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Synthesis report on adequate and sustainable pensions

Annex

Country summaries

DATA SOURCES AND METHODOLOGY

Many income-based and other indicators were initially specified to be calculated on the basis of the *European Community Household Panel* (ECHP). Information on the characteristics of that survey and availability of data issued from it can be found at the following address:
http://forum.europa.eu.int/irc/dsis/echpanel/info/data/information.html.

However, this survey expired in 2001 and is currently being replaced by data collection under the *Community Statistics on Income and Living Conditions* (EU-SILC) framework regulation (no.1177/2003 of 16th June 2003) and associated implementing regulations.[1]

EU-SILC will become the EU reference source for income and social exclusion statistics, and for the commonly agreed indicators of social cohesion in particular. EU-SILC was launched in 2003 for six member states, and by 2005 it is expected to cover all 25 EU Member States together with many neighbouring countries. During the transition to EU-SILC, indicators are being calculated using national sources, ex-post harmonised for maximum comparability. Logically, given the similarities between the indicators concerned, the same sources should be used to produce the Pensions Indicators as are used to produce the Laeken indicators of social inclusion.

Table #1 presents the different sources used for recent rounds of data collection.

Table #1

Country	Source		
		Survey year	**Income year**
Belgium	ECHP	2001	2000
	EU-SILC	2003, 2004	2002, 2003
Czech Republic	Survey on Social Situation of the Household (Sociální Situace Domácností)	2001	2000
	Microcensus	2003	2002
Denmark	ECHP	2001	2000
	EU-SILC	2003, 2004	2002, 2003
Germany	ECHP	2001	2000
	GSOEP (Sozio-oekonomische Panel)	2002,2003,2004	2001,2002,2003
Estonia	Household Budget Survey (Leibkonna Eelarve Uuring)	2000,2001,2002, 2003	2000,2001,2002, 2003
Greece	ECHP	2001	2000
	EU-SILC	2003, 2004	2002, 2003

[1] Details of the regulations issued to date can be found in the Official Journal, numbers L.165 (3.7.2003), L.298 (17.11.2003), L.5 (9.1.2004) and L.5 (7.1.2005).

Country	Source		
		Survey year	Income year
Spain	ECHP	2001	2000
	Household Budget Survey (Encuesta Continua de Presupuestos Familiares)	2002,2003	2001,2002
	EU-SILC	2004	2003
France	Tax Survey (ERF: Enquête Revenu Fiscaux)	2001,2002,2003	2000,2001,2002
	EU-SILC	2004	2003
Ireland	ECHP	2001	2000
	EU-SILC	2003, 2004	2002, 2003
Italy	ECHP	2001	2000
	EU-SILC	2004	2003
Cyprus	Household Budget Survey (FES: Family Expenditure Survey)	2003	2003
Latvia	Household Budget Survey (Majsaimniecibu Budzetu Petijums)	2000,2002,2003	2000,2002,2003
Lithuania	Household Budget Survey (Namu ukiu biudzetu tyrimas)	2000,2001,2002	2000,2001,2002
Luxembourg	ECHP	2001	2000
	EU-SILC	2003, 2004	2002, 2003
Hungary	Household Budget Survey (Háztartási Költségvetési Felvétel)	2000,2001,2002, 2003	2000,2001,2002, 2003
Malta	Household Budget Survey (Household Budgetary Survey)	2000	2000
Netherlands	Income Panel Survey (IPO : Inkomenspanelonderzoek)	2000,2001,2002, 2003	2000,2001,2002, 2003
Austria	ECHP	2001	2000
	EU-SILC	2003, 2004	2002, 2003
Poland	Household Budget Survey (Badania Budżetów Gospodarstw Domowych)	2000,2001,2002, 2003	2000,2001,2002, 2003
Portugal	ECHP	2001	2000
	Reduced ECHP sample. Only limited indicators are available (at-risk-of-poverty rates before and after transfers at level of total population; s80s20 income quintile share ratio at level of total population).	2002,2003	2001,2002
	EU-SILC	2004	2003
Slovenia	Household Budget Survey (Anketa o porabi v gospodinjstvih)	2000,2001,2002, 2003	2000,2001,2002, 2003
Slovakia	Microcensus	2003	2002
	Extrapolation from Microcensus	2004	2003
Finland	Income Distribution Survey (Tulonjakotilasto)	2001,2002,2003	2000,2001,2002
	EU-SILC	2004	2003

Country	Source		
		Survey year	Income year
Sweden	Income distribution survey (HEK: Hushållens ekonomi, formerly HINK: Hushållens Inkomstfördelningsundersökningen)	2001	2001
	Survey of Living Conditions (ULF: Undersökning av levnadsförhållanden)	2002	2002
	EU-SILC	2004	2003
United Kingdom	Household Budget Survey (FRS: Family Resources Survey)	2000/01,2001/02 ,2002/3,2003/04	2000,2001,2002, 2003

Some limitations of the data sources

Typically, coverage of these data sources is restricted to private households and excludes certain hard-to-reach groups of the population such as persons who are homeless or nomadic, and persons living in institutions. This latter exclusion may distort comparisons between countries where certain traditions favour caring for frail elderly people within their families, whilst others favour institutional care arrangements. Whilst it is considered to be the best basis for such analyses (for example it avoids the moral hazard of actual expenditure choices), income is acknowledged to be an imperfect measure of consumption capabilities and welfare as amongst other things it does not reflect access to credit, access to accumulated savings or ability to liquidate accumulated assets, informal community support arrangements, aspects of non monetary deprivation, differential pricing and other aspects. These factors may be of particular relevance for persons at the lower extreme of the income distribution. The bottom 10 per cent of the income distribution should not, therefore, necessarily be interpreted as having the bottom 10 per cent of living standards.

Income definition

Under the EU-SILC, household total disposable income is taken to be all net monetary income received by the household and its members during the income reference year – namely all income from work (employee wages and self-employment earnings), private income from investment and property, transfers between households plus all social transfers received directly including old-age pensions, net of any taxes and social contributions paid. No account is taken of indirect social transfers. Until 2007, no account has to be taken of income-in-kind (with the exception of company car), mortgage loan interest payments and imputed rent. To the extent that younger households are more likely to be indebted than older households, the omission of interest payments may introduce a distortion.

Although certain countries (eg. DK) are already able to supply income including imputed rent, for reasons of comparability, the income definition underlying the calculation of indicators currently excludes imputed rent, i.e. the money that one saves on full (market) rent by living in one's own accommodation or in accommodation rented at a price that is lower than the market rent. This could have a distorting effect in comparisons between countries, or between population sub-groups, when accommodation tenure status varies.

For the EU10 countries, income-in-kind is included in the total income definition, as it is considered to be a more substantial component of household disposable income for these countries than is the case for EU15 Member States, meaning that its exclusion would significantly underestimate the actual situation. 'Income-in-kind' covers goods produced directly by the household through either a private or a professional activity. For countries using national sources, in order to approximate as closely as possible to the EU-SILC income definition, adjustments are typically necessary to the standard information collected in the data source concerned. The impact of these on reported values can sometimes be significant.

Given the sensitivity of the topics covered by the different sources, care is needed when interpreting results. In countries using surveys, the limited sample size and the fact that

data on disposable income are based on information provided by respondents, rather than from administrative registers or other sources, can sometimes raise concerns about data quality. This is particularly the case for information on income at the two extremes of the income distribution. It is also the case for certain components of income, namely income from self-employment, capital income or income from the hidden economy.

Equivalisation

Once total household income is collected, the figures are given per "equivalent adult", in order to reflect differences in household size and composition. In other words, the total household income is divided by its equivalent size using the so-called "modified OECD" equivalence scale. This scale gives a weight of 1.0 to the first adult, 0.5 to any other adult household member aged 14 and over and 0.3 to each child aged 0 to 13. The resulting figure is attributed to each member of the household, whether adult or children.

EU averages

Group-of-country averages are calculated as population-weighted averages of the available national values. However, indicators are not presented for any given year when data is not available for countries representing 25% or more of the population of the group concerned.

Due to the relative approach, and the differences identified between national data sources, care is needed when making comparisons between countries and to the group-of-country averages.

BELGIUM

1 MAIN CHARACTERISTICS OF THE PENSIONS SYSTEM

The Belgian **statutory pension systems** (pay-as-you-go) cover old-age, invalidity and survivors and comprise three schemes: a scheme for salaried workers in the private sector, a scheme for self-employed persons and a scheme for civil servants. Pensioners who have paid contributions to more than one of these three schemes receive a pension of the type "mixed career". The retirement pension is determined on the basis of three elements: career, wages and family situation.[2] For both self-employed and private schemes, every worked year counts for 1/45th in the calculation of the pension.

Men reach a full career after 45 years, women (employees in the private sector and self-employed) after 43 years at present. As a result of the 1997 pension reform, the legal retirement age and the calculation fraction will be equalised with these of men as from 2009 in the scheme for salaried workers and self-employed. Early retirement is possible from the age of 60, on the condition that the beneficiary has cumulated 35 years of contributions for workers and self-employed and 5 years for civil servants. The effective average age of exit from the labour market is 59.4 (2004). This is below the legal early retirement age (60 years) and the legal normal retirement age (65 for men and currently 63 for women employees in the private sector and self-employed) due to the existence of specific schemes embedded in the unemployment insurance.

Pensions for workers and self-employed are calculated on the basis of the full contributory career and provide 60 % (for a single person) or 75 % (for a head of family) of the revenues earned in the whole contributory career up to a certain wage ceiling. The provision of a minimum pension relies on different mechanisms. For civil servants however, pension rights are calculated on the basis of the incomes of the last five years before retirement (multiplied by the number of worked years and divided by 60), while the family situation has no influence on the pension amount. A guaranteed minimum pension is provided for the civil servants with at least 20 years of service.

A new scheme of "**sectoral pensions**" was introduced in 2003, in order to extend the second pillar pension provisions besides existing complementary pension commitments. Membership can be mandatory at sector level, depending on collective agreements, and access is provided independently based on the size of enterprises. A guaranteed minimum return is provided on the contributions paid in occupational pension schemes by the employees and the employers.

Further, voluntary **individual pension schemes** are promoted with tax deductions for contributions up to a maximum ceiling (of 780€ per year in 2005).

The coverage of occupational pensions for the working population is estimated to be around 40% - 45 % (20% of the current pensioners are covered by these schemes). On average, around 25% of their net pension is contributed out of occupational pensions. Information on contribution rates for occupational schemes is limited. Rates are very diverse. The modal value appears to be in the range from 1% to 5%, while employers typically pay 90% of contributions.

[2] Pensioners (except civil servants) receive a supplementary family amount if they have to support a partner with no pension entitlements. In the future this pension will be more and more frequently replaced by two pensions for single persons because of higher participation of women in the labour market.

A person who has worked full-time during at least 30 years of employment can benefit from a guaranteed income in the pension schemes for salaried workers and self-employed persons. This minimum pension can be combined with other sources of income. For persons with a mixed career, a new scheme for minimum pensions has been introduced. The minimum pension for a salaried worker amounts to 10.396€ in 2005 while for a person with a mixed career the amount is around 8.200€. The minimum pension with a full career is higher than the poverty threshold for salaried workers (60% of the national equivalised median disposable income), but lower for the self-employed. Self-employed individuals receive a minimum pension of around 8.200€. This minimum level for the self-employed is planned to increase gradually until December 2007.

Individuals who are 65 or older (for women from the age of 64 during the period 2006-2008) with insufficient income are protected by a social assistance scheme, GRAPA (*Garantie de Ressources aux Personnes Agées* — GRAPA — guaranteed income for the elderly). This guaranteed income is means tested and amounts to around 8.235€ for a single person. Other supplementary benefits for pensioners like reimbursement of health care and varied offers of health care services are available.

