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Social Protection in Aging EU Economies

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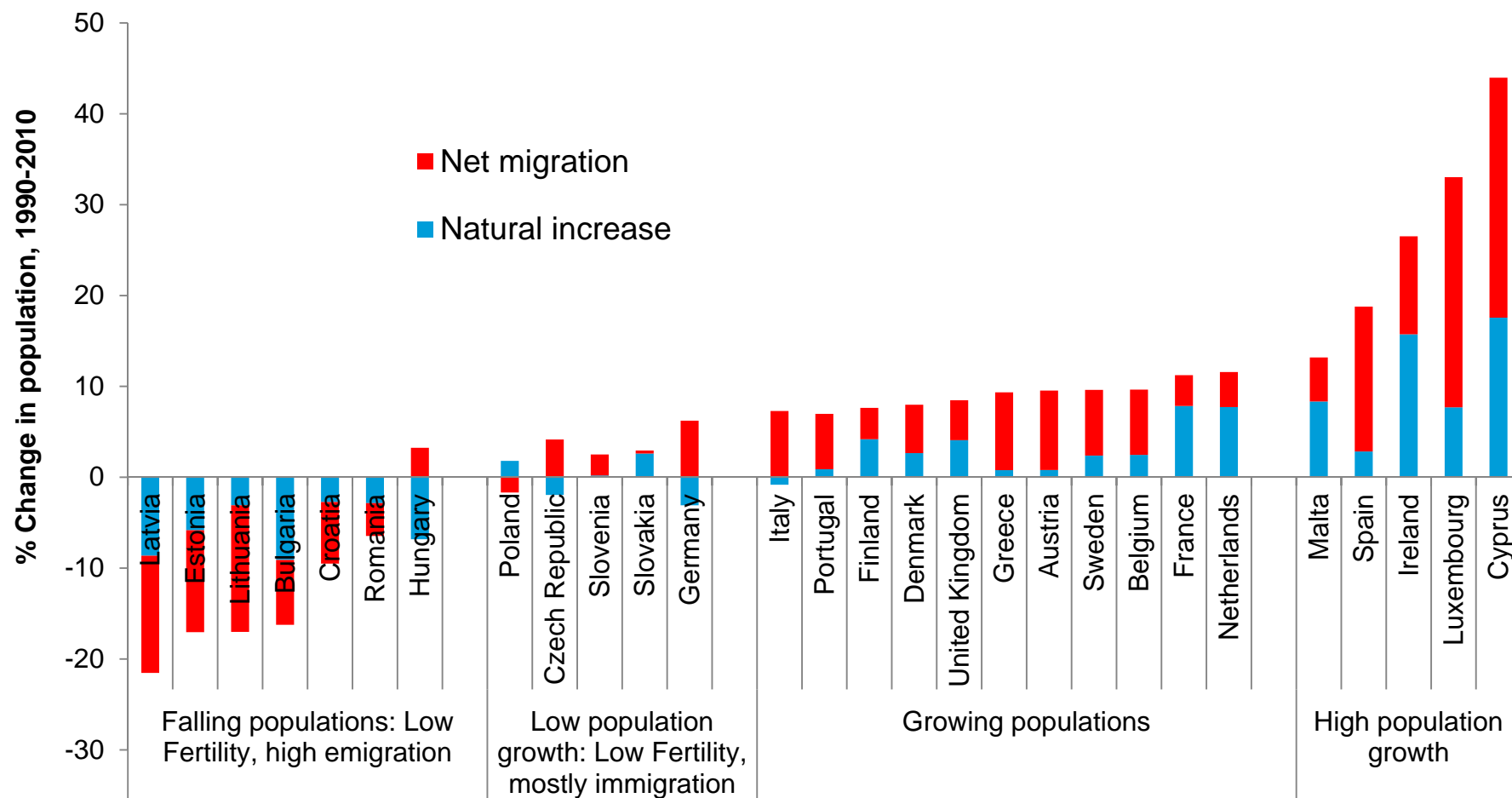
Europe and Central Asia Region

Riga

December 18, 2014

How the population ages matters for policy: Low fertility and migration have played varying roles

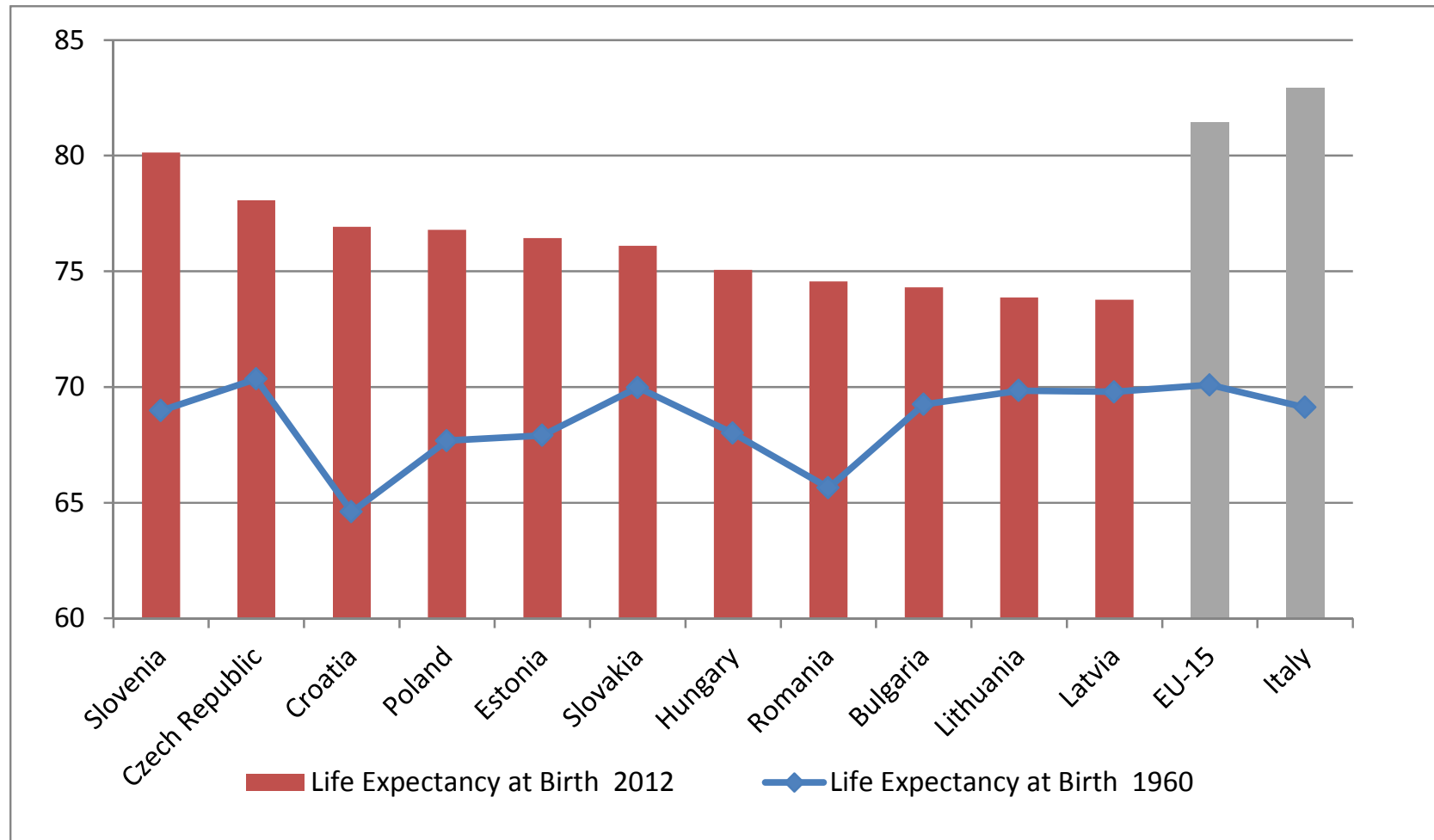
Cumulative Population change 1990-2010, in percent



