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**Article**

## The 2015 Pension Adequacy Report's Examination Of Extended Working Lives as a Route to Future Pension Adequacy

Intereconomics

*Suggested Citation:* von Nordheim, Fritz (2016) : The 2015 Pension Adequacy Report's Examination Of Extended Working Lives as a Route to Future Pension Adequacy, Intereconomics, ISSN 1613-964X, Springer, Heidelberg, Vol. 51, Iss. 3, pp. 125-134, <https://doi.org/10.1007/s10272-016-0590-2>

This Version is available at:

<https://hdl.handle.net/10419/191157>

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End of previous Forum article

Fritz von Nordheim

## The 2015 Pension Adequacy Report's Examination of Extended Working Lives as a Route to Future Pension Adequacy

The overall results of pension developments in EU countries and their impact on public expenditure and on income conditions in old age are monitored in two tri-annual reports that complement one another in focus and methodologies. These are the Ageing Report by the Economic Policy Committee (EPC)<sup>1</sup> and the Pension Adequacy Report by the Social Protection Committee (SPC).<sup>2</sup> Where the Ageing Report (AR) looks at the future fiscal sustainability of public pension schemes from primarily a macro-economic perspective, the Pension Adequacy Report (PAR) – while using the same set of demographic, eco-

nomical and employment assumptions as the AR – applies a micro-economic approach in its examination of the present and future adequacy of pensions as an element of the income of retired people.

In recent years, EU Member States have adopted a series of reforms aimed at managing public spending on pensions in order to safeguard their future sustainability in view of rising old-age dependency ratios. Thanks to these reforms, projections from the 2015 AR suggest that Member States may be able to contain the impact of population ageing to such an extent that public pension expenditure as a share of GDP would be no higher in 2060 than in 2013 for the EU28 as a whole.

While sustainability is obviously a precondition for any continued pension adequacy, providing people with income in old age that allows them a decent living standard and protects them from poverty is the very purpose of pension policy. Pension adequacy is thus an important policy goal in its own right. The sustainability and adequacy of pensions are therefore seen as two interconnected objectives and often alluded to as “two sides of the same coin”. Indeed, if reforms leave an increasing number of older women and men without adequate incomes, the future sustainability of public finances may also be im-

1 European Commission: The 2015 Ageing Report. Economic and budgetary projections for the 28 EU Member States (2013-2060), European Economy 3/2015, Luxembourg 2015, Publications Office of the European Union. The Report was adopted by the EPC in May 2015.

2 European Commission: The 2015 Pension Adequacy Report: current and future income adequacy in old age in the EU, Luxembourg 2015, Publications Office of the European Union. The Report was adopted by the SPC in September 2015.

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perilled by the risk of policy reversals. Thus, by taking a closer look at the adequacy implications of reforms, the 2015 PAR also complements the AR's analysis of risks to future fiscal sustainability.

### The 2015 Pension Adequacy Report

The 2015 PAR starts by examining the current (i.e. 2013) role of pension systems in securing the living standards of older Europeans. Secondly, it analyses the impact of recent pension reforms, identifies risks to future pension adequacy, and outlines what needs to be done to mitigate such risks and help secure adequate incomes for today's young workers when they reach retirement 40 years from now.

Along the way, the 2015 PAR looks at pension adequacy in the context of access to private assets, other public benefits and services, and employment. It offers an examination of the benefit floor below pensions in the minimum income provisions for older people and provides analyses of the crediting of non-contributory periods (e.g. education, military service, maternity, caring, unemployment and sickness) and of derived pension rights such as survivors pensions. Importantly, it presents a comprehensive assessment of the current gender gap in pensions and its causes. It furthermore gives an overview of the main trends in pension reforms over the last 20 years, including developments in the public-private mix of provisions, and of the impact of the financial, economic and sovereign debt crises on pensions and pensioners.