2 SITUATION AND PERSPECTIVES IN THE LIGHT OF THE COMMON OBJECTIVES

2.1 Current situation

Adequacy: Based on provisional EU-SILC 2004 figures, poverty risk among older people (21%) is estimated to be significantly higher than for the Belgian population below the age of 65 (14%). The Belgian government addressed the issue of poverty risks by improving the minimum pension for salaried workers and for the self-employed.

Pensions arising from the first pillar represent about three quarters of the total income of current pensioners. The theoretical total net replacement rate of the first pillar in the base case scenario of the ISG for a worker retiring in 2004 at 65 after 40 years at the average wage is currently 67% if second pillar is included (total gross 43%), and falling to 64% after 10 years of retirement (gross 38%). Indeed, pension benefits are automatically adapted to the so called health index (in line with inflation) but are only partially and discretionally adapted to the development of the general living standard. Beginning from 2007, Social partners and the Government will examine every two years the adaptation of benefits (including the minima) for the salaried workers and the self-employed.

Financial sustainability: Pension expenditures have decreased during the period 1995 to 2002 (starting from 12.1% to 11.2% of GDP), notably due to the reforms of 1990 and 1996. The total employment rate increased in the recent years but at 59.6% in 2003 and 60.3% in 2004, still well below the Lisbon targets. The situation is especially bad regarding older workers (aged 55-64) where in 2004 the employment rate of 30.0% contrasts with the Lisbon target of 50%. The gap in the total employment rate 2004 between the age groups 25-54 (77.3%) and 55-64 (30.0%) is one of the largest in EU. The Belgian government pointed out that in fact, most of the pensioners are no longer active during the years preceding retirement, but are entitled to early retirement embedded in unemployment schemes (*pré-pensions*) or invalidity benefits.

The overall contribution to social security as a percentage of individual gross earnings for private employees amounts to 46.26% (employer 33.19%, employee 13.07%). This contribution is distributed to the different social branches, strictly according to the needs (so called "global management of social security").

Modernisation: The scheme with which a person is affiliated depends on his activity status (salaried worker, self-employed person or civil servant). Between self employed

and salaried workers (and vice – versa), no qualifying periods in order to build up rights in the new scheme are required, when the activity status of a person changes. For persons with a mixed career, a new scheme for minimum pensions was developed in 2003. A minimum pension is awarded, even when the condition of 2/3 of a career as a salaried worker has not been fulfilled, but pension rights have also been built up in the scheme for self-employed persons. Since mid 2005, the helping spouses of self-employed persons are obliged to affiliate with the social status of the self-employed persons: the so-called "maxi status". This regulation shall enable them to build up proper pension rights.

Participation rates of women in the second pillar is half of that of men and the average amount of pension accrued in both pillars is also on average half of men's accruals. This is mainly due to the fact that women's wages remain below those of men. With regard to the average wage of the active salaried workers and because of the longer working career of today's women, Belgium expects that new female pensioners will have higher average pensions.

2.2. Outlook, reform measures and policy debates

Belgium is projected to face similar demographic trends to most EU15 Member States in coming decades. The fertility rate is expected to rise from 1.62 in 2004 to 1.70 by 2050 which is in line with the EU15 average. According to 2005 Eurostat demographic projections used in the new OMC round of pension projections, the number of elderly persons (age 65+) will increase by some 67% until 2050, albeit less than the average for the EU15 (77%). This implies that the old age-dependency ratio will steadily increase from 26% in 2003 to 47% by 2050 (below the EU25 average of 52%).

Belgium is facing substantial budgetary pressures due to ageing populations. According to the budgetary projections made by the AWG in 2005, public pension expenditures will rise from 10.4% to 15.5% of GDP between 2004 and 2050, an increase of 5.1 p.p. of GDP. Respectively, overall age-related expenditures are projected to increase by 5.1 p.p. of GDP between 2004 and 2050. Thanks to the determined policy to reduce the current general government debt, with the aim of creating room for manoeuvre for future increased expenditure due to the ageing of the population, the debt is projected to decline as a share of GDP from 97% in 2004 to 76% in 2010 and 29% in 2050, according to the latest available national budgetary projections included in the 2004 stability program in the context of the assessment of the long term budgetary projections of public finances.

Reducing the public dept as quickly as possible is regarded as the best way to safeguard the statutory pension benefits against the consequences of ageing. As the Belgian government stated in their NSR, further measures are necessary in order to remain close to the budgetary balance in 2005 and 2006 and to attain the surpluses programmed after 2007. The surpluses should be increased to 1.5% of GDP around 2010 in order to meet the target reduction in public debt. Belgium is building up an "Ageing fund" since 2001. In 2004, it amounted 1.8% of GDP and should be increased to 14-15% of GDP by 2020. This fund aims to build up a demographic reserve that should allow the financing of extra costs of ageing in the period between 2015 and 2030. Until 2006, the fund is mainly provided for by budgetary receipts. As from 2007, on top of this, yearly budgetary surpluses will also have to be deposited into the Ageing fund.

In order to make work pay, the Belgian government has taken measures to eliminate certain financial traps. In this context, the system of local employment agencies, which caused important financial traps in practice, was abolished and replaced by the system of the "service cheques". The tax credit was also replaced by the so-called "working bonus", so that financial incentives no longer appear at the moment of the final tax settlement, but much sooner. Nevertheless, a number of financial traps remain and need to be overcome.

According to projections of theoretical replacement rates, based on the ISG-methodology, a worker retiring at 65 after 40 years of employment at the average wage, the gross replacement rate in the statutory scheme is expected to decrease slightly from 63% to 61% in 2050 (corresponding to a decrease from 39% to 37% in gross terms), the overall net replacement rate for both pillars is expected to rise about 7 p.p. from 67% to 74% (corresponding to an increase from 43% to 47% in gross terms), thanks to contributions of 4.25% of gross wages to the second pillar (currently about 40-45% of the employed population is covered by occupational schemes). The government introduced sectoral pensions in order to extend the second pillar pension provisions starting in 2004. A guaranteed minimum return is provided on the contributions paid by the employees and the employer in all complementary pensions, in order to protect the employees from the volatility of the financial market.

A reform of the pension scheme for self-employed persons will also be introduced by mid 2006, that will reduce the differences between the general pension of the salaried workers and that of the self-employed worker.

At the end of the year 2005, the *Contrat de Solidarité entre les Générations* was agreed on, which is part of a number of measures aiming at increasing incentives to work longer and reducing paths of early exit from the labour market. As regards pensions, a bonus will be introduced for people retiring at the legal retirement age, who will also be given the opportunity to combine wages and a pension. Other measures aimed at revalorising pensions of atypical workers (mainly careers with a large degree of partial employment), notably by facilitating access to minimum pensions.

3. Conclusion

Reducing the public debt to about 60% of GDP by 2015 is a primary objective. This would reduce interest payments and aims at creating room for manoeuvre for future increased expenditure due to the ageing of the population, while the global management of social security enables the reallocation of social security contributions to changing needs. Moreover, Belgium is building up an "Aging fund" since 2001, which aims at building up a demographic reserve that should help financing the extra costs of ageing in the period between 2015 and 2030.

Since the first strategy report on pensions, the design of minimum retirement income has been strengthened (through indexation of guaranteed minimum assistance to the general increase of net national income and the introduction of new minimum pension rules for mixed careers and self-employed). Moreover, the promotion of occupational pension schemes could raise replacement rates in the long run and hence the relative living standards of pensioners. Further efforts to ensure a high coverage of the working population (especially women) by occupational pension schemes might be needed.

Encouraging an overall higher labour-force participation of people in their 50s and 60s, which is currently one of the lowest in the EU, appears to be necessary. In that respect, the recent *Contrat de solidarité entre les Genérations* could make a key contribution to adequacy and financial sustainability.

4. BACKGROUND STATISTICS

	BE			EU25		
Adequacy						
Current situation						
	Total	Men	Women	Total	Men	Women
At-risk-of-poverty rate [1]	*15*	14	16	16	15	17
0-64	14	13	15	16	16	17
65+	21	20	21	18	15	20
75+	21	20	21	Nd	Nd	Nd
Income inequality [1]						
0-64	4,1					
65+	3,4					
Income of people aged 65+ as a ratio of income of people aged 0-64 [1]	0,76	0,76	0,76			
Median pensions relative to median earnings [2]	0,61	0,62	0,61			
Long-term projections						
Theoretical replacement rates[3]	2004	2030	2050			
Total net replacement rate	67	76	74			
Total gross replacement rate	43	48	47			
Gross repl. rate 1st pillar	39	38	37			
Gross repl. rate 2nd/3rd pillar	4	10	10			
Financial sustainability						
Current situation						
ESSPROS Pension expenditure [4], % of GDP	***1995***	2000	***2003***	***1995***	2000	***2003***
	12,1	11,1	11,5		12,5	12,6
Employment (2004) [5]	Total	Men	Women	Total	Men	Women
Employment rate ***(25-54)***	77,3	85,8	68,5	76,8	85,2	68,5
Employment rate (55-64)	30,0	39,1	21,1	41,0	50,7	31,7
Effective labour market exit age (2004) [6]	59.4	59.1	59.6	60.7p	60.9	60.4p
Public finances (2003) [7]						
Public debt, % of GDP	100,7			63,3		
Budget balance, % of GDP	0,4			-2,8		

Long-term projections (EPC 2006)								
	Level			increase 2004-50	Level			increase 2004-50
	2004	2030	2050		2004	2030	2050	
Old-age dependency ratio [8]	26	41	47	+81%	25	40	52	+108%
Public pensions expenditure, % of GDP [9]	10.4	14.7	15.5	+5.1	10,6	11,9	12,8	+2,2

Factors determining the evolution of public pensions expenditure (2000-2050) [10]	Contribution to change in percentage points of GDP	Contribution to change in percentage points of GDP
Demographic dependency	7,7	8,6
Employment	-1,5	-1,1
Eligibility	-0,4	-2,1
Level of benefits	-0,6	-2,7
Total (including residual)	5,1	2,2

Notes:

1. Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, Income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).
2. Source: Eurostat. Median individual pension income of retirees aged 65-74 in relation to median earnings of employed persons aged 50-59 excluding social benefits other than pensions.
3. Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first and second pillar pension schemes, retiring at the age of 65 years in 2005.
4. Source: ESSPROS, EUROSTAT. Includes expenditure by certain private social protection schemes.
5. Source: European Labour Force Survey, 2004.
6. Source: European Labour Force Survey, 2004.
7. Source: European Commission, DG ECFIN.
8. Source: EUROSTAT (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15-64.
9. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.
10. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.

1. * proportion negligible

Czech Republic

1. Main characteristics of the pension system

Statutory old-age pensions are composed of two parts: a flat-rate basic pension and an earnings-related pension based on the personal assessment base (PAB) and the number of eligible years.

The 1995 pension insurance act launched an ongoing process of increasing the retirement age and lengthening the insurance period for pension assessment to 30 years, until 2016.[3] The reform also provided tighter definitions for those qualifying for disability and survivors benefits, introduced widower pensions and set down rules for the indexation of pensions. In 1997, the government reduced indexation, cut eligible periods for non-contributory pensions and tightened conditions for early retirement. In 2001, legal amendments further decreased the advantages of early retirement and increased the rewards for deferral. In 2002, the indexation of the minimum pension was changed to a combination of 100% of prices and 1/3 of real wage growth. The 2003 reform will see a further raising of the retirement age for the old age pension - to 63 for men and women without children (these ages will be effectively reached in 2016 and 2019, respectively).

The contribution rate was increased from 26% to 28% in 2004. Pensions are financed by both employers (21.5% of payroll) and employees (6.5% of earnings), the self-employed pay the whole 28% of declared earnings.

Non-contributory periods account for about a quarter of all insurance periods included in the calculation of pension entitlements. This refers to the period of care for a child up to the age of 4 (or 18 years, if this involves a child with a severe long-term disability), compulsory military service or the community service (as alternative to military service), those engaged in personal care for a dependent person, those receiving full disability pension (until reaching retirement age) and those registered as unemployed (the insured are also eligible for unemployment benefits, while those not in receipt of unemployment benefits, are also covered for a period of 3 years.).