Source: World Bank staff calculations based on UN Population Data (Revision 2012).

Longevity differs substantially

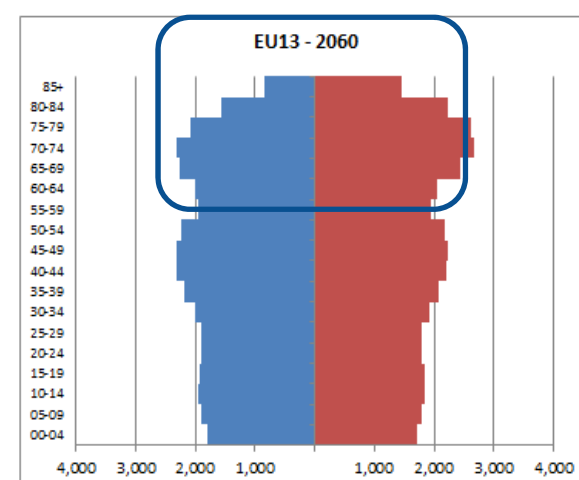
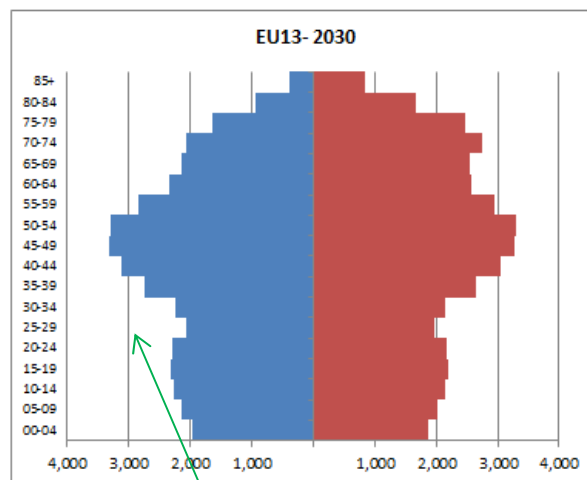
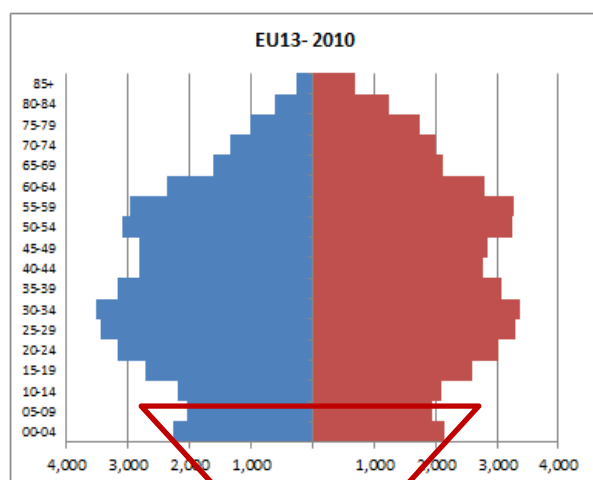
Life expectancy gains lag behind the EU-15 (with the exception of Slovenia and the Czech Republic)



Source: World Bank's *World Development Indicators Database* (2014).

