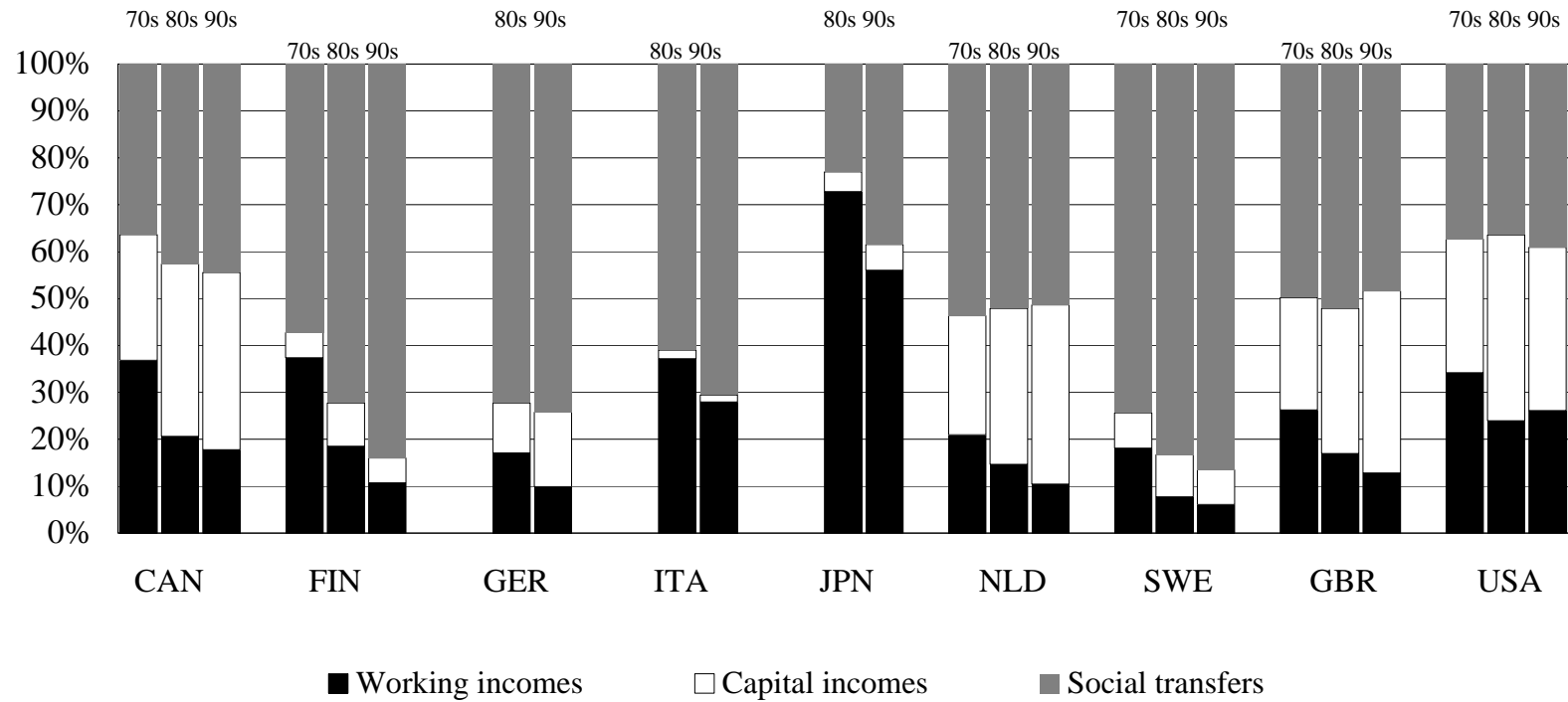
source: own calculations from LIS and equivalent data

Table 7: Relative importance of public "in-kind" benefits

	Cash benefits	Social services	Medical care	Total benefits (cash and in-kind)
Canada	100	n/a	90	n/a
Finland	100	13	35	148
Germany	100	5	48	153
Italy	100	1	n/a	n/a
Japan	100	4	70	174
Netherlands	100	6	45	151
Sweden	100	30	46	176
United Kingdom	100	8	45	153
United States	100	1	70	n/a