When assessing the ability of pension systems to fulfil their income maintenance function, both currently and prospectively, the report uses the hypothetical case methodology of Theoretical Replacement Rates (TRRs). These rates indicate the extent to which pensions "replace" incomes from work in the last year before retirement. In order to catch the effects of recent reforms and to illuminate key policy questions, the TRRs are calculated for various sets of career and income scenarios and pension system features. The adequacy impacts of reforms are assessed by comparing the TRR calculations for 2053 with those for 2013.

In the terms of reference, the SPC asked the 2015 PAR to assess the various risks to the future adequacy of pensions after recent pension reforms and to pinpoint reform possibilities that can advance both the adequacy and sustainability aspects of pensions.

A key part of the PAR therefore concerns itself with reforms that may offer such win-win possibilities by seeking to extend working life through higher pensionable ag-

es and restrictions in access to early retirement. Among other things, this leads the report to examine the current barriers and obstacles to longer working lives in workplaces and labour markets and how these may be reduced.

This article presents the main points from this part of the 2015 PAR, which is focused on how to mitigate the risks to future adequacy in our uncertain ability to prolong working life in line with the rise in pensionable ages resulting from recent reforms.

### Pension reform

Table 1 reports on the pension reform elements aiming to obtain savings and extra tax revenues by extending working lives that were adopted in EU countries over the period 2008-2014.

Even before the crisis began, it was clear that the magnitude of demographic ageing would force the majority of Member States to raise pensionable ages. Still, the extent to which reforms have focused on raising the pensionable age in public schemes and aligning it with developments in life expectancy is remarkable. By the end of 2014, 24 Member States had increased, or were in the process of increasing, the pensionable age. At the same time, seven had introduced a mechanism linking it to life expectancy, another two were on the verge of joining them and two others had established mechanisms with some similar effects. Additionally, 16 countries had taken further steps to restrict access to early retirement.

The emphasis in pension reforms on shortening the average time spent in retirement and extending the time spent working and contributing is logical. It can help Member States avoid some of the trade-offs between fiscal sustainability and benefit adequacy by freeing up resources that may be used to maintain the present adequacy of pension benefits or at least limit the extent to which they will be reduced.

However, these changes are also exposing pension adequacy to developments beyond the control of pension policy, in so far as the adequacy of future pensions, notably the income maintenance part, is to be ensured through more women and men working more and longer.

Thus, while bringing solutions to some of the dilemmas of adequacy, the reforms have made pensions much more dependent on the ability of working lives to extend in line with the rise in pensionable ages and thus on labour market and workplace developments. Changes furthermore entail that pension systems no longer provide solutions to

Table 1  
Pension reform elements aiming to extend working lives, 2008-2014

Member State	Year	Access to early retirement (incl. disability) restricted	Age for early retirement raised	Pensionable age increased	Women's pensionable age brought up to men's	Length of contribution period increased	Automatic indexation to life expectancy	Limit to combine work and pension eased
Belgium	2012/2014	X	X					X
Bulgaria								
Czech Republic	2011			X	X	X		
Denmark	2011	X	X	X			X	X
Germany	2014			X				
Estonia	2010			X	X			
Ireland	2012-2014			X		X		X
Greece	2010/2012	X	X	X	X	X	X	
Spain	2013	X	X	X		X		X
France	2010-2011	X		X		X		
Croatia	2013		X	X	X			X
Italy	2011	X	X	X	X	X	X	
Cyprus	2012	X		X		X	X	
Latvia	2011			X		X		
Lithuania	2011			X	X			
Luxembourg	2012	X						
Hungary	2010/2012	X		X				
Malta	2008-2013	X		X	X	X		
Netherlands	2012	X		X			X	
Austria	2013	X	X		X			
Poland	2008-2010	X		X	X	X		
Portugal	2012-2014	X		X			X	
Romania	2011			X				
Slovenia	2012	X		X	X	X		
Slovakia	2011-2012			X	X		X	X
Finland	2010-2014	X	X					X
Sweden								
UK	2011-2014			X	X			

Source: European Commission: The 2015 Pension Adequacy Report: current and future income adequacy in old age in the EU, Luxembourg 2015, Publications Office of the European Union.

late career employment problems through access to early retirement.