Policy priorities are related to the demographic structure

Increased longevity: Increase in retirement age, reduce morbidity



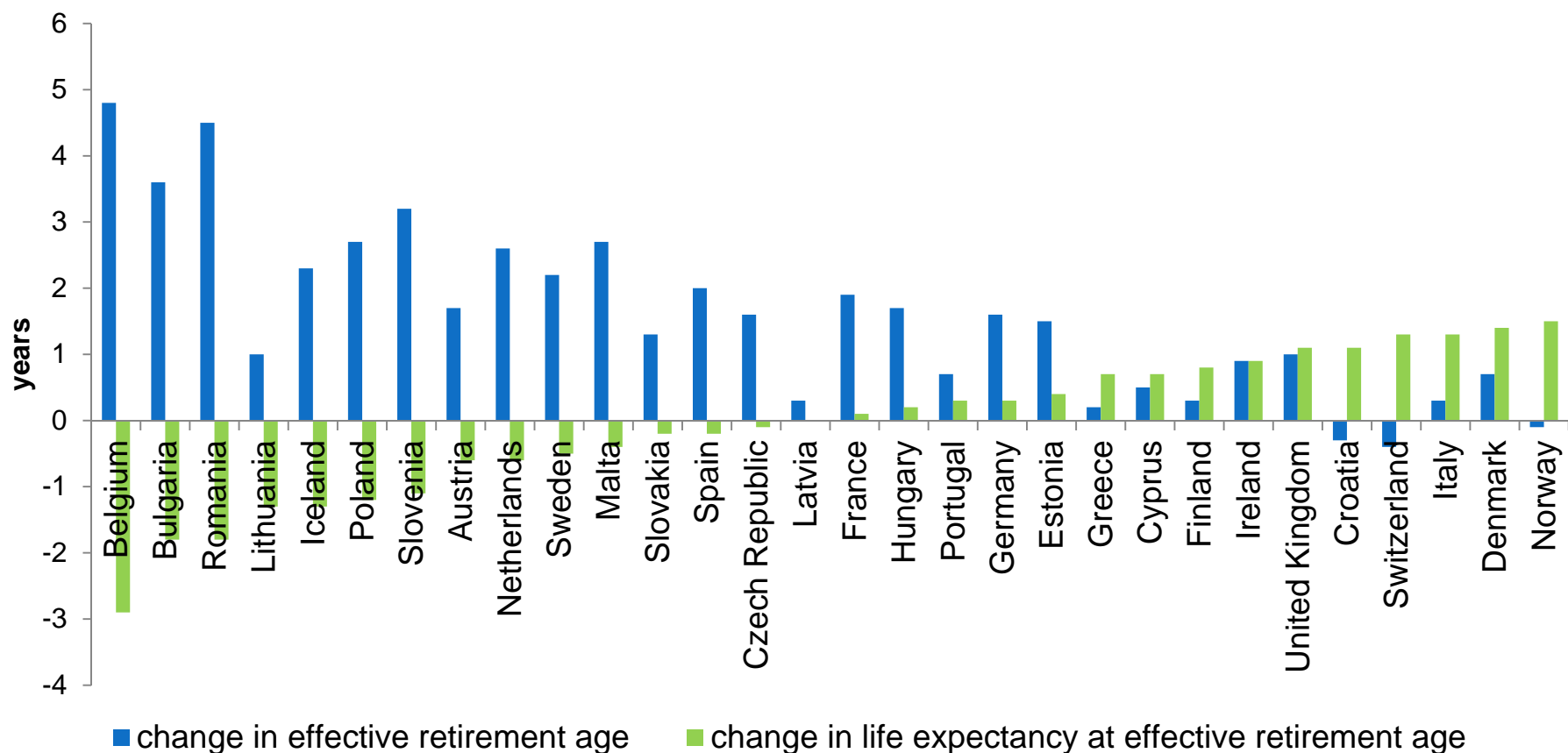
Declining fertility: Invest in human capital (health, skills) and increase labor force participation

Baby boomers: Plan to deal with large transitional generations (pensions, more deaths etc.)

Source: World Bank staff calculations based on UN Population Data (Revision 2012).

Retirement ages increased and duration of retirement fell for some countries

Change in effective retirement age compared to change in life expectancy, Selected European economies, 2001–2009

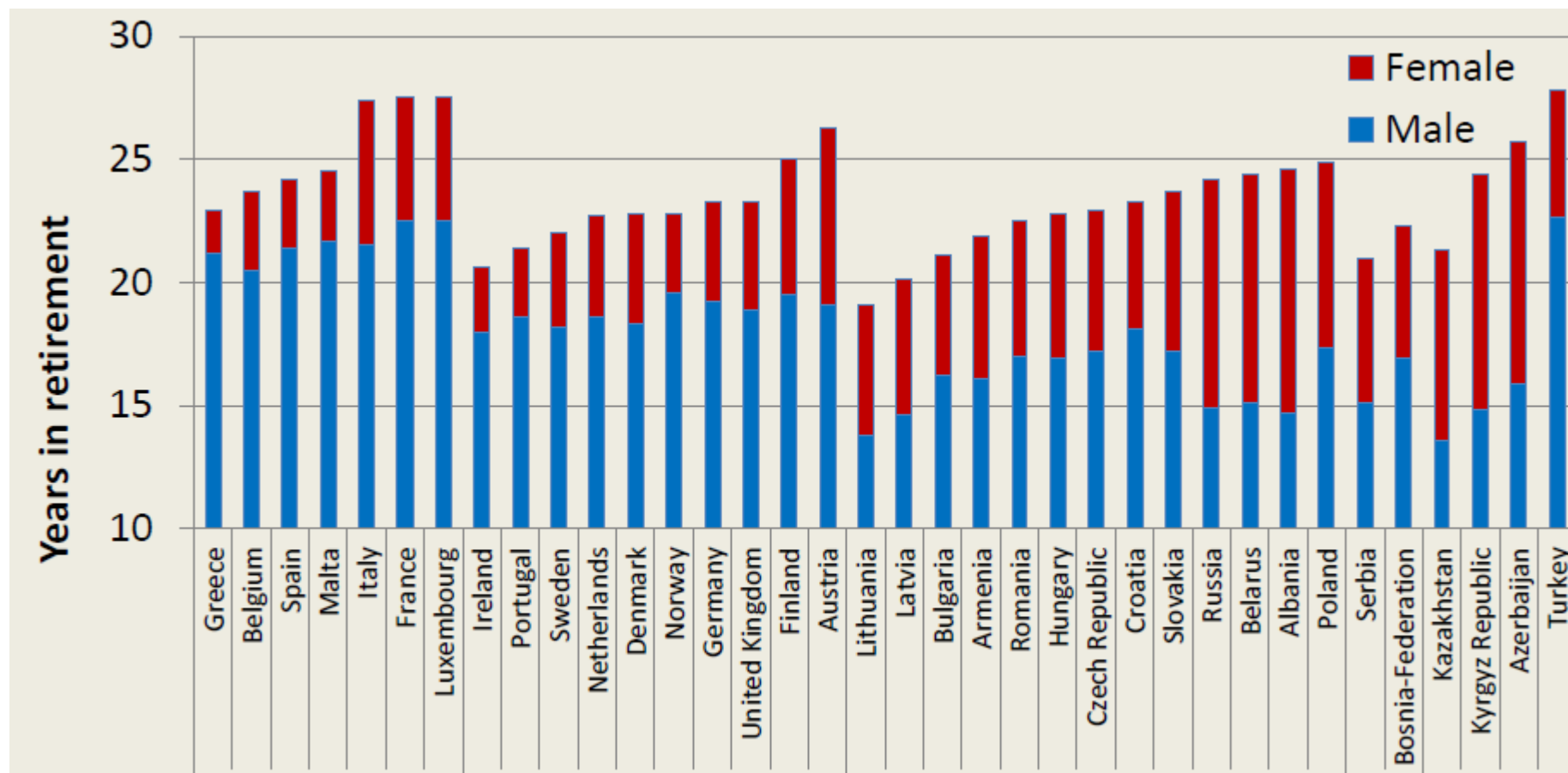


Source: World Bank staff calculations based on UN Population Data (Revision 2012).