Early retirement is possible up to 3 years before the statutory retirement age. When taking it, all employment must cease. There are temporary and permanently reduced early pension plans. *Temporarily reduced early pension* (that will be abolished from 2007) is available up to 2 years prior to the statutory retirement age, provided that the insured person has a minimum of 25 years of insurance, has received disability pension for at least 5 years and entitlement to a disability pension has expired within 5 years of reaching the statutory retirement age. The pension is reduced by 1.3% of the PAB for every period of 90 days prior to the retirement age, but the pension is fully restored upon reaching the retirement age. *Permanently reduced early pension* is available up to 3 years prior to the statutory retirement age. The insured must have at least 25 years of contribution period. The pension is reduced by 0.9% of PAB for every 90-day period preceding the statutory retirement age. This reduction is permanent and continues after the recipient reaches the statutory retirement age.

In case of deferred pension, an increase of 1.5% of the PAB is provided for every 90 days of economic activity during which the claim for an old-age pension is postponed.

[3] The assessment base of the earnings related pension is currently based on average gross earnings over the last 18 years preceding retirement. Originally based on 10 years preceding retirement, this period is being extended by 1 year every year until it reaches a total of 30 calendar years (in 2016).

State-subsidized supplementary pension insurance scheme was implemented in 1994. The state supports participation in the supplementary pension insurance schemes through the provision of a state subsidy and by an income tax allowance for participants. Contributions may be paid on behalf of the participant by his/her employer subject to the participant's prior consent. The employer's contribution may be agreed also in any collective agreement. With effect from 1 January 2000, tax allowances have been introduced for both participants and employers. Currently, there are 11 pension funds in the state-subsidized supplementary pension insurance market. The voluntary supplementary pension funds do not as yet play an important role for income security in old age. Although almost 3 million people had joined them by the end of 2004, the capital build-up in individual accounts is not significant, the assets held by pension funds are 3.7% of GDP. The average amount of the participant's contribution is low and since 1999 has been stagnating at 2% of the average wage. The level of coverage of the supplementary pension insurance scheme (as a percentage of the population aged 15-64) runs at 35%.

Pension funds are obliged by law to guarantee non negative rate of return for participants leading to low levels of revenue (yield), compensated by higher security of investments. From 1995 to 2004, the average credited real rate of return was 0.8%.

Apart from the State-subsidized supplementary pension insurance scheme, **private life insurance** is also available. Tax allowances were introduced for insurance products under private life insurance schemes for both the insured and their employers.

Pensions from the basic pension insurance scheme are neither income-tested nor means-tested (the income test for the early old-age pension and partial disability pension has been abolished since 2006). The **minimum** amount of pension currently amounts to about 17% of the average net wage. An additional instrument, as regards the social security of the elderly (but not only them) is the subsistence level which complements the basic pension insurance scheme. Subsistence level currently amounts to CZK 4,300 for an individual which is some 34% of the average net wage. Benefits from the social care system are income-tested and means-tested.

2. SITUATION AND PERSPECTIVES IN LIGHT OF COMMON OBJECTIVES

2.1. Current situation

Concerning **adequacy**, the living standard of those aged 65 or more is 83% of those aged 0-64 (equivalised household income) and 75% of those aged 45-54.

For income security in old-age most people depend on the statutory pension insurance scheme. In spite of periodic indexation, the real value of pensions dropped in the last decade (though in 2004 the real value is approximately the same as in 1989). The proportion of average old-age pension to average net wage gradually decreased from 61% in 1998 to 57% in 2004 (the proportion of the average gross wage decreased from 47% in 1998 to 44% in 2004). The gross replacement rates for a worker at the average wage retiring at 65, after 40 years of contributions is 61% with net replacement rate at 79%.

However, a broad scope of coverage through non-contributory periods may have an adverse impact on the willingness to pay pension insurance contributions into the basic pension scheme, since the structure of the system requires a relatively high contribution rate over a long period of time.

The earnings related part of the statutory pension follows a progressive formula, which translates into significant redistributive effects. Old-age pensions are not taxed up to an

amount four times larger, than normal tax-free allowance that workers have, which contributes to higher net replacement rate of wages by pension benefits.

The basic pension insurance scheme contributes to a considerable extent to the reduction of poverty of the older generation. The relative poverty rate (at the 60% threshold) among people aged 65 or more stands at the low level of 4 % in 2003, below EU average and significantly below the level of poverty among people aged 0-64 (which was at 9% in 2003).

Of 3.2 million pensions paid out, 60% represent old-age pensions, 17% full disability pensions and partial disability pensions and 23% widower's, widow's and orphan's pensions. The employment rate of 55-64 (42.7% in 2004) is slightly higher than EU25 average (41%), and increased significantly in recent years. Possibilities for increases remain. In 2001 and 2004 access to **early retirement** was further restricted and better rewards for deferred retirement were offered. The penalties introduced in 2001 could however be too low to discourage people from applying for early retirement pensions.

The legislation allows pensioners to receive (apart from any pension) income from gainful activity regardless of the level of their income. Since 2001, for each 90 calendar days of gainful activity pursued beyond eligibility for the old-age pension (without taking the pension), the level of the percentage assessment is increased by 1.5% of PAB (6% annually), in comparison with the former increase of 1% (4% annually).

Currently, some 15% persons aged between 50 and 64 years receive a disability pension. Persons who are eligible for the full disability pension are not prevented from working. A full disability pension is in general higher than the early old-age pension.

Concerning **sustainability**, the pension system has been in debt for several years (1997 – 2003) due to demographic and economic changes. Pension expenditure was 8.8% of GDP in 2003. Of the total pension expenditure, old-age pension expenditure accounts for 72%, disability pension expenditure for 18% and the survivor's pension expenditure for 10%. Controlling public expenditure on pensions has been a major concern over the recent decades, which has led to several reforms of the earnings-related public pension scheme since 1993. The measures included rising the retirement age, lengthening the period of service required for a pension and lowering the assessment basis, the index-linking was made less favourable and conditions for non-contributory pensions and early retirement were tightened.

So far, the state-subsidized supplementary pension insurance scheme has been used for the purpose of mid-term savings rather than as the supplementary income for the elderly. Since the launching of the system, lump sum settlements account for 72% of all benefits granted to date. .

Concerning **modernisation**, since 1996, the retirement age has been gradually increased and harmonised and is due to reach 63 in 2016 for men. For women the retirement age will vary from 59 to 63 by 2019 - differences are dependent on the number of children raised.

2.2. Outlook, reform measures and policy debates

The Czech Republic is projected to face rapid ageing in the coming decades, due in particular to a low fertility rate. The old-age dependency ratio is projected to rise from a currently low level of 20% (EU average of 24%) to 55% in 2050 (above EU average of 52%), one of the highest increase among EU25.

Replacement rates are projected to decline by about 10 p.p. by 2050 (both gross and net) for people retiring at 65 after 40 years of contributions, reaching 70% net (53% gross) in

2050 for someone on the average wage, but would remain higher for modest pensioners (79% for someone at two thirds of average wages) and lower for higher wage earners. Encouraging people to join the supplementary funded scheme and increase personal saving for the old age may increase replacement rates.

According to national figures, in parallel with the long-term increase of expenditure, the relative level of average pensions to average wage should be decreasing from the current level of 44% to reach some 37% of average gross wage (49% of average net wage) by around 2026, with subsequent moderate growth until the end of the projection in 2050.

Incentives for later retirement resulting from measures taken in 2001 and 2004 could probably be increased, in particular through further preferential treatment of deferred retirement.

In order to obtain the appropriate level of benefits from private pension schemes citizens' confidence in these schemes will need to be further strengthened. Within the state-subsidized supplementary pension insurance schemes the National Strategy report underlines that further steps will be necessary to separate shareholders' assets from the participants' assets and to enable pension funds to offer pension plans with diversified investment foci, whilst increasing the coverage rate (especially with respect to younger age brackets) and motivating members and employers to greater involvement and higher contributions. Limiting the drawing of the lump sum settlement and elimination of the guarantee of the year-on-year non negative revenue (yield) should also be considered.

The current reforms, in particular the higher retirement age, should ensure sustainability up to 2020. Beyond this, if PAYG is to remain the main source for old age income provision, the system would need to be further reformed.

The Czech Republic is facing rapidly growing budgetary pressures of a significantly higher magnitude than most Member States due to their ageing population. According to the AWG projections of 2005, the Czech Republic is expected to increase its spending on public pensions from 8.5% of GDP in 2004 to 14.0% of GDP in 2050, a rise of 5.6 p.p., while all age-related expenditure is projected to rise by 6.9 p.p.. Thus, pensions are by far the fastest growing item among the age-related expenditures. Hence, assuming no policy change, public debt is expected to climb from 38.6% of GDP in 2004 to over 300% in 2050.

Through the implementation of the reforms, the basic pension insurance scheme has been stabilized for a period of approximately 20 years but the spending would rise rapidly after 2025. However, the measures so far taken will not sufficiently guarantee the sustainability of pensions and demographic developments need to be accompanied by the adoption of further reform steps. It is estimated in the National Strategy report that in order to maintain the balance in the pension system in 2050, the retirement age should be raised to about 68 years for men and or 67 years for women between 2020 and 2050

While political parties submitted their options for pension reform in 2004, the future shape of the Czech pension system was considered by an Expert Team, the final report of which will be used for further political negotiations. Social partners have been informed about the progress of pension reform. Political parties, the Prime Minister, the Minister of Labour and Social Affairs and the Minister of Finance are represented in the Expert Team which was established in 2004. The authority in charge of the pension insurance system is also preparing for changes to the system.

The following issues will probably be considered: further strengthening of incentives to work longer through additional gradual extension of the eligible age for the old-age pension (plus consideration of equalisation of men and women's statutory pension ages) and further extension of the period from which income for the pension calculation

is derived. The possible introduction of gradual retirement (with the option of converting pensions paid out in addition to income from gainful activity) is also being looked at. A limiting of the inclusion of non-contributory periods in the calculation of pension entitlements, changes in the indexation of the income actually earned for the purposes of pensions and changes in indexation of current pensions as well as updating of criteria for determining disability are also being considered.

3. Conclusions

New pension reforms are expected to follow from further negotiations based on the final report of the Expert Team. It would be an important step if the principles of pension reform are agreed in 2006. Measures suggested include further reforms of the statutory pension (notably increases to retirement age), the creation of a reserve fund and also further development of voluntary private pensions.

The Czech Republic has managed to ensure adequacy of pensions over the last decade and achieved a low rate of poverty amongst older people. Although replacement rates are projected to decline, future adequacy should be preserved. The employment rate of 55-64 year olds has also increased significantly in the recent years. However, the creation and the take-up of jobs for older workers should be encouraged so as to facilitate the balancing of financial sustainability and pension adequacy, while incentives to work longer need to be strengthened.

The Czech Republic is facing growing budgetary pressures due to an ageing population, which is projected to grow faster than most other EU countries. According to the National Strategy report, the pension system is projected to run growing deficits from 2020 onwards under current policies. It will have to be seen to what extent further reform efforts will strengthen the sustainability of the pension system, while securing adequacy.