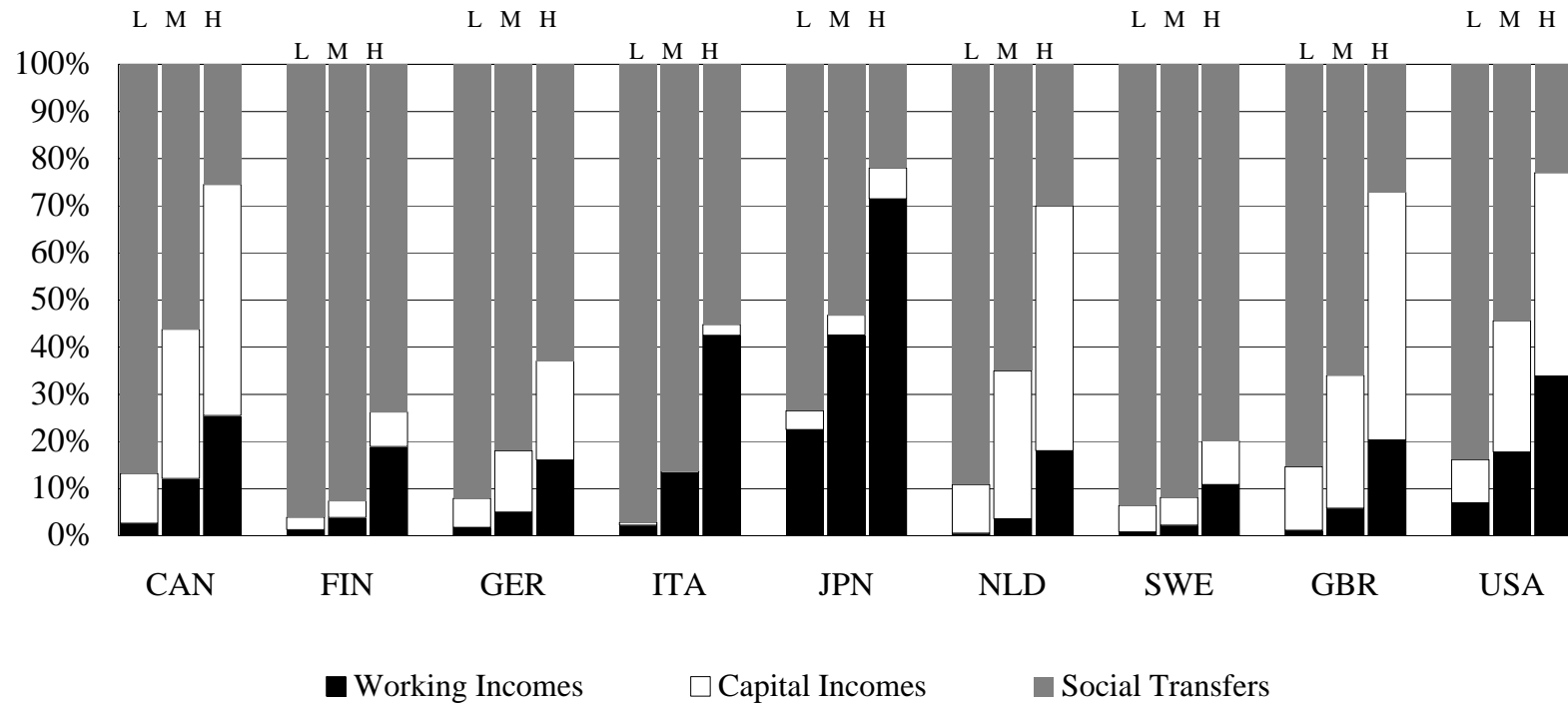
source: own calculations from OECD Public Expenditure and Health datasets

Figure 1: Composition of gross income over time for people aged 65 and above
 Percentages, mid-70s, mid-80s and mid-90s



Source: Calculations from the OECD questionnaire on distribution of household incomes