Source: World Bank Pensions' team.

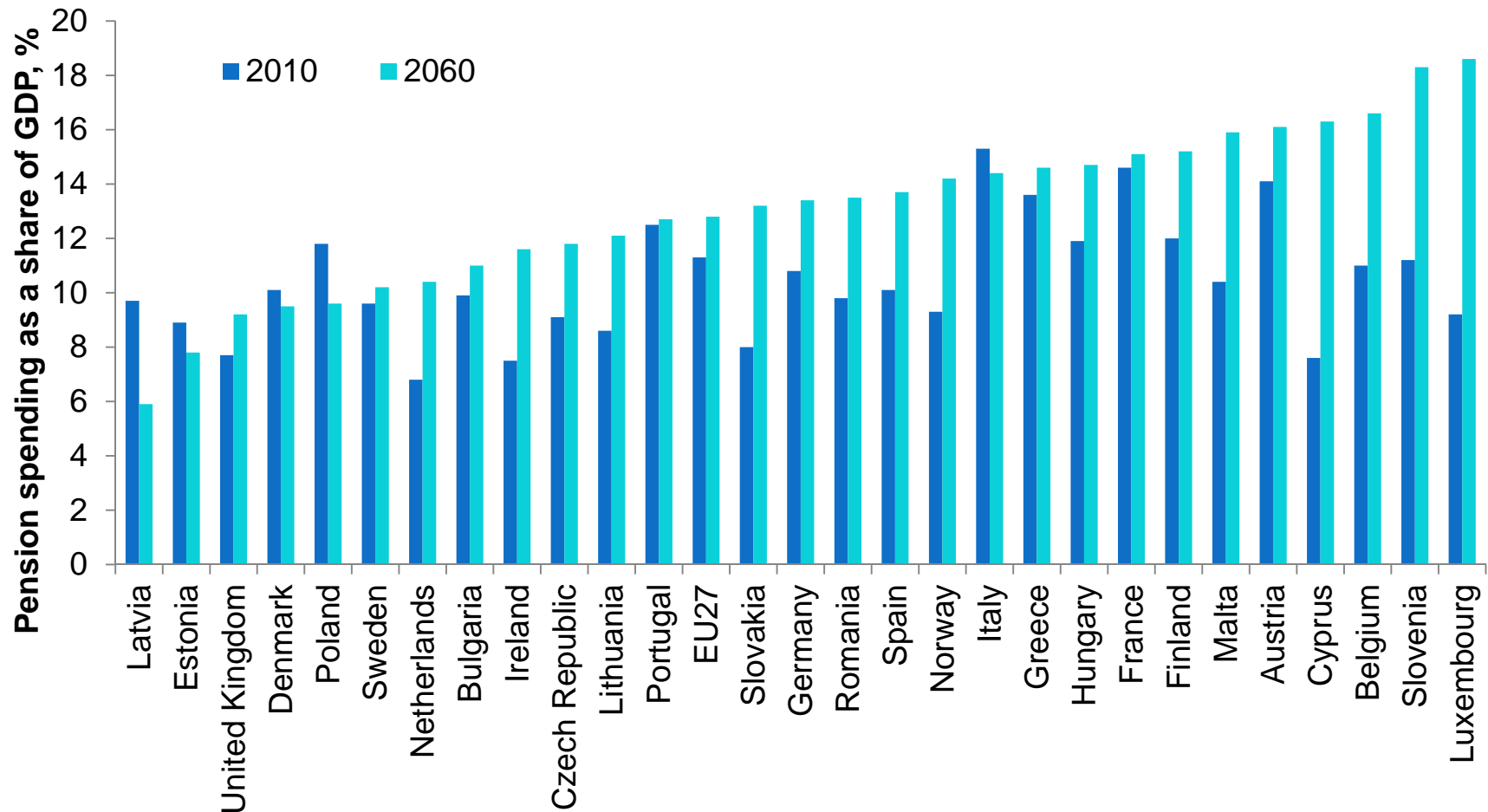
Social Protection Seminar - Latvia

Duration of retirement still remains far above 15 years

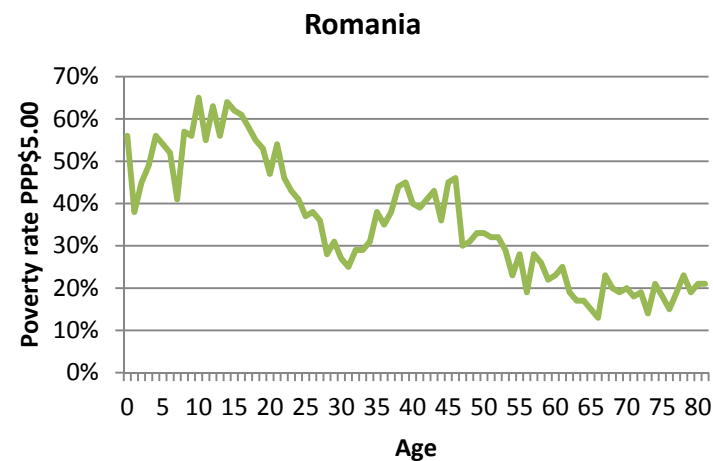
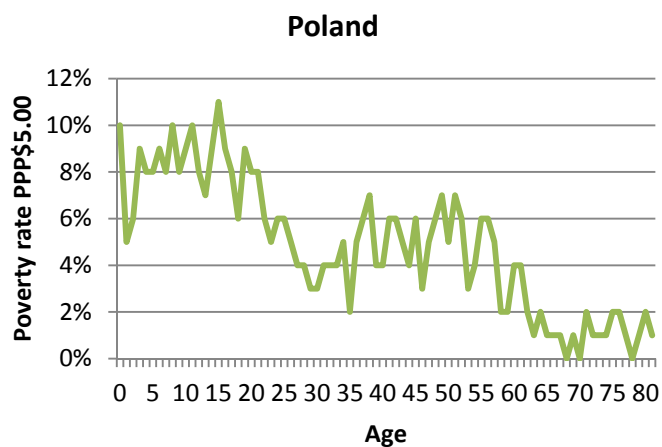
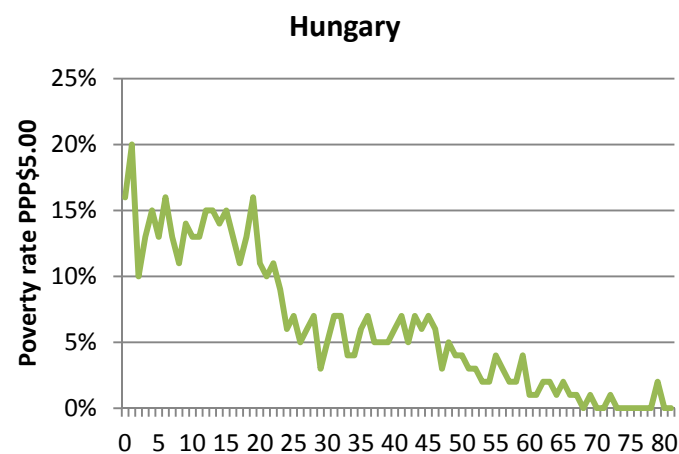