4. Background statistics

	CZ			EU25		
Adequacy						
Current situation						
	Total	Men	Women	Total	Men	Women
At-risk-of-poverty rate [1]	8	7	9	16	15	17
0-64	9	8	9	16	16	17
65+	4	1	6	18	15	20
75+	7	2	9	Nd	Nd	Nd
Income inequality [1]						
0-64	3.5					
65+	2.1					
Income of people aged 65+ as a ratio of income of people aged 0-64 [1]	0,83	0,85	0,82			
Median pensions relative to median earnings [2]	Nd	Nd	Nd			
Long-term projections						
Theoretical replacement rates[3]	2005	2030	2050			
Total net replacement rate	79	70	70			
Total gross replacement rate	61	54	53			
Gross repl. rate 1st pillar	61	54	53			
Gross repl. rate 2nd/3rd pillar	*	*	*			

	CZ			EU25		
Financial sustainability						
Current situation						
ESSPROS Pension expenditure [4], % of GDP	***1995***	2000	***2003***	***1995***	2000	***2003***
	7,3	8,7	8,8		12,5	12,6
Employment (2004) [5]	Total	Men	Women	Total	Men	Women
Employment rate ***(25-54)***	81,4	89,2	73,4	76,8	85,2	68,5
Employment rate (55-64)	42,7	57,2	29,4	41,0	50,7	31,7
Effective labour market exit age (2004) [6]	60.0	61.3	58.9	60.7p	60.9	60.4p
Public finances (2003) [7]						
Public debt, % of GDP	37,8			63,3		
Budget balance, % of GDP	-12,6			-2,8		

Long-term projections (EPC 2006)

	CZ Level 2004	CZ Level 2030	CZ Level 2050	CZ increase 2004-50	EU25 Level 2004	EU25 Level 2030	EU25 Level 2050	EU25 increase 2004-50
Old-age dependency ratio [8]	20	37	55	+175%	25	40	52	+108%
Public pensions expenditure, % of GDP [9]	8.5	9.6	14	+5.6	10,6	11,9	12,8	+2,2

Factors determining the evolution of public pensions expenditure (2000-2050) [10]	CZ: Contribution to change in percentage points of GDP	EU25: Contribution to change in percentage points of GDP
Demographic dependency	10,5	8,6
Employment	-0,3	-1,1
Eligibility	-3,5	-2,1
Level of benefits	-0,6	-2,7
Total (including residual)	5,6	2,2

Notes:

1. Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, Income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).
2. Source: Eurostat. Median individual pension income of retirees aged 65-74 in relation to median earnings of employed persons aged 50-59 excluding social benefits other than pensions.
3. Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first and second pillar pension schemes, retiring at the age of 65 years in 2005.
4. Source: ESSPROS, EUROSTAT. Includes expenditure by certain private social protection schemes.
5. Source: European Labour Force Survey, 2004.
6. Source: European Labour Force Survey, 2004.
7. Source: European Commission, DG ECFIN.
8. Source: EUROSTAT (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15-64.
9. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.
10. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.

* proportion negligible

3 MAIN CHARACTERISTICS OF THE PENSIONS SYSTEM

The public old age pension is a universal, residence-based and non-contributory statutory old age pension scheme financed from general taxation. A full public old-age pension is conditional on 40 years' residence in Denmark after the age of 15. It consists of a basic amount and an income tested pension supplement. The pension depends on the pensioner's present income and martial status, but assets have no effect on the amount. The benefits are adjusted once a year based on the wage development in the private sector, and are taxable. Since 2003, in addition a supplementary pension benefit of a flat rate amount is paid once a year to the most disadvantaged pensioners (means-tested). For the 70% of older people with the lowest incomes, social pension accounts for 50% or more of the gross income for both single pensioners and couples. The statutory retirement age for both men and women is 65 years, being lowered from 67 years in July 2004.

Reforms were undertaken during the 1990s, aiming in particular at increasing labour force participation of older workers so as to offset the impact of an ageing workforce. In addition, people who postpone the take-up of a voluntary early retirement benefit beyond t 62 are paid a tax-free bonus at the age of 65 (which increases with time worked beyond the age 62). Rules on deferred pension were introduced with effect from 1 July 2004. Persons who have reached public old-age pension age and who participate actively in the labour market (at least 1,500 hours annually) may choose to defer their public old-age pension and are rewarded with a higher amount.

Denmark has a supplementary mandatory funded **ATP** scheme, which can be considered as part of the first pillar due to the fact that it is mandatory. But it also has the characteristics of an occupational pension scheme being employment-related and organised in private funds, thus not burdening public finances. On average ATP offers about 10% of public old-age pensions to current pensioners. In collective agreements of 2004 covering the private labour market, the social partners agreed in raising contribution rate to ATP in 2006. .

Payments from the Special Savings Scheme (**SP**, launched in 1999), are suspended from 2004 until 2007 (all employees and self-employed contribute 1% of their income in order to receive benefits, that are paid out over a 10-year period after the retirement age is reached)

Statutory pensions are supplemented by occupational pension schemes, such as **Labour market pensions**, labour market supplement pensions (SAP) and individual pension saving. Labour market pension schemes in particular expanded in their coverage of employees during the last 25 years from 30% to around 90%. The bulk of labour market pensions are defined contribution. In 2004, contributions to the agreement-based labour market pension schemes were typically 7-10 per cent of the wage in the private sector and 12-16 per cent of the wage in the public sector. In connection with the collective bargaining in 2005, a number of increases of these contributions were agreed. The employer contributes two-thirds, while the employee contributes one-third.

Access to a number of needs and income tested cash supplements (e.g. housing, heating and medicine allowances), as well as free health and long-term care and to recreational activities contribute to guaranteeing a decent minimum standard for all.

4 SITUATION AND PERSPECTIVES IN THE LIGHT OF THE COMMON OBJECTIVES

4.1 Current situation

Adequacy The income of all people aged 65+ relative to the 0-64 age group stands at 70%, which is lower than in most other member states.[4] In spite of the projected significant rise of funded schemes, the first pillar will continue to play an important but decreasing role in pension provision.

The statutory pension schemes keeps the risk of poverty for the elderly population at a moderate level (17% at the 60% threshold) higher than that of the 0-64 years (10%).[5] The gender gap between men and women is one of the lowest in Europe. This is linked to the high labour market participation of women and also to the prevalence of supplementary labour market pension being as high for women as that of men. In addition, pension rights in ATP and labour market pensions (since 1998) are calculated on the basis of a unisex principle (labour market pension schemes are based on a unisex principle and are open to everybody in the labour market, irrespective of the person's health conditions). The unisex principle implies that a person's gender must not be taken into account when the pension is calculated in regard to the remaining projected life expectancy.

Theoretical pension replacement rates of today (2005) are relatively low compared to almost all other member States. The current total gross replacement rate is 49%, resulting in net replacement rate of 71%. Since most Danish funded schemes are not yet fully mature (a majority of new pensioners have not yet contributed during a full working life) the level of measured income of pensioners relative to the working age population will improve gradually, in particular for people on low and average incomes. The counterpart is however that the build-up of the mandatory savings-based schemes to some degree will supersede other savings. The replacement rate ensured by the pension system must be seen in relation to the supplementary benefits targeted at pensioners and the public financed health and elderly care.

The Danish Government wishes to put **self-employed** persons on an equal footing with employees when it comes to the possibility for saving for retirement. Self-employed persons are now entitled to full deductions for pension contributions of up to 30 per cent of any profits they earn that year and can thus decide on an ongoing basis how much they wish to contribute.

Financial sustainability: Public debt has been reduced since 1998 and is below the average in EU, being 45.9% of GDP in 2003 and the State budget had a small surplus in 2002 (0.7% of GDP) and 2003 (0.3% of GDP). Government has set the operational fiscal target of upholding a structural budget surplus of 0.5 - 1.5 per cent of GDP (1.5-2.5 per cent of GDP including ATP) on average through 2010. This reduction of debt improves fiscal sustainability. To support the long-term sustainability of public finances and the pension system tight expenditure control and a permanent rise in employment generated from new structural policy initiatives are pursued. In relation to this, the Government has launched the integration plan that a majority of the political parties signed up to in June 2005.

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[4] Accumulated wealth, which is higher for older people, should also be considered when comparing living standards across generations. Due to data limitations unfortunately this is not possible for all countries.

[5] This figure does not include as income negative capital income and imputed rent from private housing, which gives an incomplete picture of income situation, in particular for older people. When taking into account this more comprehensive definition of income, the risk of poverty in Denmark for elderly people is fairly the same as in the rest of the population (8.7% for people aged more than 65 and 10.6% for people aged more then 75, compared to 9.8% for 0-64 aged people).

The total employment rate (75.7%) and the total female employment rate (71.6%) are currently the highest in the EU (2004), while for older workers (60.3%) it is the second highest and far exceeds the Lisbon targets. As from 1 July 2004, the age at which a person becomes eligible for a public old-age pension is 65 years (reduced from 67). The formal pensionable age was lowered as part of a reform of the voluntary early-retirement scheme in 1999. The lowering of the formal pensionable age is not thought to have any significant effect on the average retirement age.

Modernisation: Reduced transfer fees for individual pensions in the 3rd Pillar have improved transfer possibilities, and this is expected to result in intensified competition between insurance companies and thus greater efficiency. New employees are often subject to a waiting period before becoming a member of the pension scheme (waiting periods can generally be transferred within the private and public sectors and generally range between one and three quarter years in the private sector and from no waiting period to four years in the public sector).

The complex structure of the Danish system (means-tested elements, ATP, defined-contribution schemes) can make it difficult to have a clear idea of a person's income situation after retirement. This issue is addressed by an obligation on pension schemes to disclose their administrative costs and performance records. In addition, a common database, *PensionsInfo*, has been established in cooperation between pension funds, life-insurance companies, banks and public authorities. *PensionsInfo* gives the individual pension saver access to information from almost all pension suppliers, thus enabling the individual to get a total overview of their pension savings.

4.2 Outlook, reform measures and policy debates

Denmark is projected to face similar demographic trends to most EU15 Member States until 2030 when it will then experience more favourable trends. According to the latest projections of Eurostat, ageing will be slower than the EU average. Indeed, the elderly dependency ratio will increase from the present 23% (2004) to 38% in 2030 and 42% in 2050, staying significantly below the EU25 average of 52% in 2050.

Since individuals are now entitled to higher pensions compared to the previous system, supplements for deferred public old-age pension for those wishing to work beyond the retirement age of 65 will not necessarily improve fiscal sustainability. Nevertheless the aim is to increase the average retirement age by six months to 61.5.

The expansion of occupational pension schemes (SP and labour market schemes) is expected to raise replacement rates significantly and therefore reduce the current difference. Theoretical total gross replacement rates for a worker retiring at 65 after 40 years at the average wage is expected to increase from 49% in 2005 to 64% 2050 because of an expected increase of the gross replacement rate in the second pillar from today's 4% to 25% in 2050 and despite a slight decrease of the gross replacement rate for the first pillar (including ATP) from 45% today to 39% in 2050. Because of taxation, the increase in total net replacement rate is significant lower, (71% in 2005 to 76% in 2050).

Denmark's national strategy report highlights that the budgetary pressure from ageing is not only related to public old-age pension, but also to health and elderly care expenditures, and that the sustainability of the public pension system cannot be assessed independently of other public expenditures and the overall assessment of the long-term sustainability of public finances because public pensions are financed by general tax revenues. The AWG 2005 projections indicate that public pension spending will grow from 9.5% to 12.8% of GDP, by 3.3 p.p. of GDP, between 2004 and 2050, while total age-related expenditure would increase by 3.6 p.p.. However, it should be borne in mind

that a major increase in pension expenditures is expected in occupational pensions as these schemes will mature in the coming decades.

ATP and SAP savings-based schemes, pension rights are earned on the basis of a unisex principle. SP is a purely saving-based scheme without re-distribution. The unisex principle, which implies that a person's gender must not be taken into account when pension is calculated, became statutory for labour market pensions in 1998. The principle will only take full effect for pensions paid out from 2040. As regards maternity leave without wage, the social partners in the central, local and regional government area agreed in connection with the collective bargaining in 2005 that pension contributions will be paid in the maternity leave periods in which no wage is paid.