### Risks and pension adequacy

When assessing reform measures and their impact on pension adequacy, however, it is important to remember that all pension arrangements entail exposure to internal and external risks. Different types of pension schemes differ in their risk profiles, and many of these risks cannot be removed but only mitigated or balanced. Reforms that

aim to remove or reduce risks in present arrangements usually also introduce new or increased risks elsewhere. Thus, when reforms seek to take the pressure off public pensions, diversify risks, and maintain or raise the overall adequacy of pension provisions by promoting pre-funded private pensions, they may make pension adequacy far more dependent on the volatilities in financial markets. Similarly, when reforms tighten the link between pension entitlements and contributions based on earnings from work, increase the contribution period and raise the pensionable age, their success depends on tackling some of the challenges and risks to longer working lives at the

Figure 1  
Average ages of first pension take-up in 2012 and pensionable ages in 2013



Note: \* Legislated pensionable age varies.

Source: European Commission: The 2015 Pension Adequacy Report: current and future income adequacy in old age in the EU, Luxembourg 2015, Publications Office of the European Union, p. 96.

workplace and in labour markets more generally. What is important is to detect the new risk profile emerging from reforms and to take measures to mitigate such risks and develop instruments to address them.

Comparisons of prospective TRRs for 2053 with those from 2013 show that income replacement rates from public pension schemes after a full career are set to decline in most Member States. This is in line with the AR calculations showing that benefit ratios (average pension benefit as a share of average wage) will decline significantly in most EU countries.

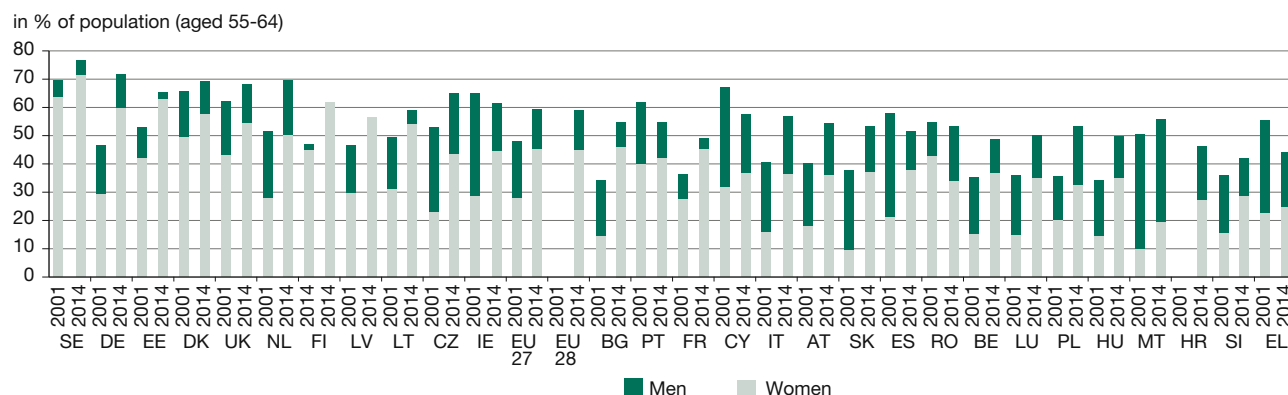
Importantly, the TRR projections highlight the particular risks from incomplete careers due to involuntary early retirement two to five years before the standard pensionable age or because of a shorter career lasting just 30 years. These results correspond with the increasing gaps

between exit and pensionable ages in several Member States identified in the projections of the Ageing Report.

Hence, the two main risks for future pension adequacy arising from recent reforms are, first, those that emanate from the reduction in the relative value of pension benefits due to tighter links to contributions and weaker valorisation and indexing, and second, those that result from career patterns that fail to match rising pensionable ages and the lengthening contribution periods.

When considering measures to mitigate the risks to pension adequacy from reduced indexation, dropping replacement rates and declining benefit levels, one tends to be confronted with the trade-offs between adequacy and sustainability concerns. If Member States are to avoid the relative value of pension benefits falling well below acceptable levels, they will inevitably need to monitor de-

Figure 2  
Comparison of employment rates of older workers, 2001 and 2014



Source: Eurostat.

developments and create appropriate fiscal space to enable benefit levels to be raised. Reforms that seek to ensure financial sustainability merely by lowering pension benefits can make it difficult to guarantee income security in old age and provide protection against poverty, and consequently they enlarge the risk of policy reversals.