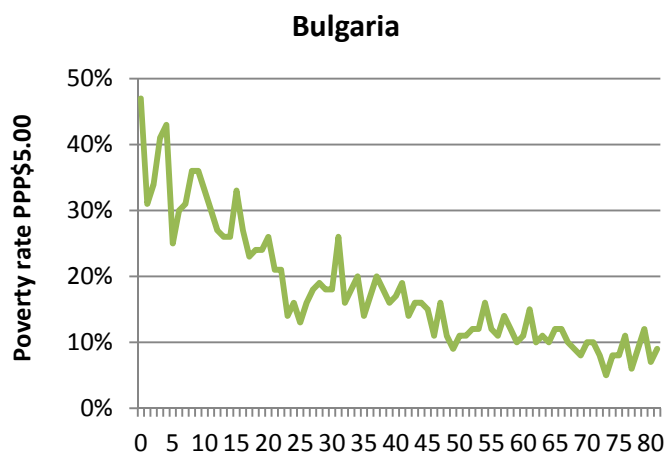


Projected coverage/benefit levels differ and translate into different rates of pension growth

Spending as share of GDP in 2010 Vs. 2060



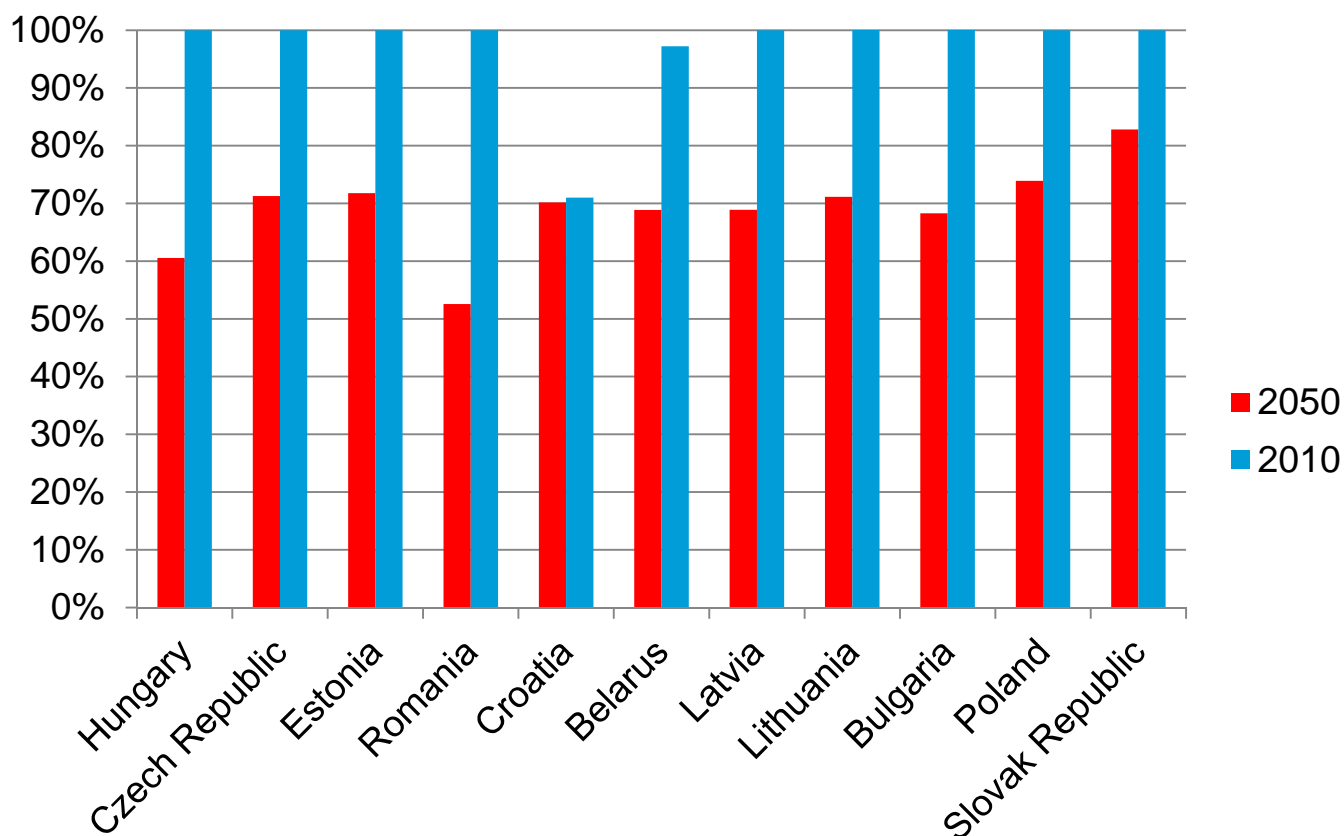
Currently pensions protect the elderly from poverty



Source: ECA Poverty team.