The system is based on a broad consensus between the major parties about the overall structure and the relative role of its various elements. In addition, a large majority in parliament agreed in 2000 on the principle that the public old-age pension should form a sound income basis for present and future pensioners. The government has set up a Welfare Commission charged with submitting specific proposals before the end of 2005 for reforming the Danish welfare model, including social pensions. In the light of the analyses from the Welfare Commission and with a view to maintaining the long-term targets of economic policies, the Government will, in spring 2006, present a new economic multi-year plan for Denmark, covering at least the period up to 2015.

5 CONCLUSION

The strategy for ensuring adequacy and financial sustainability of public pension provision seems appropriate. A budget policy leading to quick debt reduction has already been sustained for some years and all major parties support the continuation of this policy until 2010, when the public debt is expected to be substantially reduced.

In sum, the pension system seems to be financially sustainable in the long term under present policies with a fairly equitable sharing of the burden between generations. Denmark reports not only one of the lowest gender gaps between men and women in the risk of poverty in Europe but also a very small gender gap in the pension entitlements of the current pensioners. While relative living standards of older people are moderate, building up private pensions is expected to increase replacement rates in the future and thereby alleviate potential pressure for increases in public pension rates. Nevertheless, the future contribution of private pensions to adequate pensions would benefit from periodic reviewing.

Yet, the sustainability calculations hinge critically on maintaining large surpluses in public finances. Furthermore, ambitious targets have been set to increase employment by 60.000 persons by 2010. Given Denmark's proven record in employment, further rises in employment rates will be difficult to achieve and will require further measures, especially to slow the outflow of older workers through early retirement schemes.

In the light of the proposals for welfare system reforms from the Welfare Commission and with a view to maintaining the long-term targets of economic policies, the Government will in spring 2006 present a new economic multi-year plan for Denmark, covering at least the period up to 2015.

4. BACKGROUND STATISTICS

	DK			EU25		
Adequacy						
Current situation						
	Total	Men	Women	Total	Men	Women
At-risk-of-poverty rate [1]	11	11	11	16	15	17
0-64	10	10	10	16	16	17
65+	17	16	18	18	15	20
75+	23	25	22	Nd	Nd	Nd
Income inequality [1]						
0-64	3.4					
65+	2.8					
Income of people aged 65+ as a ratio of income of people aged 0-64 [1]	0,71	0,74	0,71			
Median pensions relative to median earnings [2]	0,57	Nd	Nd			
Long-term projections						
Theoretical replacement rates[3]	2005	2030	2050			
Total net replacement rate	71	77	76			
Total gross replacement rate	49	63	64			
Gross repl. rate 1st pillar	45	42	39			
Gross repl. rate 2nd/3rd pillar	4	20	25			
Financial sustainability						
Current situation						
ESSPROS Pension expenditure [4], % of GDP	***1995***	2000	***2003***	***1995***	2000	***2003***
	11,3	10,5	11,1		12,5	12,6
Employment (2004) [5]	Total	Men	Women	Total	Men	Women
Employment rate ***(25-54)***	83,7	87,6	79,8	76,8	85,2	68,5
Employment rate (55-64)	60,3	67,3	53,3	41,0	50,7	31,7
Effective labour market exit age (2004) [6]	62.1	62.6	61.6	60.7p	60.9	60.4p
Public finances (2003) [7]						
Public debt, % of GDP	45,6			63,3		
Budget balance, % of GDP	0,3			-2,8		

Long-term projections (EPC 2006)

	DK Level			DK increase 2004-50	EU25 Level			EU25 increase 2004-50
	2004	2030	2050		2004	2030	2050	
Old-age dependency ratio [8]	22.5	37.7	41.9	+86%	25	40	52	+108%
Public pensions expenditure, % of GDP [9]	9.5	12.8	12.8	+3.3	10,6	11,9	12,8	+2,2

Factors determining the evolution of public pensions expenditure (2000-2050) [10]	DK: Contribution to change in percentage points of GDP	EU25: Contribution to change in percentage points of GDP
Demographic dependency	7,2	8,6
Employment	-0,4	-1,1
Eligibility	-2,8	-2,1
Level of benefits	-0,5	-2,7
Total (including residual)	3,2	2,2

Notes:

1. Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability These figures do not include as income negative capital income and imputed rent from private housing, which gives an incomplete picture of income situation, in particular for older people. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, Income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002),
2. Source: Eurostat. Median individual pension income of retirees aged 65-74 in relation to median earnings of employed persons aged 50-59 excluding social benefits other than pensions.
3. Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first and second pillar pension schemes, retiring at the age of 65 years in 2005.
4. Source: ESSPROS, EUROSTAT. Includes expenditure by certain private social protection schemes.
5. Source: European Labour Force Survey, 2004.
6. Source: European Labour Force Survey, 2004.
7. Source: European Commission, DG ECFIN.
8. Source: EUROSTAT (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15-64.
9. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.
10. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.

* proportion negligible

GERMANY

1. MAIN CHARACTERISTICS OF THE PENSIONS SYSTEM

The general pay-as-you-go, earnings-related first pillar statutory pension scheme covers around 80% of the employed population in Germany (33 million people). Since 2003 the contribution rate stands at 19.5%, paid in equal shares by employers and employees. Civil servants' pensions are paid directly from public budgets and special schemes exist notably for farmers and the liberal professions (e.g. for doctors, lawyers, architects).

For each year of contributions, an insured person in the statutory pension scheme receives "earnings points" depending on the individual income position in relation to the average earned income. Someone who earns exactly the average therefore receives one "earnings point" for his contributions of that year. The sum of one's individual earnings points is multiplied by the value of one earnings point. The earnings point value is adjusted annually by an index which is based on gross earnings development but curbed by the sustainability factor and the increase in the contribution rate. All pensions are adjusted in line with the change of the earnings point value, irrespective of when the pensioner retired.

The main reforms in the statutory pension scheme in order to ensure sustainability began in 1992 with the Pensions Reform Act which modified the pensions adjustment formula, began a gradual increase of retirement ages and introduced actuarial reductions for early retirement. The 2001 reforms of old-age pensions led to a gradual reduction of first pillar pension levels through the modification of pensions adjustments, new widow's/widower's pension (with a child component) and the creation of state supported capital-covered (voluntary) second and third pillar old-age pension provision. In 2003 short term measures in order to avoid an increase in the contribution rate anticipated for 2004 were put into force. Finally, in 2004 the Old-age Pensions Insurance Sustainability Act modified the pension adjustment formula and introduced a "sustainability factor" which is geared to changes in the ratio between contribution payers and pension recipients.

In 2003, benefits from the statutory pension insurance (without pensions to civil servants, farmers and the liberal professions) contributed 66% of the total income of people over 65. The systems of retirement income beside the statutory old-age pensions insurance amount to 21% of the total old age income (of which 7% is occupational pensions in private industry and supplementary pensions for employed persons in the public service). It should be noted however that the share of statutory old-age pension insurance in the new Länder (former East Germany) is 91% and the share of supplementary retirement schemes is still small, since these systems were only introduced to the new Länder fairly recently. The various forms of private old-age provision making up the third pillar contribute an estimated 7% to pensioners' total income. The remaining 6% come from other sources such as income from working or social assistance.

The 2001/2004 reforms promoted the development of supplementary pension schemes. As to the second pillar, legislation provides for five options for occupational provision: "*Direktzusage*" (book reserves), "*Unterstützungskasse*" (support fund), "*Direktversicherung*" (direct insurance), "*Pensionskasse*", and "*Pensionsfonds*" (pension fund). Since 2001, the coverage rate of occupational pension schemes has increased, in the private sector from 38% to 46%. Currently, about 10.3 million workers in the private sector and 5.4 million public employees contribute to an occupational pension plan (roughly 60% of all employees in accordance to TNS Infratest Sozialforschung, 2001-

2004). Furthermore, since the 2001 pension reform, employees are entitled to convert remuneration into contributions to employee-funded occupational pension schemes. Remuneration conversion was used by roughly 1.7 million employees at mid 2004. The average amount converted was 1.100 € per year.

With "*Riester pension*", introduced in 2002, reductions in the pension level of the statutory pension scheme shall be compensated by private savings in specially regulated contracts where up to 4% of an individuals income (within set limits – the contribution base), gradually increasing until 2008. It is promoted by bonuses (independent of wages) or by contributions being tax deductible. The system is also progressive, where the greatest support is provided to low income groups and for those who have children. 4.7 million "*Riester contracts"* have been concluded until September 2005. Besides the "Riester pension" there are other forms of private pension provision. Since 2002 for instance some 8 million private annuity contracts were concluded in addition to the "Riester contracts".

There is no minimum pension, but disabled and older people without sufficient incomes are entitled to means-tested benefits.

2. SITUATION AND PERSPECTIVES IN THE LIGHT OF THE COMMON OBJECTIVES

2.1 Current situation

Concerning **adequacy**, people aged 65 and more have a living standard (disposable income) close to that of the 0-64 population (with a relative equivalised income of 94% taking into account the number of persons in the household), while the gross median pensions account for about 60% of median earnings. According to the second Federal Government Report on Poverty and Wealth, “Living Conditions in Germany” from March 2005, older people have a favourable income development in comparison to the rest of the population; the risk of poverty of senior citizens declined by about 2 percentage points since 1998. The risk of poverty among people aged 65 and more (at 16%) is comparable to the level of poverty (at the 60% threshold of median equivalised income) of the total population (15%). [6]

According to ISG calculations of replacement rates (of 2005), the gross replacement rate for a worker working 40 years at the average wage and retiring at 65 is currently at 43% (63% net). As several recent pension reforms will translate into a reduction of first pillar benefits, the German government committed itself to make adjustments, should the pension benefits fall below a minimum level. The minimum projected pre-tax replacement rate should not be less than 46% until the year 2020 and 43% until the year 2030.[7] Based on a legally defined “standard pensioner” with 45 years of contributions at average earnings, the current level of the pre-tax replacement rate is at 53%, the corresponding net replacement rate is at about 71% (2004). The Old-age Pensions Insurance Sustainability Act of 2004, foresees that the Federal Government will report to the legislative bodies every four years from 2008 onwards regarding compliance with a

[6] Effects of imputed rents of owner-occupied housing are not taken into account in the calculation of this figure. According to more recent figures, referring to income year 2003, the poverty rate of people aged 65 and more is at 15%, while the poverty rate of the general population is 16%.

[7] To calculate this level, the standard pension (gross), reduced by the pensioner’s social insurance contributions, e.g. the contributions to health and long-term care insurance paid by pensioners, is put into ratio with the average wage, reduced by the social insurance contributions paid by employees, e.g. their contribution to pension, health and long-term care insurance and Federal Employment Office as well as the payments made into additional private provision for old-age. The calculation of these pension replacement rates relates to the pension of a legally defined “standard pensioner” with 45 years of contributions at average earnings.

target level of provision before tax of 46 % beyond 2020, and in the event of it being at risk, will submit proposals to attain this objective, while maintaining a contribution rate of up to 20% until the year 2020 and of up to 22% until the year 2030.

Concerning **financial sustainability**, the core element of the Pension Insurance Sustainability Act of 2004 is the introduction of a sustainability factor in the pension adjustment formula: changes in the ratio of pensioners and contribution payers are taken into account when calculating the pension adjustment. For instance, whenever the number of contributors declines due to cyclical fluctuations, the next pension adjustment is lowered, or an increase in the number of pensioners will also lead to a lower pension adjustment. In order to avoid pension reductions, it is stipulated by law that the sustainability factor can lower the adjustment down to zero but can not go beyond this point. The new government has already envisaged curbing future indexation by introducing a new adjustment factor in order to make up for lost indexation cuts because of this restriction. According to ESSPROS figures, pension expenditure was 13.0% of GDP in 2000 and 13.4% in 2003, slightly above EU average in 2003 (12.6% of GDP in 2003).

The employment rate for the total population has been stable over the recent years. At 65% in 2004 it remains below the Lisbon target. For older people, it has been on a steady growth path since 2000, and from 2003 to 2004 it increased from 39.5% to 41.8%. Still the gap to the 50% Lisbon target remains substantial.

