ESIP Workshop briefing: "Pension systems' sustainability and adequacy in an ageing society"

ESIP hosted a public workshop on March 27, 2024, titled "Pension systems' sustainability and adequacy in an ageing society." Discussants addressed the impact of Europe's ageing population on the long-term sustainability of pension systems, while also ensuring that all workers, including those in non-standard employment, receive sufficient retirement benefits.

Demographic Changes: State of play & projections

All panellists agreed with the chair of the ESIP Pension Standing Committee, Zofia Czepulis-Rutkowska's contextualisation. She highlighted in her introduction of the workshop that ageing population as a key challenge across Europe. The fertility rate in several EU Member States is approximately 0.7 children per woman, while the population of individuals reaching 80, 90 or even 100 years of age continues to increase. Furthermore, it is anticipated that the population will decrease in several EU Member States. The latter development not only poses a serious challenge for national pension systems' sustainability and stability (over the next 20-30 years) but also for the long-term care sector as stressed out by Zofia Czepulis-Rutkowska (Senior researcher, Institute of Labour and Social Studies, Director of International Cooperation Department, Polish Social Insurance Institution, ZUS).

As a result, an increasing number of individuals are exiting the job market, where the so-called baby boomers have already begun reaching the age of retirement as explained from national experience in Austria as mentioned by Verena Zwinger (Special Advisor, Department for national and international fundamental issues, Austrian Pension Insurance, PV) or in Poland as pointed by Paulina Jarmuż-Zawadzka (Chief Specialist, International Cooperation Department, Polish Social Insurance Institution, ZUS). However, despite the existence of policies and measures that promote greater participation in the labour market, those are insufficient to fully meet the financial requirements of the pension system.

In addition, migration has a significant impact on demographic changes, but its effects vary. Southern European countries, for example, experience a brain drain as many highly educated young individuals travel abroad for employment, while other Member States have a large number of foreigners from either another EU Member State or a third country. Francesco Verbaro (Senior Advisor, Association of the pension schemes of liberal professions in Italy, AdEPP) says that southern countries like Italy suffers from the lack of contribution from its younger generation which significantly impacts the stability of the country's system in the long term. On the other hand, countries with immigration receive larger contributions, provided that these workers actively participate in the formal economy.

The evolution of the world of work: how to include the non-standards workers in the system

Our panels have shown that the evolving world of work also affects the evolution of pension systems. It impacts the adequacy of pensions for individuals who have held non-permanent and/or part-time employment at some point in their lives. These flexible and diverse career pathways become ever more common. The experts invited to the workshop agreed that some categories within these groups were excluded from the overall system and hence did not participate in the pension contribution system. This includes platform workers and the younger generation who often engage in many unpaid internships or flexible jobs. If these occupations have limited duration, it has an undesirable effect on individuals' pension plans as pointed out by some of the panellists representing national Pension schemes. This is because their contributions to the pension scheme begin at a later stage, which adversely impacts their pension benefits, especially in a contribution-based system.

Furthermore, an increasing number of countries are considering the expansion of coverage and enhancement of social security for self-employed individuals. According to Maciej Lis (Economist, Social Policy Division, Directorate for Employment, Labour and Social Affairs, OECD), although EU countries treat self-employed individuals in very different ways in their pension systems, many of them try to include them similarly to employees. Still, some Member States, like the Netherlands and Germany, exclude self-employed individuals from the requirement to participate in the earning-related pension for various reasons.

Regarding this matter, governments adopt diverse strategies regarding the contribution of self-employed individuals. In certain countries, like Finland as confirmed by Aart-Jan Riekhoff (Senior Researcher, Finnish Centre for Pensions, ETK), the authorities inquire about the potential wage that someone who is self-employed might make if they were working as an employee. The contributions would be subsequently estimated using the virtual wage, but, this system exhibits deficiencies, prompting decision-makers in those countries to strengthen the regulations. In a number of countries, all self-employed are required to pay a fixed amount to participate in the social protection system.

It is noteworthy that an ever-increasing number of individuals have chosen to initiate a business endeavour and assume the role of self-employment, either partially or completely, while concurrently participating in the regular employment system. This reality highlights the limitations of our Pension system, which is still mainly centred on outdated assumptions of career trajectories. The process of transitioning from one system to another can then be arduous and involve significant administrative responsibilities, especially in regard to pension contributions.

Nevertheless, Verena Zwinger explains that the Austrian pension system responds to such challenges as it permits the transfer of both schemes' contributions and credits in a reciprocal manner. This implies that persons who have chosen to terminate their employment contract in order to become self-employed might rejoin as employees after a few years without forfeiting any pension contributions. In addition, those who have chosen to engage in both a part-time work and a part-time self-employed activity have the opportunity to aggregate their contributions, resulting in a higher pension payout in the future and greater adequacy.

In addition, Aart-Jan Rieckhoff addresses the concept of low-activity self-employment, which is demonstrated by the light entrepreneurship principle in Finland. This is a type of self-employment where an individual acts as an entrepreneur but uses an invoicing service offered by a third-party corporation to handle payments on their behalf. Since 2017, they are regarded by the pension system as self-employed persons as they were classified as employees of the invoicing company beforehand. For about three fourth light entrepreneurs the annual income (from their entrepreneurship activities only) falls below the threshold of 9,010€ meaning, there is no requirement for them to make any pension contributions for their light entrepreneurial activities. The majority of them are employed elsewhere and engage in light entrepreneurial activity as a side labour. The number of light entrepreneurs has increased from 23,000 in 2017 to 68,000 in 2022, making it a highly popular phenomenon.