But pension reforms that lower coverage are likely to increase poverty

Share of elderly receiving social insurance benefits



Source: World Bank Pensions' team.

Concept of pensions has changed over time

- Moved from initially been thought of as a supplement to income from part-time work to full income source
- Became consumption smoothing insurance guaranteeing a comfortable retirement

Public pensions reforms to date

Reforms focused partly on reducing spending

- Restricted eligibility criteria: Raising retirement age; Tightening disability conditions; Raising years-of-service requirement
- Reducing benefits in the long run: Basing benefits on full-career salary; Indexing only to inflation; Lowering accrual rate

Focus on poverty prevention through generous indexation of minimum benefits

- Some adopted by default or by choice for flat, universal benefits, sometimes complemented by savings pillar

Tightly linking contributions to benefits

- Aim: Pension differentiation to match newly differentiated wages; Wanted to use incentives to combat informality
- Defined benefit systems based on average lifetime wages; point systems; notional accounts
- Added savings pillar, many countries adopted second pillar (fully-funded defined contribution)

Need more holistic approach

Pension policy changes are not enough

- Raising retirement ages without enabling workers to work longer cuts costs, but leaves some workers with an income gap, for example

Prioritize public pension spending

- If there isn't budget to provide earnings-related pensions for some and poverty relief for all elderly, priorities will have to be set
- Implications for financing and pension policy design as well as interactions with safety nets

Increase savings to maintain adequate benefits

- Instead of focus on second pillar vs. third pillar, focus on savings using mechanisms like automatic enrollment
- **Encourage longer working life through enabling policy environment**
- **Increase fiscal space if possible**

Rethinking financing pensions

Why?

- High tax wedge
- Mitigate incentives to unwind funded pension schemes

How?

- Rely more heavily on tax financing of transition deficit
 - Earmarking revenues (i.e. VAT increases in Japan)
 - Reduce subsidies (energy, SOE); Increase marginal tax rates, increase wealth/inheritance taxes

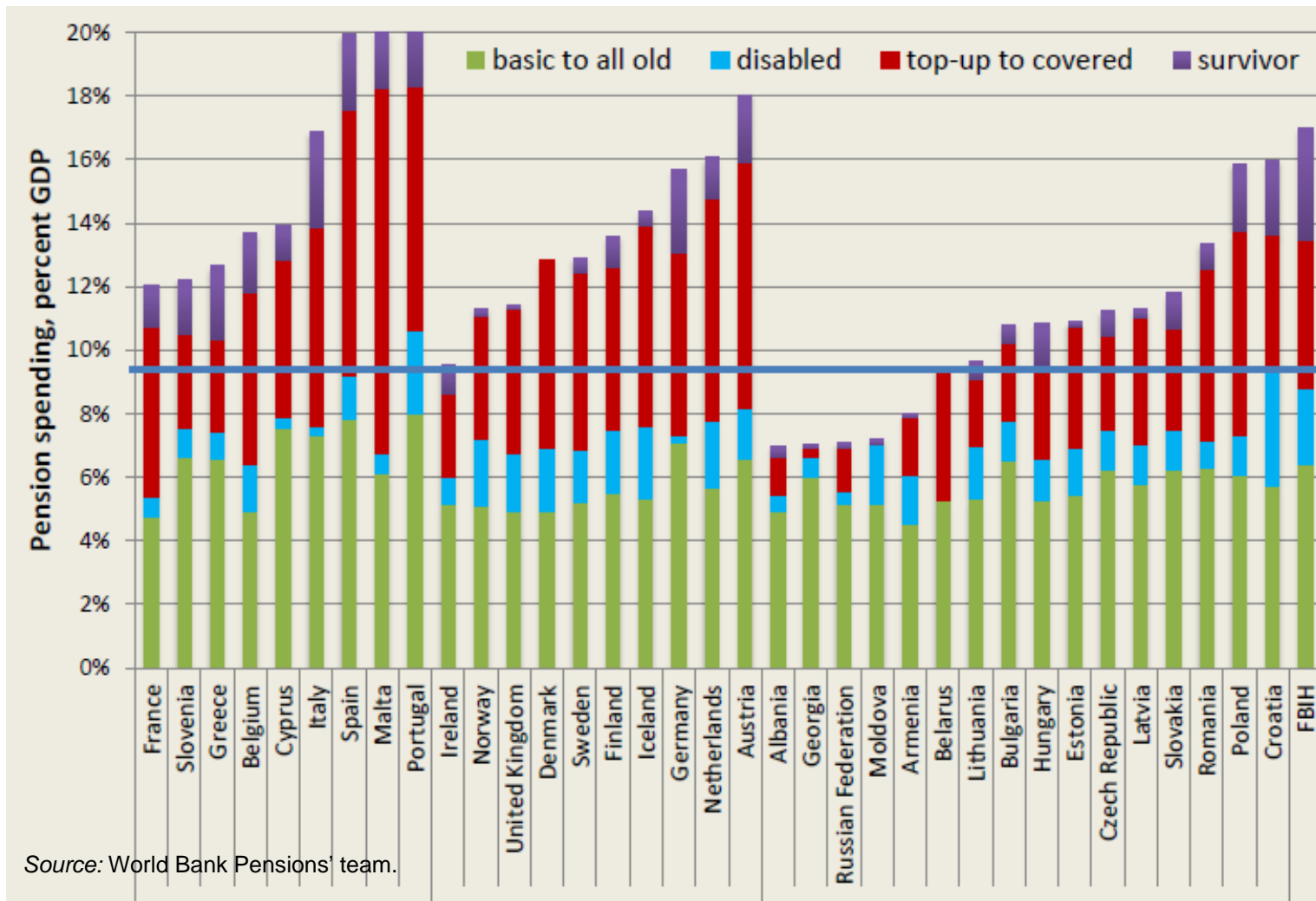
Be transparent

- Define reliable methodologies for calculating the implicit pension debt, and make these figures available to public
 - Increase awareness of government commitments that are not reported in the main variables of the Stability and Growth Pact
- **In the absence of fiscal responsibility no pension system will be sustainable**