Concerning **modernisation**, despite the fundamentally gender-neutral wording of the pension law, there are major differences between the pension entitlements of women and men which reflect above all women's shorter average working lives and lower incomes, mainly due to part time occupations. In order to balance this, policies to increase labour market participation for women and pension credits for child and elderly care were significantly improved.

By virtue of the new regulation applied in 2005, beneficiaries of social assistance considered able to work are covered by the unemployment benefits II and so have access to the State pension system.

Portability of occupational retirement provision has been improved with effect from 2005. A right (under certain conditions) has been introduced for employees to take occupational pension entitlements with them to their new employer. This right applies to new agreements concluded since 1 January 2005 and implemented through direct insurance, “Pensionskasse” or pension fund.

Since 1 January 2004, the statutory old-age pension insurance institutions inform all insured people (from the age of 27) on an annual basis about their individual pension entitlements and the amount of their expected pension. Insured people can then check their insurance careers or their pension information online. As for private insurance, the information obligations have been expanded as from 2005, and further information must be provided prior to conclusion of contract (possible investments, the structure of the portfolio and the risk potential).

2.2 Outlook, reform measures and policy debates

It is expected, that for people taking advantage of the opportunities of supplementary provision, the replacement rate can roughly be maintained at a constant level at a given age and that the increase of older workers employment will enable them to accrue higher pensions. Due to the most recent enacted reforms, the gross replacement rate of the statutory pension scheme for a worker working 40 years at the average wage and retiring at 65 will decrease from 43% in 2005 to 34% in 2050 (according to ISG projections of

2005). The overall gross replacement rate would increase from 43% to 48% until 2050 (total net 63% to 67%), mainly due to a projected increase in the second and third pillar replacement rate up to 15 p.p. in 2050, which is assumed to compensate the decline of 9 p.p. in the statutory scheme.[8]

Recent reforms of the statutory pension scheme and Civil Servants Pension Scheme (since 2002), and in particular the introduction of the sustainability factor in 2004 will significantly improve the long run sustainability of the pension system. The AWG 2005 projections indicate that the expected increase of public spending on pensions from 2004 to 2050 would be 1.7 p.p. of GDP, in contrast to the level of 5.5 p.p. increase projected in the 2001 AWG projections. A similar rise (1.6 p.p. of GDP) is projected for all age-related expenditure over the period 2004-2050.

Measures to increase older people employment have been introduced. The minimum age to receive a state pension because of unemployment or on account of old-age part-time work will be increased from 60 to 63 years from 2006 to 2008 for those born after 1945. For insured persons born after 1951, the possibility of drawing a pension earlier because of unemployment or after part-time working in old age or old-age pension for women has already been completely eliminated. So in future, statutory old-age pensions insurance only offers the possibility to draw an old-age pension before the age of 65 for persons with disabilities and people insured for a long period (35 years of insurance) – but with reductions (0.3% per month of early retirement). People who postpone their retirement beyond the age of 65 receive a bonus of 0.5% per month. Due to these reforms the average retirement age for old age pension increased by one year to 63.1 years since 1998 to 2004. Furthermore the new government has planned to gradually raise the statutory retirement age from 65 to 67 (from 2012 to 2029, with an intermediary stage of 66 in 2023), while keeping open the possibility of retirement at 65 without reductions for people who already have 45 years of contributions. Regarding all types of pension schemes, the German Parliament has also decided to gradually reform pension taxation. This will translate into tax deductibility of the pension insurance contribution of the employed, while pensioners' income will be fully taxed in the long run.

To have a balanced mix between statutory, occupational and private pensions, the awareness of the necessity of self-managed provision could be developed. At the beginning of 2006 the third pension provision report has to be submitted to the Parliament. For the first time there will be a part illustrating to what extent the new support for supplementary pensions (occupational and private) is being taken advantage of and how far the supplementary pension system is being established. The government expects that the high relative support level provided for low income groups and for those raising children will trigger a sufficient participation and coverage in supplementary pension schemes especially for the economically weakest groups. Besides, the new government has announced plans to raise the support level for "*Riester-contracts*" for persons who bring up children, in order to raise the support to more than 50% for parents having one child born in 2008 or later. With the introduction of unisex-tariffs as a new condition for support for the funded private pensions, from 2006 on, men and women will receive equal benefits for equal contributions in *"Riester contracts"*.

3. Conclusion

The last pension reform made progress in terms of financial sustainability. From 2005 on, the introduction of the sustainability factor in the pension adjustment formula will

[8] Contributions of 4% of wages to the second or the third pillar are assumed. These schemes currently cover around 70% of the employed.

automatically slow down annual pension adjustments, including for new pensioners. Due to recent pension reforms and the gradual change in taxation, the replacement rates of public pensions will be significantly reduced.

Germany is terminating early retirement paths within a fairly short transition period. Progress in raising the employment rates, particularly of older workers, is a major condition for future adequacy and sustainability. There is therefore also a priority for further labour market measures. The Federal Government will report in 2008 on trends in adequacy and sustainability of the pension system as well as the employment of elderly employees. The new government has planned to gradually raise the statutory retirement age from 65 to 67, from 2012 to 2029.

In order to meet Germany's expectation to compensate the pension cuts in the statutory pension scheme by better occupational and personal provision, further improvements in the coverage rate might be necessary. Social partners have a key role in developing extensive occupational pension schemes so that the largest possible number of workers can benefit from this provision. They should also ensure that such schemes do not hinder mobility.

4. BACKGROUND STATISTICS

	DE			EU25		
Adequacy						
Current situation						
	Total	Men	Women	Total	Men	Women
At-risk-of-poverty rate [1]	15	13	17	16	15	17
0-64	15	13	17	16	16	17
65+	16	11	19	18	15	20
75+	17	9	20	Nd	Nd	Nd
Income inequality [1]						
0-64	4.4					
65+	3.9					
Income of people aged 65+ as a ratio of income of people aged 0-64 [1]	0,88	Nd	Nd			
Median pensions relative to median earnings [2]	Nd	Nd	Nd			
Long-term projections						
Theoretical replacement rates[3]	2005	2030	2050			
Total net replacement rate	63	65	67			
Total gross replacement rate	43	46	48			
Gross repl. rate 1st pillar	43	37	34			
Gross repl. rate 2nd/3rd pillar	0	9	15			
Financial sustainability						
Current situation						
ESSPROS Pension expenditure [4], % of GDP	***1995***	2000	***2003***	***1995***	2000	***2003***
	12,5	13,0	13,4		12,5	12,6
Employment (2004) [5]	Total	Men	Women	Total	Men	Women
Employment rate ***(25-54)***	78,1	83,9	72,1	76,8	85,2	68,5
Employment rate (55-64)	41,8	50,7	33,0	41,0	50,7	31,7
Effective labour market exit age (2004) [6]	61.3	61.4	61.1	60.7p	60.9	60.4p
Public finances (2003) [7]						
Public debt, % of GDP	64,2			63,3		
Budget balance, % of GDP	-3,8			-2,8		

Long-term projections (EPC 2006)

	DE Level			DE increase	EU25 Level			EU25 increase
	2004	2030	2050	2004-50	2004	2030	2050	2004-50
Old-age dependency ratio [8]	26,8	44	51,7	+93%	25	40	52	+108%
Public pensions expenditure, % of GDP [9]	11.4	12.3	13.1	+1.7	10,6	11,9	12,8	+2,2

Factors determining the evolution of public pensions expenditure (2000-2050) [10]	DE: Contribution to change in percentage points of GDP	EU25: Contribution to change in percentage points of GDP
Demographic dependency	7,5	8,6
Employment	-1,1	-1,1
Eligibility	-0,6	-2,1
Level of benefits	-3,5	-2,7
Total (including residual)	1,7	2,2

Notes:
1. Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, Income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002),
2. Source: Eurostat. Median individual pension income of retirees aged 65-74 in relation to median earnings of employed persons aged 50-59 excluding social benefits other than pensions.
3. Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first and second pillar pension schemes, retiring at the age of 65 years in 2005.
4. Source: ESSPROS, EUROSTAT. Includes expenditure by certain private social protection schemes.
5. Source: European Labour Force Survey, 2004.
6. Source: European Labour Force Survey, 2004.
7. Source: European Commission, DG ECFIN.
8. Source: EUROSTAT (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15-64.
9. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.
10. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.

* proportion negligible

ESTONIA

1 MAIN CHARACTERISTICS OF THE PENSIONS SYSTEM

Statutory schemes: There are two kinds of statutory schemes: the State PAYG DB pensions and mandatory funded DC pensions. Pension benefits of PAYG scheme can be divided into two groups: employment-related and national pensions. The employment-related benefits are the old-age pension, the pension for incapacity for work and survivors' pensions. They are financed by 20 percentage points (or 16 in the case of members of the mandatory funded pillar) of the 33% social tax, paid by employers. The purpose of the national pension is to guarantee a minimum income for those who are not entitled to an employment-related benefit. They are financed from the general State budget. The coverage of the PAYG system is practically universal.

The retirement age for men is 63 and for women it will reach the same age by 2016. There is a possibility for early retirement 3 years prior to the normal retirement age if the person has a work record of at least 15 years. For every month of early pension the pension entitlement is reduced by 0.4%. Where the pension is deferred the entitlement is increased by 0.9% for every month after the normal retirement age.

The compulsory funded DC scheme was introduced in 2002 by diverting a portion of contributions from the statutory PAYG scheme into private funds. This has reduced the problem of contribution evasion. Participation is mandatory only for persons born in 1983 or later. For people born between 1942 and 1982 joining the scheme was voluntary, but there is an upper age limit for choosing the system, which is reduced until 2010, when joining will become compulsory. By 2005 around 75% of the labour force has joined the new system. The scheme is financed by 4 percentage points of the 20% pension contribution paid by the employer and an employee's contribution of 2% of the gross wage, withheld by the employer. Benefits can be received upon reaching the standard retirement age. First benefits should be paid in 2009, but so far the payout phase has not been developed (neither detailed products nor logistics of the system). Invalidity and survivor risks are not covered by this scheme.

Individual provision: In 1998, voluntary private pension schemes were introduced, participation in which can take two different forms: pension insurance policies offered by licensed private insurance companies or units of pension funds managed by private asset managers. Occupational pension provisions are not promoted by the authorities in Estonia. Nevertheless, under the individual pension provision there is a possibility for the employer to make contributions on an employee's behalf, but as this is subject to high taxation it is not widely used.
To encourage participation in the voluntary private pension schemes, tax incentives have been introduced. For income tax, contributions are deductible from the taxable income up to the limit of 15 % of the annual income, and benefits are taxable at a lower 10% rate (normal rate is 26%) while lifelong annuities are not taxable. Nevertheless participation in the voluntary individual scheme is low (around 8% of labour force) and therefore, its contribution to older people's incomes is projected to be rather marginal.

Minimum income guarantees and other benefits for older people: Although the Estonian pension system and the social protection system in general include some minimum income guarantees (national pension; minimum old age pension; social assistance subsistence benefit), these benefits do not necessarily take the beneficiary above the poverty line. About 1% of all persons of pension age receive a national pension

and about 2.6% receive social assistance subsistence benefit in addition to their pension (mainly during the winter months to compensate for heating costs).

2 SITUATION AND PERSPECTIVES IN THE LIGHT OF THE COMMON OBJECTIVES

2.1 Current situation

Adequacy: Adequacy of pensions is already an issue in Estonia as replacement rates are low. According to ISG calculations the theoretical net replacement rate is 41% in 2005, while the gross replacement rate is 33%. The pension formula favours low-wage recipients: the theoretical net replacement rate for persons with earnings at 2/3 of the average wage is 58%, while the theoretical net replacement rate to a person earning twice the average wage stands at 23%.