### Is prolonging working life the answer?

By contrast, many recent reforms that have focused on promoting longer working lives through increases in pensionable ages and through restrictions in access to early retirement options hold greater possibilities for win-win scenarios. To the extent that working lives do increase, such reforms offer the possibility of overcoming the adequacy and financial sustainability trade-off by lowering costs and developing extra revenues, thereby creating the basis for sustainable pension benefits that are higher than they would otherwise be.

One key question is whether effective retirement ages are likely to change merely as an effect of the restricted access to early retirement and the increase in pension eligibility ages or if a set of flanking policies will be necessary to ensure the success of pension reforms. To find likely answers to this question, the PAR took a closer look at current gaps between the pension take-up and pensionable ages and at developments in the employment rates of older workers and the duration of working lives since the turn of the millennium.

As demonstrated in Figure 1, there was a considerable gap in all Member States between the age of first pension take-up and the general eligibility age. But of course

that may primarily be an effect of the access to early retirement options, and it could quickly change as many of these are phased out or as access is severely restricted.

When looking at developments in employment rates for older workers (Figure 2), it was discovered that these started to improve in most countries before significant reforms were adopted and that employment rates in general have mostly continued to increase even where reforms had yet to take effect.

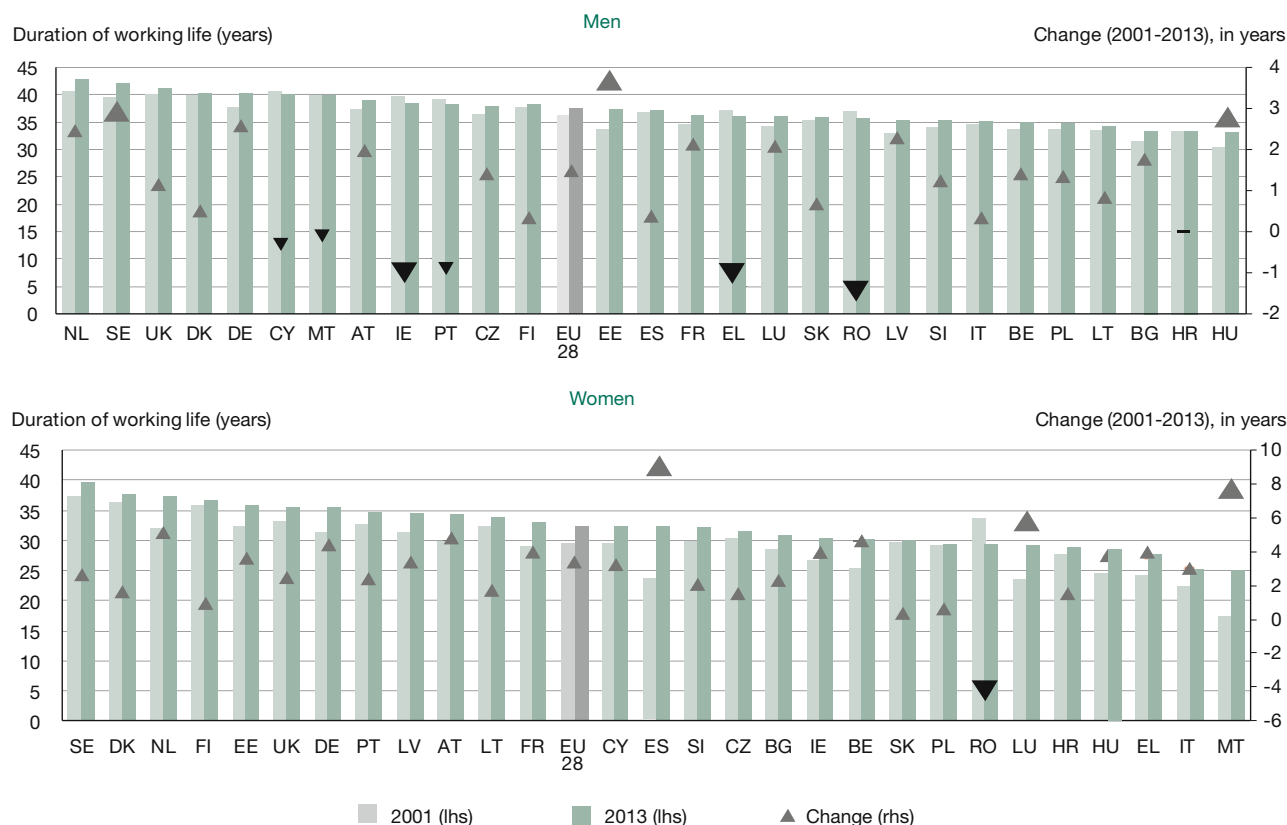
A similar lack of obvious relations between pension reforms and developments stood out when the PAR analysis looked at increases in the duration of working lives over the last decade and a half (Figure 3).