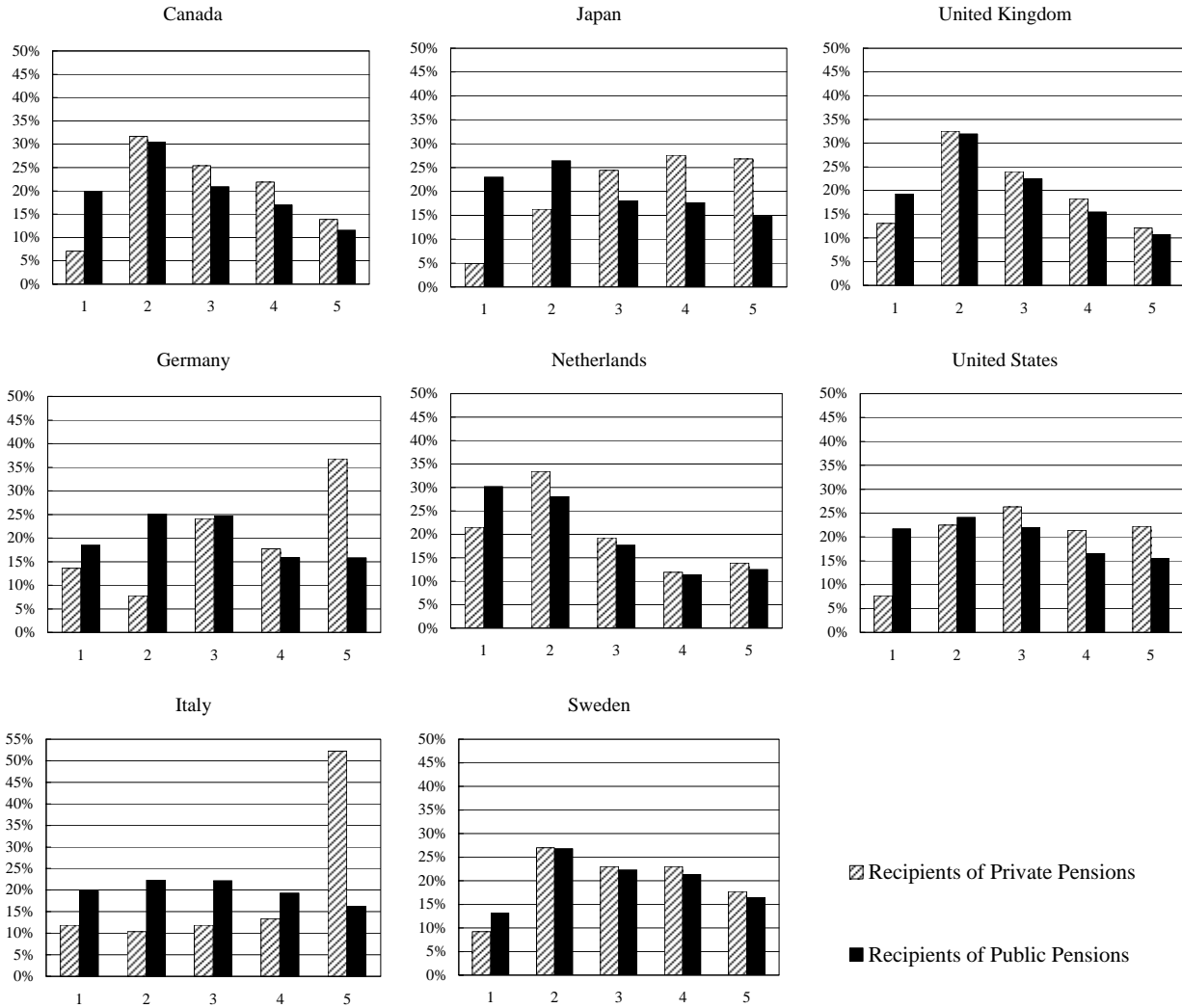
Figure 2: Income source, by income group, people aged 65 and above
 Percentages, mid-90s



Source: Calculations from the OECD questionnaire on distribution of household incomes