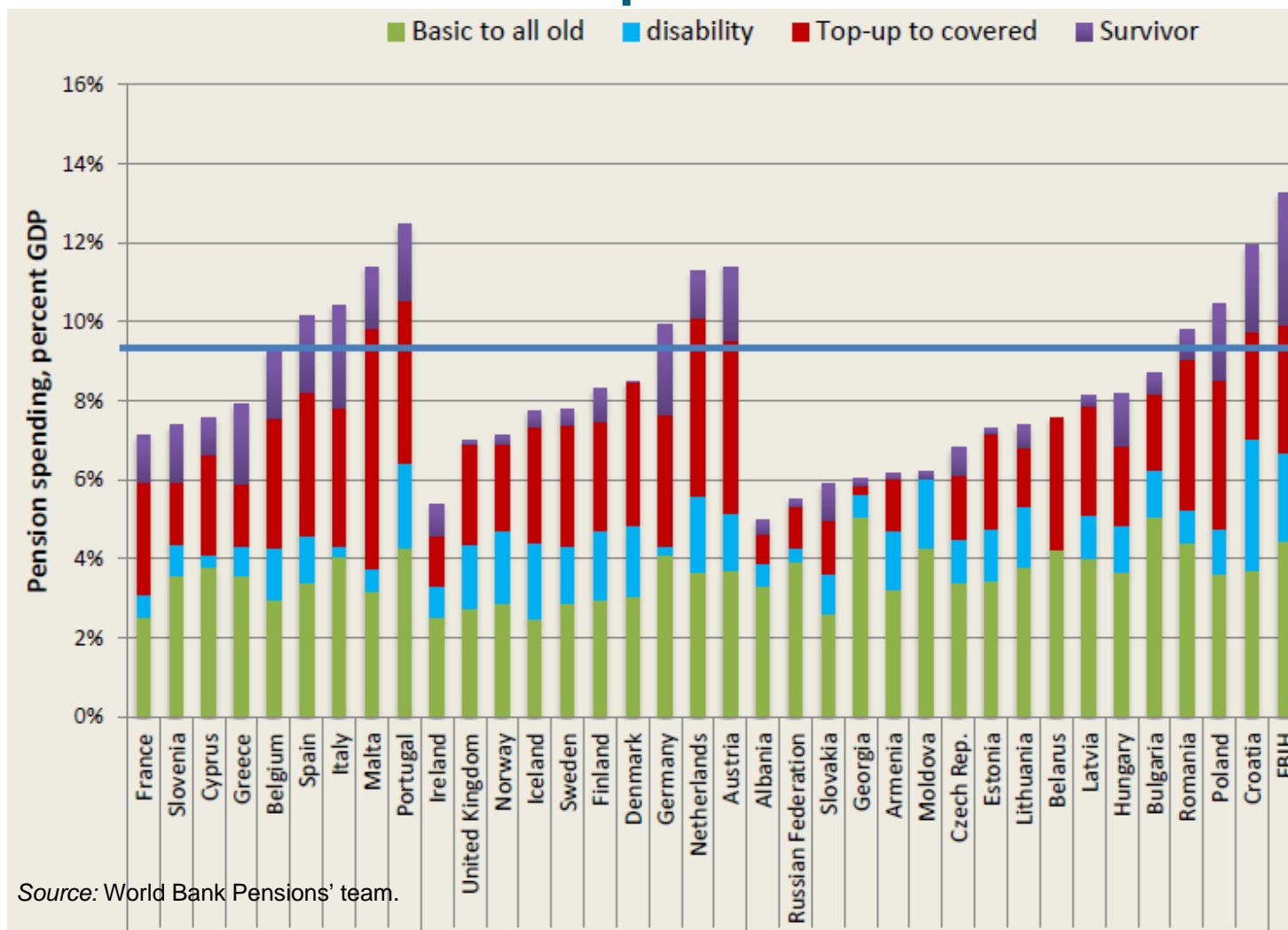
Challenge for pension fund management industry

- Centralize business areas with scale economies (reduce costs)
- Create competition in the portfolio management industry along a common default pension portfolio using lifecycle strategies
- Design payout structures that ensure proper risk allocation of investments and longevity risks

An Example Of Prioritizing Pension Spending and Costing It Out If Effective Retirement Age Is 65 with Prime Age Labor Force Participation Until Age 64 - 2050



Same Priorities As Before But With Retirement Age Where Life Expectancy Equals 15 Years and Prime Age Labor Force Participation Until Then - 2050