Attention therefore turned to other and additional drivers of developments in working and retirement patterns. It quickly became obvious that cohort and composition effects in the older workers age group (55-64) were likely to have facilitated the growth in employment rates substantially.

Basically, some of the earlier barriers to longer working lives receded as average educational achievement levels rose considerably, as many more older workers became employed under the less strenuous working conditions in the service sector (as opposed to manufacturing and primary sector occupations) and as the share of women increased dramatically.

Changes in age management practises in workplaces and labour markets also seemed to have played a key role in a number of countries.

**Figure 3**  
**Increase in average duration of working lives, 2001-2013**



Source: Eurostat.

The PAR also took a closer look at how factors in late-career working and retirement patterns can best be modelled. The dominant assumption that retirement can be modelled as the result of a decision by the individual worker and is primarily determined by the generosity of pension benefits generally does not hold. Retirement patterns are significantly structured by collective agreements, the organisation of work and cultural legacies. They emerge from the complex interaction between several different factors located in workplaces and labour markets, in tax/benefit systems, and in health and family conditions. A useful typology of retirement patterns distinguishes between push, pull and jump factors, and when looking at what motivates one to work longer, one merely needs to distinguish between positive and negative reasons for continuing to work – or what have been labelled as stay and stuck factors.

Finally, one needs to distinguish between working longer through retention and through rehiring and also separate between retention in the same job and retention in a “new” or changed job.

On that basis, the 2015 PAR found strong reasons to doubt that changes in pension systems would be sufficient to deliver the longer working lives required to ensure pension adequacy. However, time constraints did not allow it to fully investigate the implications of these insights into the drivers and motivations of retirement patterns. Instead, these questions will be examined in further work with the OECD, which will feed into the future monitoring of pensions and late-career labour markets in the EU.<sup>3</sup>

With regard to the general decline in net replacement rates from public schemes in most Member States, it will be important to give people the opportunity to recoup some of the loss, not least by ensuring that working longer and delaying pension take-up will be rewarded, for example by easing the limits on combining work income with pension benefits. Such opportunities exist in the reformed pension systems of most Member States but not necessarily in the right proportions. There are also coun-

<sup>3</sup> Concerning this work, please see European Commission: Conference: Identifying ways of raising effective retirement ages, 2016.

tries that still need to take steps to ensure that working longer brings improved pension entitlements.

### Obstacles to longer working lives

Some of the people most likely to be affected by the obstacles to longer working lives with fewer interruptions can be clearly identified already. For example, in several Member States, young people have been among those most affected by long-term unemployment since the onset of the crisis. Moreover, when they get a foothold in labour markets, it is often through short-term or otherwise precarious work contracts involving low wages with little or no pension coverage and relatively short working careers with limited pension accrual.