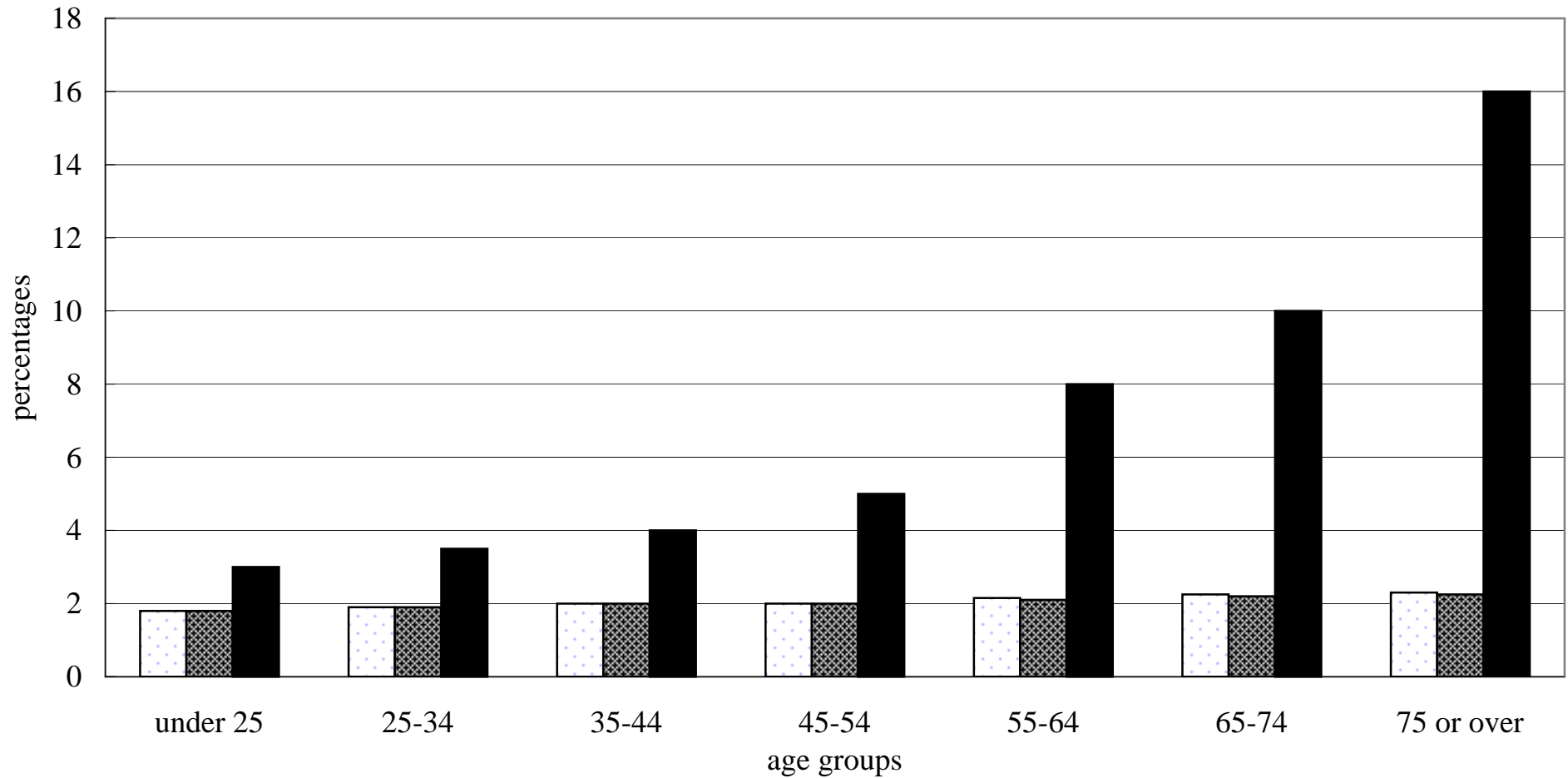
Figure 3: Position of recipients of private pension recipients and all recipients of public pensions in the income distribution, people aged 65-69

(Population of Quintiles as a percentage of each category)



Note: data refer to disposable incomes
 source: own calculations from LIS and equivalent data

Figure 4: Share of household consumption accounted for by health spending



source: Smeeding, 1997