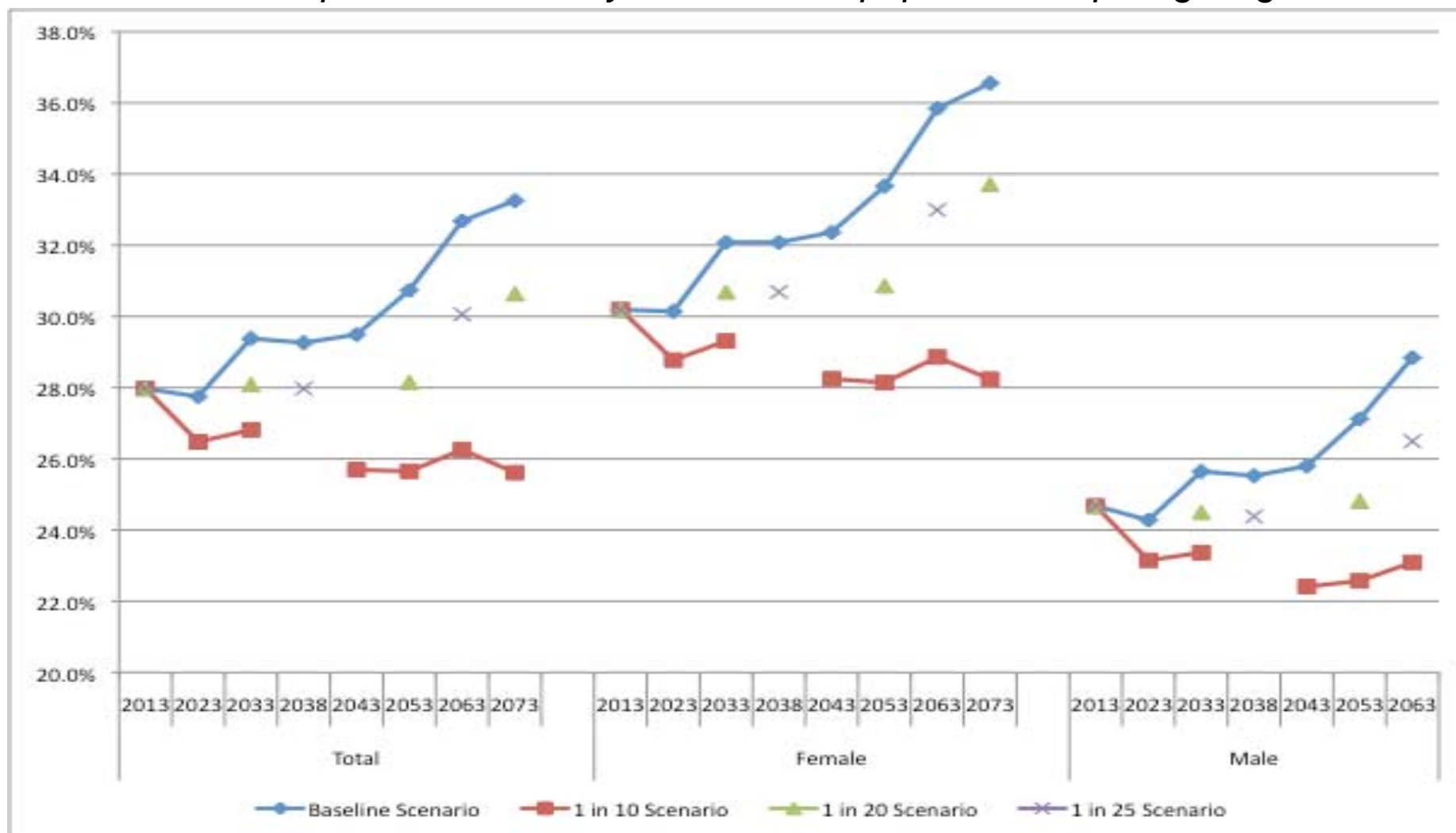
Questions

Financing pensions

- What is the scope for tax and non-tax revenue reforms to open fiscal space for financing pensions?
- Is spending reallocation possible while maintaining intergenerational equity?
- What are the implications for financing a poverty-prevention pension benefit ?
- Should we finance social/minimum pensions and/or disability benefits from general revenue?
- Should their financing be left to local governments (with a likely inequality effect) or be paid out of the national budget?
- How to accommodate together with other age-related costs (long-term care)?

Future long-term care needs depend on healthy aging

Romania: Proportion of the 65 year and older population requiring long-term care



Source: World Bank calculations based on 2008 data from Eurostat and European Union population projections for Romania

Questions

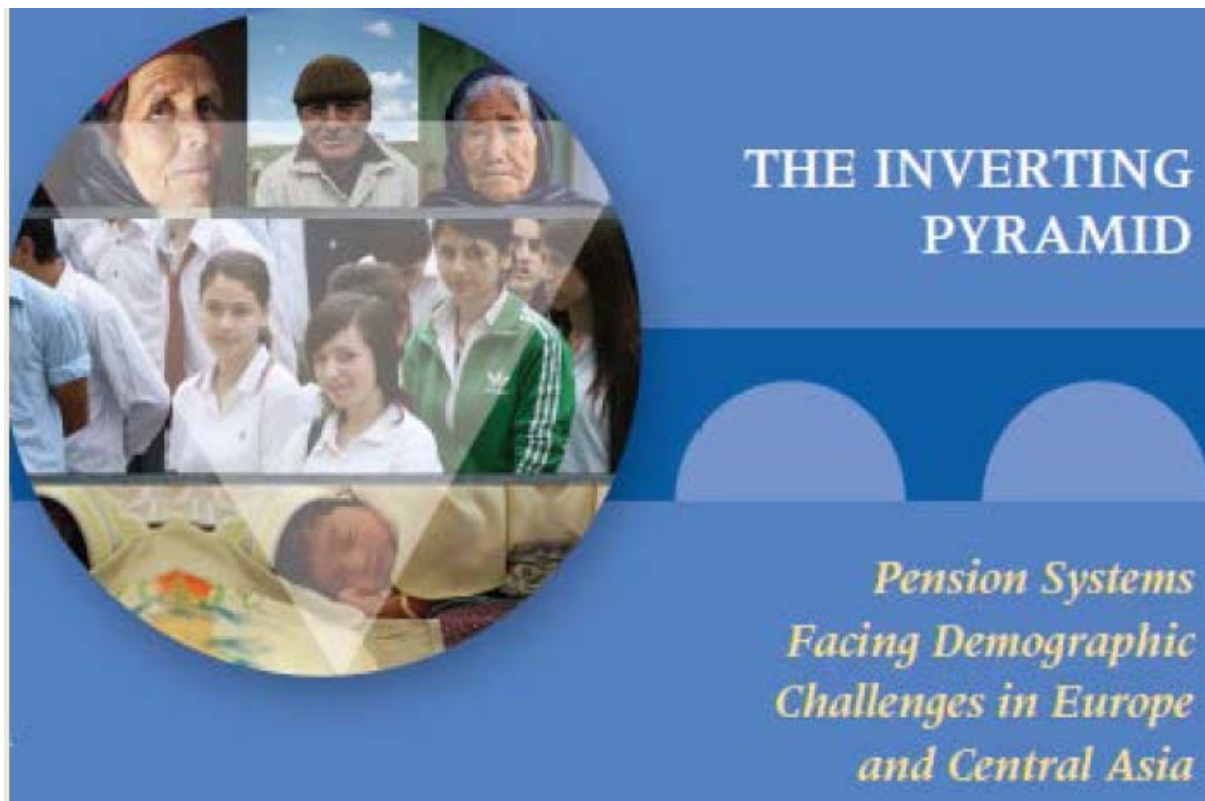
Working longer

- Will bringing more workers and longer working lives address the challenges to the sustainability of pensions systems?
- What would it take?
 - Implications of longer working lives for the labor market, i.e., for generating jobs that older (50+, 65+) workers can take?
 - Mobility between sectors/regions/jobs
 - Increase in demand (reduce in employer bias)
 - Rise not only in life expectancy, but in health life years

Questions

Social protection

- Role of social pensions vis-à-vis social assistance programs for the elderly poor?
- How to make compatible insurance and poverty-reduction pension's role?
- Should we maintain a tight link between contributions and pension benefits? Or separate the redistributive function from the savings component of the pension system?



Thank you