Non-EU migrants are also particularly exposed to the threat of accruing short work histories, partly due to late entry into the labour market – particularly those parts of the labour market with regular pension coverage – and partly due to wider problems with regard to educational, social and economic integration. The risk of ending one's working life with a pension-entitling career of only 30 years is much greater for women than for men, largely due to the length and frequency of their career interruptions to fulfil caring and household duties and the often associated higher frequency of part-time work. Even if increasing female employment rates lead to increased entitlements in contributory pension schemes, many are liable to fail to accrue rights to more than a minimum pension. Moreover, though both men and women are forced into early retirement five years before the pensionable age at about the same frequency, women are currently more likely to be low-wage earners and therefore more affected by the resulting risks of low pension levels and poverty.

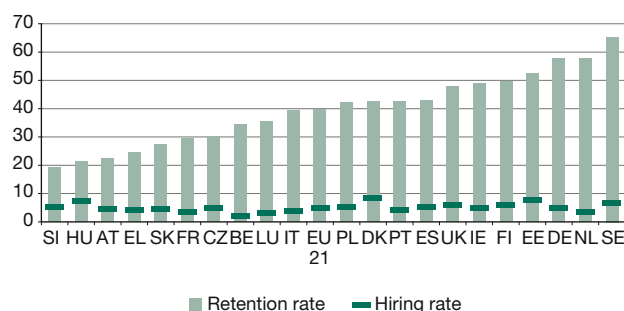
Supply-side factors that may make it difficult for older workers to continue working until they reach the pensionable age include reduced workability (including for work-related health problems) and reduced employability (including due to out-of-date skills and reduced productivity and adaptability).

Demand-side factors include the lack of flexibility in working arrangements; possible negative perceptions of older workers and age discrimination affecting hiring, firing, and promotion processes; as well as the absence of appropriate age management in workplaces.

A further important obstacle on the demand side is the difference between working longer through retention versus rehiring. Figure 4 shows that, while the retention rates of those aged 60 or over can be significant in some

**Figure 4**  
**Retention and hiring of older workers, 2013**

in %



Notes: The retention rate refers to employees currently aged 60-64 with tenure of five years or more as a percentage of all employees aged 55-59 five years previously. The hiring rate refers to employees aged 55-64 with job tenure of less than one year as a percentage of all employees aged 54-63 the year before.

Source: OECD: Working Better with Age: Poland, Paris 2015, OECD Publishing.

Member States, the hiring rate of workers aged 55-64 is dismally low in all countries. On one hand, this indicates that longer working lives are fully possible as long as they occur through retention, as managers appear more positive about employing older workers who they already know. On the other hand, the thresholds for recruiting older workers are much higher than for prime-age workers. In terms of rehiring, the labour market for people aged 55+ is seriously limited in all 21 EU countries covered.