This example demonstrates the significance of implementing innovative strategies to facilitate the autonomy of all individuals, particularly those who depart from the labour norm, in exploring new occupations.

Solutions

Agnieszka Chłoń-Domińczak (Member, High Level Group on the Future of Social Protection in the EU and Vice-Rector, Research and Director, Institute of Statistics and Demography, SGH Warsaw School of Economics, Poland) outlines three main approaches to address the impacts of demographic changes on Pension systems: 1) Decreasing future pension rates; 2) Increasing the age at which people retire; 3) Leveraging available resources in the employment market. Implementing the first option appears challenging due to the likelihood of causing a problem with pension adequacy. The second option will only be taken into account under specific conditions, as it is a highly political action. The third solution is unanimously regarded by all our panellists as the foremost priority.

For instance, Portugal as pointed out by Susana Rosa (Director, National Pensions Centre, Institute for Social Security, Portugal, ISS) has implemented a system in which the retirement age is directly tied to life expectancy. Encouraging people to participate in the job market will help ensure the long-term financial stability and support adequate solutions for old-age pensioners as Zofia Czepulis-Rutkowska expresses that Pension sustainability and adequacy are two sides of the same coin.

Adequate Pensions

Building on Agnieszka' Chłoń-Domińczak's perspective of addressing the difficulties of ageing, Maciej Lis raised the issue of balancing sustainability and adequacy in pension systems. He emphasised that secured financing plays a crucial role in guaranteeing both the sustainability and adequacy of pensions in longer term. If decision makers wish to provide greater benefits, they would need to provide more funding to avoid long-term sustainability issues. In addition, he highlighted that some European countries, such as Hungary or Poland, have introduced financial bonuses to motivate individuals to work for longer periods, as increasing retirement ages and imposing sanctions on leaving labour market early have become more difficult politically.

Paulina Jarmuż-Zawadzka informed that Polish retirees are allowed to supplement their retirement benefits with additional income without any restrictions, assuming they have reached the official retirement age and their job contract, which began before their retirement, has been formally terminated.

Partial old age pension serves as a means to extend one's period of contribution. Partial pension has gained popularity in Finland due to the elimination of early retirement options. From the age of 61, workers have the option of claiming either 25% or 50% of their pension. Yves Stevens (KU Leuven) observes a noticeable change over the past decade among the Member States, as debates have shifted towards finding ways to bring together employment and retirement.

Pension system's sustainability

Maciej Lis argues that increasing the retirement age alone would not be a sufficient long-term solution for many countries. This is because the population is expected to shrink by as much as 10% to 20% in some of them. Therefore, he adds that It is important to incentivise more individuals to participate in the system and contribute. This process involves labour market activation and transitioning individuals from the informal economy, such as platform workers, to the formal one. According to him, this would enable the government to gather further contributions.

Hence, the sustainability of pensions is also dependent on employment policies. As Francesco Verbaro rightly pointed out, the world of work is undergoing rapid transformations. Therefore, it is crucial for decision-makers to closely monitor these changes to implement the most appropriate employment policies, which will ultimately have an impact on the social protection system.

Latest Pension reforms

Yves Stevens (Full Professor & Academic Director, KU Leuven, Belgium) used the opportunity to dive into the complexities of pension reform dynamics. He subsequently clarifies that pension reforms mostly result from an ideological narrative, while being perceived as very technical.

There are two distinct categories of reforms according to him: parametric reforms and structural reforms. Parametric reform is a revision that targets a particular aspect of a system, such as the retirement age. A structural change completely transforms the system. However, the parametric reform can still impact structurally the system due to substantial changes. He proceeds to inform us about the French pension system. Annually, the social partners convene to collectively determine the valuation of a point, as the system is point-based. Under those circumstances, it is evident that the modification is of a parametric nature. However, it can have a significant impact on both the adequacy of pensions and the sustainability of the system, thus affecting the entire structure.

Ultimately, every reform leads to various outcomes. According to the Rumsfeld Matrix, the reform has known and wanted repercussions, as well as unknown and unwanted effects. However, there are also unknown and unwanted consequences. The latter primarily arises when there is an extended transition phase or numerous exceptions to the overarching rule.

Regardless, the success of a pension reform is contingent upon the public's trust in the system. As an illustration, sustainability has emerged as the foremost concern in Finland. Aart-Jan Riekhoff informed us that the government has made the decision to reduce spending in the Pension system by 1 billion €. In order to accomplish this, they have designated the social partners to achieve a common agreement enhancing the trust in the system.

In addition, Verena Zwinger stated that Austria implemented measures in 2024 to achieve long-term sustainability. Austrian decision-makers have introduced financial incentives to encourage individuals to work for a longer period. This includes the alignment of the surcharges with the highest deductions of pension benefits when postponing the retirement age, while requiring individuals to contribute only half of the usual amount (up to three years). Austria has made the decision to increase the female retirement age by 6 months from 2024-2033 to align it with current male retirement age of 65 years.

Susana Rosa further clarifies that Portugal underwent three significant reforms during the past 20 years, which established the current pay-as-you-go system in the country. In 2002, a decision was made to include the entire career when calculating an individual's pension amount, rather than just the past 10 or 15 years as is the case in most countries. In 2007, Portugal implemented a new index design to strengthen and substitute the minimum wage system, which also included the minimum pension one. Ultimately, it has been determined to link the legal retirement age to the population's life expectancy, as mentioned before. Consequently, by 2025, the legal retirement age will be set at 66 years and 7 months. Collectively, these improvements significantly influenced the long-term viability of the system, while also guaranteeing adequate retirement benefits, particularly for individuals with a low income.

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