The poverty rate among the elderly currently lies at 17%, slightly lower than for the 0-64 population (19%), reflecting that neither the national pension nor minimum old-age pensions can currently take beneficiaries above the poverty line. Furthermore, the old-age pension formula (introduced in 1999), including a coefficient on personal contributions to the pension system which is expected to lead to a strong increase of recipients of minimum pensions. According to national projections, the current level of 1% of those in receipt of the minimum pension will increase to 17% by the time reforms take full effect (when those entering the labour market in 1999 retire).

Under the current indexation rules, pensions are indexed on the basis of 50% CPI and 50% of the increase in social contribution revenues. The plans to increase the share of social contribution revenues and reduce the share of CPI in the indexation formula have been postponed.

Financial sustainability: The Estonian pension system is currently financially stable – expenditure has stayed around 7% of GDP for almost a decade, there is a small reserve, a balanced budget strategy and debt level is low. At the same time however, demographic trends suggest future pressure on public finances.

The total employment rate in Estonia in 2004 was 63% and has been on an increasing trend since 2000. Employment rates of workers aged 55-64 (52.4%) fulfils the Lisbon target already and the employment rates for women (60%) are almost in line with this target. Focusing in particular on reducing early retirement options for special favourable pension schemes could have a significant impact on employment rates.

The average exit age from the labour market (62.3 in 2004) is reflecting the increase in the retirement age (an ongoing process for women until 2016), the reduction of pension rights in cases of early retirement and incentives for deferred retirement. Recently a new rule was introduced enabling further accrual of pension rights, when working beyond the public retirement age. Besides early retirement pensions there are other pathways in the system for earlier retirement including in some special pensions (e.g. for military and police officers) the right to a pension before the general pension age. So far there has been a lack of political consensus on the way to reform these pension rights.

The development of the mandatory funded pension scheme results in lower contribution for the State PAYG scheme while the accumulation of funded pensions is projected to maintain the level of pensions in payment. In the first years after launching the funded tier of the statutory scheme – in 2002 and 2003 – the PAYG pillar budget surplus increased, due to improvements in the labour market and increased incentives to contribute. In 2004 direct transfer costs amounted to 0.1% of GDP, which was financed by the government from the surplus of social tax revenues from previous years. According forecasts of the Ministry of Finance, the existing reserves of the state pillar

(1.4% of GDP at the end of 2004) will be exhausted due to pension reform transition costs by 2006 and in 2007-2012 the state pension insurance budget needs additional public subsidies.

Modernisation: The Estonian pension system encourages transparency and adaptation to labour market evolutions. Further reforms under discussion regarding the pension formula and reform of special favourable pensions are ongoing.

Members' rights in the state pillar as well as in the funded pillars are well protected. Rights in the funded pillars are secured through internationally recognized prudential rules, transparency of fund operations and a regulated fee structure. Pension funds are transparent and information widely provided to members and non-members.

The pension system makes great use of the Internet. Not only is a lot of information available, but the paying of taxes and contributions is done electronically, people can follow their PAYG pillar records as well as funded pillars statements over the Internet and even join funded pillars or change the funds there. As most of the transactions are done electronically, the system is also swift and transparent.

2.2 Outlook, reform measures and policy debates

According to Eurostat population projections, low fertility rates and increases in life expectancy will lead to the old-age dependency ratio increasing from its present 24% to 31% by 2025 and to 43% by 2050.

Estonia acknowledges a consolidated general government budget surplus of 2.6% of GDP in 2003 and the total government sector debt was only 5.8%. By the end of 2003, the stabilisation reserve (established to reduce macro-economic risks and to finance long-term structural reforms, incl. pension reform) amounted to about 3.9% of GDP. There is also a reserve for the State pension insurance scheme, the size of which also depends on future decisions concerning exceptional pension increases.

According to the AWG 2005 projections, Estonia will see a noticeable fall in spending on public pensions (from 6.7% of GDP in 2004 to 4.2% in 2050) linked to the diversion of part of the social security pension contributions into privately funded schemes (taking into account the mandatory funded system, pension expenditures will move from 6.7% in 2004 to 6.6% in 2050). Total age-related expenditure is expected to decrease by the same percentage of GDP. Such budgetary developments would allow it to eliminate the small current public debt of about 5% of GDP by 2020.

ISG projections of replacement rates reflect an increasing role of the defined-contribution mandatory funded pillar. By 2050 the theoretical net replacement rate of a worker retiring at 65 after 40 years at the average wage are projected to remain roughly constant at 43%. This reflects a steady decrease of the replacement rate provided by the first tier of the first pillar (from 33% of gross replacement rate in 2005 to 15% in 2050), while the contribution of the funded tier is projected to reach 13% of gross replacement in 2030 and 21% in 2050. At 2/3 of average earnings the net replacement rate is projected to decline to 46%, while the replacement rate for pensions based on earning twice the average will increase to 31%.

3 CONCLUSIONS

The pension reform in Estonia, started in 1998, modified the pay-as-you-go scheme and introduced new mandatory and voluntary funded components. The reformed system is financially well balanced at present as well as sustainable in the long run. Transition costs are estimated to be moderate, requiring additional public subsidies only during the

period from 2007 to 2012. Moreover, transparency of the system is outstanding, especially due to high level of internet usage of the public and availability of most information and transactions via electronic channels. While poverty rates among the elderly currently remain moderate, the main challenge concerns the future adequacy of pensions, as current replacement rates are already rather low and projected to decline even further. Although the employment rate of older workers is higher than the EU average, for a number of special pension schemes the retirement age remains considerably lower, than in the public PAYG old-age pension scheme, while in some cases these schemes offer additionally much higher pensions than contributions made would allow. Attention should be paid to such early retirement schemes. Furthermore, the benefits payout system in the mandatory funded tier needs to be developed before 2009, when first payments should be made.

4. Background Statistics

	EE			EU25		
Adequacy						
Current situation						
	Total	Men	Women	Total	Men	Women
At-risk-of-poverty rate [1]	18	17	20	16	15	17
0-64	19	18	19	16	16	17
65+	17	7	22	18	15	20
75+	18	3	24	Nd	Nd	Nd
Income inequality [1]						
0-64	6.1					
65+	4.7					
Income of people aged 65+ as a ratio of income of people aged 0-64 [1]	0,76	0,80	0,72			
Median pensions relative to median earnings [2]	0,68	0,7	0,68			
Long-term projections						
Theoretical replacement rates[3]	2005	2030	2050			
Total net replacement rate	41	42	43			
Total gross replacement rate	33	34	36			
Gross repl. Rate 1st pillar	33	21	15			
Gross repl. rate 2nd/3rd pillar	0	13	21			
Financial sustainability						
Current situation						
ESSPROS Pension expenditure [4], % of GDP	***1995***	2000	***2003***	***1995***	2000	***2003***
		6,9	6,3		12,5	12,6
Employment (2004) [5]	Total	Men	Women	Total	Men	Women
Employment rate ***(25-54)***	78,8	81,6	76,2	76,8	85,2	68,5
Employment rate (55-64)	52,4	56,4	49,4	41,0	50,7	31,7
Effective labour market exit age (2004) [6]	62.3			60.7p	60.9	60.4p
Public finances (2003) [7]						
Public debt, % of GDP	5,3			63,3		
Budget balance, % of GDP	3,1			-2,8		

Long-term projections (EPC 2006)

	EE Level			EE increase 2004-50	EU25 Level			EU25 increase 2004-50
	2004	2030	2050		2004	2030	2050	
Old-age dependency ratio [8]	23,8	33,4	43,1	+81%	25	40	52	+108%
Public pensions expenditure, % of GDP [9]	6.7	5.3	6.6	-0.1	10,6	11,9	12,8	+2,2
Factors determining the evolution of public pensions expenditure (2000-2050) [10]	Contribution to change in percentage points of GDP				Contribution to change in percentage points of GDP			
Demographic dependency	3,1				8,6			
Employment	-0,6				-1,1			
Eligibility	-1,5				-2,1			
Level of benefits	-3,8				-2,7			
Total (including residual)	-3,0				2,2			

Notes:

1. Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, Income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002),
2. Source: Eurostat. Median individual pension income of retirees aged 65-74 in relation to median earnings of employed persons aged 50-59 excluding social benefits other than pensions.
3. Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first and second pillar pension schemes, retiring at the age of 65 years in 2005.
4. Source: ESSPROS, EUROSTAT. Includes expenditure by certain private social protection schemes.
5. Source: European Labour Force Survey, 2004.
6. Source: European Labour Force Survey, 2004.
7. Source: European Commission, DG ECFIN.
8. Source: EUROSTAT (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15-64.
9. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.
10. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.

* proportion negligible

GREECE

1 MAIN CHARACTERISTICS OF THE PENSIONS SYSTEM

The first pillar pension system includes primary and auxiliary pensions. Primary pensions consist of pay-as-you-go financed schemes, which are dispersed across industrial sectors and provide varying levels of pension. The largest funds are IKA (for wage earners) and OGA (for farmers) while a separate scheme (OAEE) also covers the self-employed. Employees' and self employed pensions are defined-benefit. The equal retirement age for men and women was stipulated for those persons who entered the pension system from 1993, the current legal retirement age for men is 65 and 60 for women. A second tier of the first pillar consists of occupation-based auxiliary funds which provide supplementary pensions. They cover all employees and a small percentage of the self-employed and typically offer additional replacement rates of up to 20%. In 2001, they accounted for 1.8% of GDP (14.5% of pensions expenditure), a proportion which is growing over time. In the public sector, lump-sum severance payments are also common.

All funds are financed through the pay-as-you-go system and benefit levels are implicitly guaranteed by the State. The implicit rates of return (taking into account contributions, age limits and benefits) differ among funds, reflecting possible different retirement provisions. As far as contributions to IKA are concerned, a worker insured to IKA pays 6.67% of their gross salary for the primary pension and 3% for the auxiliary pension (9.67% in total). Employers pay 13.33% of the employees' gross salary for the primary pension and 3% for the auxiliary pension.

Second-pillar occupational pensions are not widespread. Third pillar life insurance benefits, not as popular as in several other Member States, typically come in the form of a lump sum and only rarely as an annuity.

Means-tested benefits are provided to those 65 and over without a sufficient insurance record, whilst a large number of pensioners receive contributory pensions at a guaranteed minimum level. Pensioners whose total income (from any source, including pensions) is below a guaranteed minimum level and whose other income and household situation fulfil additional criteria are provided with a pension supplement (known as EKAS, to which OGA pensioners are not eligible).

2 SITUATION AND PERSPECTIVES IN THE LIGHT OF THE COMMON OBJECTIVES

2.1 Current situation

Concerning **adequacy,** the 2002 law permits pension rights to insured persons with 37 years of contributions independent of age. It also reduces divergences between insured people from the "old" (before 1993) and "new" (after 1992) regime, as well as between the private and the public sector. The gradual implementation of the new measures will begin after 2007. From 2017 on, a common replacement rate of 70% for the primary pension (for 35 years of contributions) will be applied to both "old" and "new" insured persons both in the private and the public sector. This entails an increase for the primary pension replacement rate for the new system entrants up from 60% to 70%; on the other hand, it entails a reduction for public sector employees from 80% to 70%.

The 2002 reform took measures to increase the minimum pension level, which should reach 70% of the minimum salary of a married fully employed person. Despite the progress that has been achieved in the recent years, old age is still the most important

factor in determining risk of poverty. According to SILC figures for 2003 (income year 2003), the poverty rate of people aged 65 or more stands at 28% (35% for pensioners aged more than 75, but with very low gender difference), 10 p. p. higher than the poverty risk of people aged 0-64, despite the fact that pension expenditure represents 13% of GDP in 2002. When interpreting these figures, it should be borne in mind that older people are much less likely than elsewhere in the EU to live in old peoples' homes, hospitals or other communal institutions (less than 3% of the retired population). They also have higher rates of home ownership. Both these factors may lead to an over-estimation of poverty risks. Partly due to the fact that a large proportion of pensioners live with their children, pensions constituted a smaller share of their household income than elsewhere.[9] Nevertheless, a large number of pensioners rely on the protection of minimum pensions and on the means-tested pension supplement EKAS.