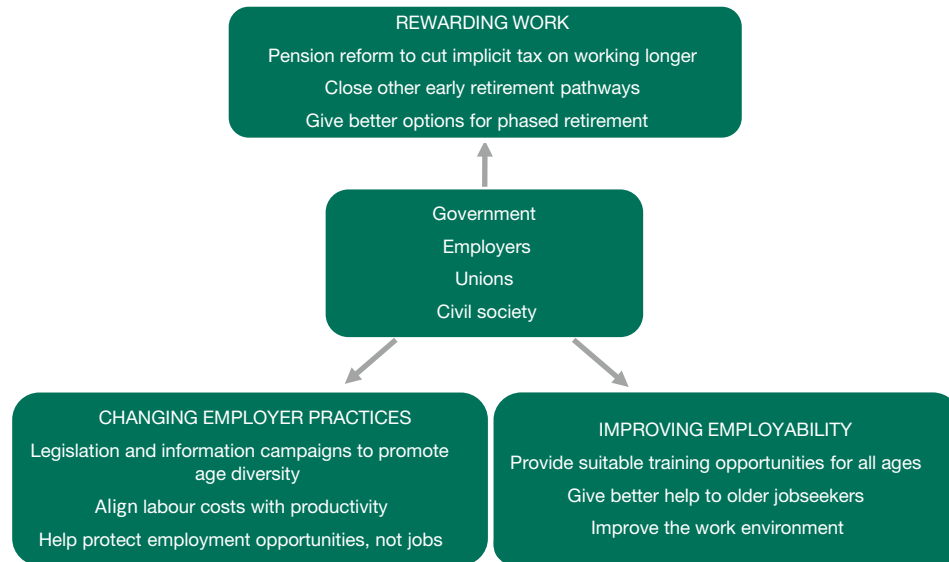
### Mitigating risks

When it comes to mitigating adequacy risks linked to the uncertain ability of labour markets to respond to the extra supply of labour from older workers resulting from pension reforms, policy makers in the fields of pensions and employment have a mutual interest in delivering on longer working lives.<sup>4</sup> In pensions there is a need to secure future adequacy, while in employment there is a need to counteract the decline in the labour supply from a shrinking working age population.

<sup>4</sup> Recognition of a common interest in raising effective retirement ages by enabling and motivating women and men to work to higher ages formed the basis for the joint workshop with the OECD of the SPC and EMCO on 12-13 November 2014, at which the chairs of the two committees pledged to intensify collaboration on the goal of "delivering longer working lives and higher retirement ages"; see <http://ec.europa.eu/social/main.jsp?langId=en&catId=88&eventId=1020&urtherEvents=yes>.



Figure 5  
Policy mix needed to deliver longer working lives



Source: OECD, Older workers reviews (2014, 2015).

Mitigating future risks to pension adequacy from early retirement or short careers would appear to depend on the development of appropriate measures in workplaces and labour markets that enable and encourage women and men to have longer working careers with fewer interruptions and to defer retirement until they fulfil the requirements for a full pension. To deliver on longer working lives, policy makers will therefore need to work on both the demand and the supply side of late-career labour markets and do so in close cooperation with the social partners. This implies a complex agenda of interrelated policies and measures.

Ideally, Member States would transform “early retirement cultures” into “working longer cultures”. The type of policy mix needed to deliver longer working lives and higher pension take-up ages is illustrated in Figure 5. Rewards from working longer must be sufficient to compete with the benefits of retirement. If policy makers are to ensure that a larger proportion of older workers are in employment, they need older workers who in terms of employability and workability are able to work longer, and they need to ensure that workplaces and work practices can exploit the potential of this segment of the workforce.

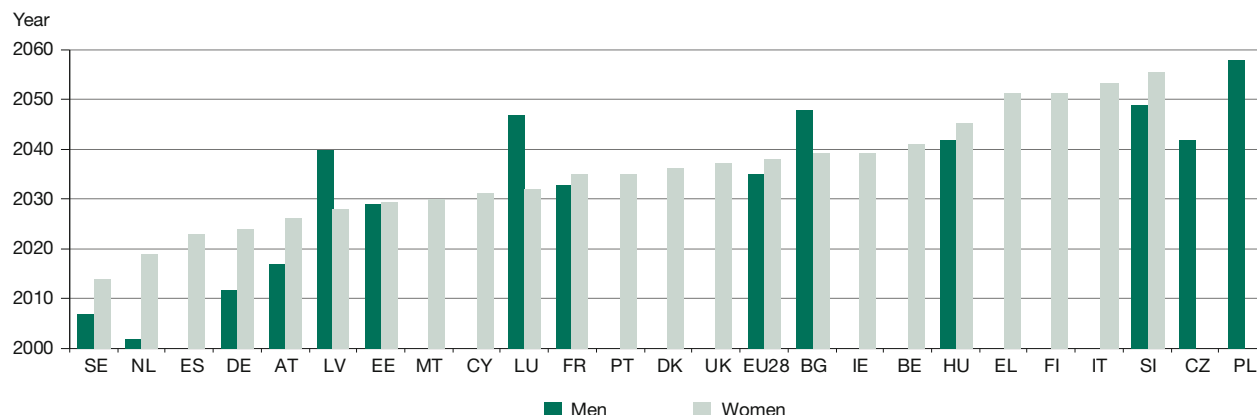
All of this implies that the agenda for adequate income maintenance in old age will increasingly overlap with the general agenda for employment and adequate income in working age. Measures that reduce longer-term unem-

ployment among youth and ensure early labour market integration under normal contractual conditions including social protection coverage will also contribute to lowering the risks to pension adequacy. The agenda for promoting the earlier and better integration of non-EU migrants into labour markets and society is also an essential part of a programme for reducing risks to income maintenance in old age. Policies for reducing gender gaps in pay, working hours and career length are, likewise, active means of narrowing the gender gap in pension entitlements.

