Trends in pension systems around the world

PENSIONS
GLOBAL SYSTEMS AND KEY DYNAMICS
WASHINGTON DC, MAY 2018

MONTSERRAT PALLARES-MIRALLES
EDWARD WHITEHOUSE
Multi-pillar framework

Retirement-income system

Zero pillar: mandatory, public, adequacy

First pillar: mandatory, public, mainly income replacement

Second pillar: mandatory private, income replacement

Third pillar: voluntary private

Basic
Resource-tested
DB
Points
NDC
Public DC
Minimum pensions
Private DC
Private DB
Coverage

Active members of mandatory pension systems per cent of labor force
Mandatory pensions today

- Institutional arrangements:
  - Public or private?
  - Defined benefit (DB) or defined contribution (DC)?
  - Prefunded (fully or partially) or pay-as-you-go financed?

- Pie chart showing:
  - Publicly managed PAYG DB: 43%
  - Publicly managed DB (Provident funds): 7%
  - Publicly managed partially funded DB: 31%
  - Privately managed DC: 4%
  - Public PAYG DB plus private DC: 18%
Defined-benefit public schemes in 1935
Defined-benefit public schemes in 1975
Defined-benefit public schemes in 2012
Growth of mandatory DC plans

**Number of countries**

- Chile
- United Kingdom
- Argentina
- Australia
- Colombia
- Peru
- Uruguay
- Mexico
- Bolivia
- El Salvador
- Hungary
- Kazakhstan
- Hong Kong
- Costa Rica
- Latvia
- Bulgaria
- Croatia
- Estonia
- Russia
- Lithuania
- Poland
- Sweden
- Nigeria
- Slovakia
- Korea
- Slovenia
- Croatia
- Macedonia
- Argentina
- Check Republic
- Hungary
- Kosovo
- Romania
- closed
- Bulgaria
- closed

Years:
- 1980
- 1988
- 1993
- 1994
- 1996
- 1997
- 1998
- 1999
- 2000
- 2001
- 2002
- 2003
- 2004
- 2005
- 2006
- 2008
- 2009
- 2011
- 2012
Mandatory DC plans in 2012
Conclusions

• Public defined-benefit plans spread across the globe and dominated until the 1990s
• But, pension promises are proving difficult to keep as scheme mature and populations ages
• Defined contribution plans play a growing role
• This raises new issues such as costs, investments, payouts and regulation/supervision
• There is no single World Bank blueprint to apply to all countries
• Nevertheless, there are important best-practice principles that apply to all different retirement-income arrangements
Trends in pension systems around the world

PENSIONS
GLOBAL SYSTEMS AND KEY DYNAMICS
MANAMA, BAHRAIN, OCTOBER 2016

MONTSERRAT PALLARES-MIRALLES
EDWARD WHITEHOUSE
Main themes

• Pace of change accelerated during the financial and economic crisis and beyond
• Balancing objectives of benefit adequacy and financial sustainability remains difficult
• Need for longer working lives widely accepted
• But cuts in public benefits to achieve financial sustainability leaves ‘pension gaps’
• These can be filled by greater private pension saving
Live longer, work longer
Pensionable age: 2000

Number of OECD countries

Normal pensionable age, years
Pensionable age: long-term rules

Number of OECD countries

Normal pensionable age, years
Live longer, work longer

- 18 countries have taken other steps to prolong working lives
- Tighter conditions for early retirement: higher age or longer contribution years
  - Austria, Belgium, Czech Republic, Denmark, Finland, France, Greece, Hungary, Poland, Portugal, and Spain
- Lower benefits for early retirees
  - Austria, Canada
- Improved work incentives after normal pension age
  - France and Australia in pension system
  - Portugal and Sweden through taxes and contributions
Fiscal sustainability
Reform measures

• Improved work incentives and higher pension ages will reduce costs

• Direct benefit cuts (e.g., in accrual rates) remain rare
  • Austria, Korea, Greece, Hungary

• Indirect cuts through uprating of pensions in payment (indexation)
  • Belgium, Czech Republic, Finland, France, Greece, Hungary, Italy, Norway, Slovak Republic

• Changes in earnings measure and/or revaluation of earlier years’ earnings
Earnings measures: before and after

Number of years of earnings in pension calculation

Pre-reform Post-reform

Iceland

Germany

Hungary

Japan, Korea, Luxembourg, Switzerland

United States

Canada

Norway, United Kingdom

Austria, Finland, Poland, Portugal

Czech Republic

France

Spain, Sweden

Greece, Netherlands, Slovak Republic, Italy, Turkey
Putting pensions on auto-pilot

- Automatic changes in the pension system to help financial sustainability
- Adjustments based on financial and demographic indicators
- Changing benefits
  - level at time of retirement: Canada, Finland, Germany, Italy, Japan, Norway, Poland, Portugal, Sweden
- Pension eligibility: age or contribution years
  - Denmark, France, Greece, Italy
- Contribution rates:
  - Canada, Germany
- Defined-contribution schemes are automatically sustainable and prefunded
Public pension spending: EU

Pension expenditure per cent of GDP

- 2012 projection (2010 data)
- 2009 projection (2007 data)
- 2015 projection (2013 data)
Future adequacy and private-pension savings
Role of private pensions

• Mandatory schemes
  • defined-contribution in Australia, Chile, Denmark, Estonia, Mexico, Norway, Slovak Republic, Sweden
  • defined-benefit in Iceland, the Netherlands and Switzerland

• ‘Soft compulsion’ or automatic enrolment
  • New Zealand, United Kingdom and some US states

• Widespread voluntary coverage
  • in Canada, Czech Republic, Germany, Ireland, United States
  • supported by tax incentives or matched contributions
Pensioner income sources

Share of total income of over 65s

OECD

Hungary
Belgium
Austria
Ireland
Luxembourg
Greece
Czech Republic
Slovenia
Portugal
France
Slovak Republic
Italy
Poland
Estonia
Germany
Spain
Iceland
Norway
Sweden
Denmark
New Zealand
United States
Switzerland
Netherlands
Australia
Canada

Public transfers
Occupational transfers
Capital
Work
Public pensions

Gross replacement rate
Pension, per cent of earnings

Spain
Austria
Luxembourg
Turkey
Portugal
Italy
Greece
Hungary
Finland
France
Czech Republic
Belgium
Poland
Korea
Slovenia
Germany
Canada
United States
Japan
Ireland
Public and private pensions

Gross replacement rate
Pension, per cent of earnings
Public and private pensions

Gross replacement rate
Pension, per cent of earnings
Assets: private plans and public reserves

Private plans

Public reserves

Value, per cent of GDP

Value, per cent of GDP
Security through diversity

• ‘It is the part of a wise man to keep himself today for tomorrow, and not venture all his eggs in one basket’ (Miguel de Cervantes, 1605, Don Quixote)

• Pay-as-you-go public pensions:
  • sustainable rate of return = earnings growth + employment growth

• Funded pensions
  • rate of return in capital market directly or indirectly affects pension value

• Think of pension package as a ‘portfolio’ of different ‘assets’
Conclusions

• Two key objectives for the pension system
  • adequacy of benefits (or social sustainability)
  • financial sustainability needed to ensure pension promises can be delivered
• Balancing the two is the key challenge
• Need for longer working lives
• But fiscally necessary cuts in public benefits leaves pension gaps
• These can be filled by greater private pension saving
• Greater diversity means better, safer pensions
• But public schemes must leave space for private plans to develop