Still, extending working lives at the “upper end” of people’s careers presents a challenge not fully covered by the general employment agendas above. Flexibility in working arrangements (e.g. working hours, working time, degree of autonomy in work organisation, job rotation, etc.), including actions to improve the reconciliation of work and family obligations, can be important for workers of many ages and is proving a particularly useful instrument for enabling and encouraging labour force participation at higher ages. Improvements to working arrangements have an important role to play in helping older workers stay in the labour market longer, either by preventing occupational diseases and the premature erosion of work abilities or by offering reasonable accommodation in working arrangements to fit the evolving needs and preferences of workers. Overall, it is one of the key measures required to encourage and enable women and men to extend their working lives.

Figure 6

**Date when average working life duration reaches 40 years, if 2000-2013 trend continues**



Source: European Commission: The 2015 Pension Adequacy Report: current and future income adequacy in old age in the EU, Luxembourg 2015, Publications Office of the European Union, p. 236.

Furthermore, even where reasonably successful, these agendas for employment and adequate income in active years are unlikely to remove the need for safeguards in pension systems that can protect people from poverty risk. As pensionable ages rise, the need for some form of premature retirement benefit and for minimum and basic pensions is likely to increase. Consequently, pension policy may need to devote more attention and greater resources to poverty protection functions in the future. In addition, some form of credit for involuntary absence from employment will also be called for in order to reduce the impact of illness, unemployment, caring duties, etc. on entitlement accruals.

With regard to this need for some form of “work-to-pension bridge”, it is necessary to avoid re-installing work disincentives or early retirement traps that have been experienced in the past. Forms of social protection that strike the right balance between protection and disincentives will have to be developed. The instruments in the social protection arsenal that are presently available to most Member States and which come closest to serving the purpose would seem to be a form of carefully scrutinised access to disability pensions combined with access to protected jobs, possibly with in-work benefits. Organising access to minimum or basic pensions without undermining work incentives in earnings-related pensions will be challenging. However, incentive problems with respect to minimum income provisions for older people and supplementary allowances are likely to be far smaller, in so far as they are needs-, income- or means-tested.

## Conclusion

There are two key messages to policy makers emerging from the analysis of the risks to pension adequacy from obstacles to longer working lives and later pension take-up. Policy makers and the social partners should prepare better for rising pension ages and the phasing out of early retirement and take more determined measures to align working lives with reformed pensions through changes in age management in workplaces and labour markets. Together they are well-placed to establish more appropriate and better functioning labour markets for people aged over 55. De facto extension of the working age can both help counteract the decline in labour supply due to population ageing and ensure opportunities for a larger share of people to acquire pensions that offer adequate income maintenance in old age.

In terms of social protection, policy makers should prepare for the fact that not all groups and individuals can work to higher ages and have longer, or less interrupted, careers. While the majority can expect to meet the new requirements – or at least be enabled and motivated to do so – there will be some who cannot. For these it will therefore be necessary to continue some form of “work-to-pension bridge” in social protection and to provide some poverty-avoiding pension benefits as well.

In conclusion, core uncertainties concern the average length of contributory careers people will be able to complete in the future. The crucial question is whether combinations of structural changes facilitating longer work-

ing lives, incentives in pension reforms and underpinning policies securing the right changes in age management practices in workplaces and labour markets can deliver on pension adequacy for EU Member States.

Despite all of the risks and uncertainties, we end on an optimistic note. As Figure 6 illustrates, if the speed of in-

creases in employment rates and the duration of working lives experienced over the last 15 years were to continue, the EU would reach an average working life duration of 40 years – which pensions are counting on – before 2040. Policy makers must work with the social partners and ensure that the right bundle of policies are put in place and implemented with sufficient determination.