Concerning **sustainability,** the total employment rate has been on a rising trend over the last few years, but continues to stay far below the Lisbon target (59% versus 70% in 2004). Unemployment has been declining since 2000, but remains higher than the EU-25 average and continues to affect mainly the young and women. There are significant differences in employment rates between men (89% for 25-54) and women (58%). The employment rate of older workers has slightly increased since the beginning of the 90's and reached 42% in 2003. In 2004 this figure decreased to 39% and remains below the Lisbon target. Incentives to prolong working life have recently been increased for insured persons to remain in service for the full 35 year period: if one works until 67 years of age (instead of 65), an individual receives an increase of 1% to their pension.

The pension system appears to adapt to changes in the labour market, in particular with regard to the protection it offers to part-time employees, but also in relation to the principle of equal treatment of part-time and full-time employees. Part-time employees are entitled to equivalent rights to those of full-time employees, while their insurance coverage for working 4 hours a day gives them the right to insurance for a full-days employment.

Concerning **modernisation,** while the legal system provides for equal treatment of men and women, women are indirectly affected in their pension incomes, in particular because of their shorter working records. The quantitative and qualitative improvements of the services and of the benefits for pensioners are steadily progressing through the computerization and simplification of administrative procedures.

2.2 Outlook, reform measures and policy debates

Greece is projected to face unfavourable demographic trends, similar to most other EU Member States, in the coming decades. Fertility rates have rapidly decreased since the 1980s. Life expectancy at birth, currently close to the EU average is expected to grow by 4.6 years for men and 4.5 years for women between 2004 and 2050. Net migration flows are not projected to be substantial. As a consequence, the old-age dependency rate will grow from a moderate 26% in 2005 to 60% in 2050, among the highest in the EU.

An important policy direction refers to the adequacy of those with lower pension incomes. This issue will constitute an important item of the national dialogue on pension system reform. In that respect, a recent measure is the abolition of contributions of pensioners to the main and auxiliary insurance organisations introduced in 2004, this is estimated to increase pensioner income by 1-5%.

[9] According to EU-SILC 2003, 65% of the total income of individuals over 65 years comes from pensions, 26% from employment and 3% from other social benefits.

Current adequacy issues also reflect the limited years of contributions for people currently retiring (the average length of contribution careers is 27.5 years for men and 20.8 years for women), as well as contribution evasion and the fact that in a number of cases contributions are paid for only a part of actual individual wages.

According to ISG projections for workers insured to IKA achieving a complete career of 40 years of contributions, the net replacement rate for someone retiring at 65 in 2005 will increase by 6 p.p. by 2030 and then decline by 15 p.p., a 9 p.p. deduction between 2005 and 2050, due to the effect of recent reforms. For workers having achieved a complete career of 40 years of contributions, according to ISG calculations, the total net replacement rate for someone retiring at 65 would currently be 115% (total gross 105%). If, instead of the hypothesis of 40 years of contributions, the current weighted average of contribution years is taken into account (25 years), and instead of the 65 retirement age we consider the current weighted average retirement age (which is 60), then the replacement rate for the primary pension is 33%.

A main challenge is to address the multiplicity of systems of compulsory insurance for different professional groups which results in the fragmentation and legislative complexity of the social security system, with a view to reducing inequities that might undermine social acceptance of the system. Since even within one fund, different occupational categories may be subject to different conditions and different pay-as-you-go rules, schemes may provide varying levels of pension. Recent reforms, such as the unification of different funds and the reforms in the banking sector suggest the direction of travel is right.

Greece can expect strong budgetary pressure resulting from the process of ageing populations. Adverse demographic trends will contribute to a very high increase in public spending on age-related items. According to the budgetary projections made by the AWG in 2001, expenditure on pensions is projected to almost double reaching a level of 24.8% of GDP in 2050, almost twice the EU15 average of 13.4%. Such developments are confirmed by the budgetary projections included in the 2004 update of the Stability and Growth Programme in the context of the assessment of the long-term sustainability of public finances, which project public spending on pensions increasing from 12.3% of GDP to 22.6% between 2009 and 2050. While the 2002 reform addresses a number of issues with the aim of making the system more credible and socially acceptable, the still-large projected increase in expenditure, despite the high starting level, suggests that significant further efforts will be required.

Many of the recent measures are aimed at tackling the existing problems to clear the path for further reform measures needed in order to prepare for the demographic problem. The extra public funding of IKA by on average, 1% of GDP between 2003 to 2032, has been established with the double aim of managing the cash flow of the main pension fund (IKA) over the medium-term but also of transferring resources for the use of the fund for the period from now until 2030.

There is substantial scope for improving the adequacy and sustainability of the pension system in the medium and long term by increasing employment rates. In that respect, increases of the employment rate of women and older people represent very important potential resources. Recent initiatives such as promoting part-time employment and active labour market policies could contribute to especially improve women's participation.

3 CONCLUSION

Implementation of the 2002 reform is considered to be crucial for rebuilding confidence in the pension system and for laying the groundwork for further reform efforts. In order to meet the financial challenge of ageing, the process of pension reform needs to continue with financial consolidation in due course, building on the modernisation that started with the 2002 reform. However, further steps needs to be taken.

There is substantial scope for improving the adequacy and viability of the pension system in the medium term by increasing employment rates (in particular of women) and curbing contribution evasion. Nevertheless, significant further efforts will be needed to stabilise expenditure growth in order to ensure the long-term financial sustainability of the pension system.

In addition, while most recent reforms have translated into strengthened incentives to work longer, further measures are needed to raise employment rates especially for women and older workers. Thus active labour policies in this direction need to be strengthened. Gradually equalising the legal retirement age for men and women and for people already contributing to the system before 1993 might be taken into consideration.

4. BACKGROUND STATISTICS

	EL			EU25		
Adequacy						
Current situation						
	Total	Men	Women	Total	Men	Women
At-risk-of-poverty rate [1]	20	19	21	16	15	17
0-64	18	18	19	16	16	17
65+	28	26	30	18	15	20
75+	35	35	34	Nd	Nd	Nd
Income inequality [1]						
0-64	6,0					
65+	5,1					
Income of people aged 65+ as a ratio of income of people aged 0-64 [1]	0,78	0,81	0,77			
Median pensions relative to median earnings [2]	0,76	0,81	0,69			
Long-term projections						
Theoretical pension replacement rates[3]	2005	2030	2050			
Total net replacement rate	115	121	106			
Total gross replacement rate	105	112	94			
Gross repl. rate 1st pillar	105	112	94			
Gross repl. rate 2nd/3rd pillar	*	*	*			
Financial sustainability						
Current situation						
ESSPROS Pension expenditure [4], % of GDP	***1995***	2000	***2003***	***1995***	2000	***2003***
	11,2	12,5	12,9		12,5	12,6
Employment (2004) [5]	Total	Men	Women	Total	Men	Women
Employment rate ***(25-54)***	73,5	89,3	57,6	76,8	85,2	68,5
Employment rate (55-64)	39,4	56,4	24,0	41,0	50,7	31,7
Effective labour market exit age (2004) [6]	59,5	60,3	58,8	60,7p	60,9	60,4p
Public finances (2003) [7]						
Public debt, % of GDP	109,9			63,3		
Budget balance, % of GDP	-4,6			-2,8		

Long-term projections (EPC 2006)

	EL Level			EL increase 2004-50	EU25 Level			EU25 increase 2004-50
	2004	2030	2050		2004	2030	2050	
Old-age dependency ratio [8]	26,4	39,5	60,4	+129%	25	40	52	+108%
Public pensions expenditure, % of GDP [9]	Nd	Nd	Nd	Nd	10,6	11,9	12,8	+2,2
Factors determining the evolution of public pensions expenditure (2000-2050) [10]	Contribution to change in percentage points of GDP				Contribution to change in percentage points of GDP			
Demographic dependency	Nd				8,6			
Employment	Nd				-1,1			
Eligibility	Nd				-2,1			
Level of benefits	Nd				-2,7			
Total (including residual)	Nd				2,2			

Notes:

1. Source: Income and living conditions data. Based on equivalised incomes. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, Income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).
2. Source: Eurostat. Median individual pension income of retirees aged 65-74 in relation to median earnings of employed persons aged 50-59 excluding social benefits other than pensions.
3. Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first and second pillar pension schemes, retiring at the age of 65 years in 2005.
4. Source: ESSPROS, EUROSTAT. Includes expenditure by certain private social protection schemes.
5. Source: European Labour Force Survey, 2004.
6. Source: European Labour Force Survey, 2004.
7. Source: European Commission, DG ECFIN.
8. Source: EUROSTAT (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15-64.
9. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.
10. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.

* proportion negligible

SPAIN

1 MAIN CHARACTERISTICS OF THE PENSION SYSTEM

The first pillar of the Spanish pension system consists of a general earnings-related scheme financed through contributions (and special schemes for civil servants working for the central government or the justice system and for people working for the armed forces). The general scheme is mandatory for all employees and self-employed and provides pension entitlements after a minimum contribution period. For retirement pension, this period is 15 years (of which at least 2 must have occurred in the last 15 years). The contribution rate is 28.3% of earnings (4.7 percentage points paid by the employee and 23.6 by the employer). It covers in addition to old-age pensions, disability and survivors and other risks including maternity and temporary incapacity.

Benefits are calculated as a percentage of a so-called 'base pension', which is an average of the contributions paid during the 15 years before retirement (up to an annual ceiling of 33.760.8€ corresponding to about 190% of the average wage; contributions are revalorised with prices for the 13 first years). A full pension of 100% of the 'base pension' is reached after 35 contribution years (or retirement at the standard age of 65). The percentage of the base pension that is paid increases with the number of years a person contributed to the system: it increases from 50% after 15 years by 3% a year between the 16th and the 25th year (reaching 80% after 25 years) and by 2% a year until the 35th year (reaching 100%).

Pensions are, in principle, adjusted annually in line with the consumer price index, but, in practice, they have increased in real terms in recent years, particularly the guaranteed minimum pensions which raise low contributory pension entitlements to the guaranteed level.

Two mechanisms contribute to providing minimum pensions: a guaranteed minimum contributory pension and non-contributory pensions. The earnings related pensions are topped up to the minimum levels for pensions. The share of pensioners receiving top-ups, which was 28.3% in 2005, declines as a result of the higher pension entitlements of new retirees (the proportion of new pensioners eligible for top-ups decreased from 30.1% in 1995 to 18.4% in 2004). Introduced in 1990, non-contributory pensions cover 6.3% of pensioners and provide a means-tested guaranteed minimum income for those without earnings related pension benefits (e.g. because of insufficient contribution periods or a lack of contributions). In addition, pensioners can benefit from additional services: right to healthcare, social services and future protection through new legislation focused on situations of dependency.

Supplementary pension schemes of the second or third pillar were estimated to cover nearly 7.3 million people in 2003 (around 41% of the employed). As a result of the development of occupational pensions in the public sector, the number of members increased by more of 500 000 in 2004. Along with this, Autonomous Communities are promoting parallel schemes, which could increase the total number of members by 2 millions approximately. Pension plans tend to be more often adhered to on an individual basis or through membership in a group (association, trade union, etc.) and about 10% of the members participate in an occupational scheme established by a collective agreement. The benefits can be drawn in the form of regular or lump-sum payments covering retirement, invalidity, death and survivors' benefits. In 2003, about 40% of pension plans beneficiaries chose to take only lump sum payments (corresponding to around 60% of benefits). Proportions are comparable for individual insurance beneficiaries.

The legal framework for private pension provision was reformed in 2002 regulating in particular the tax treatment of these schemes and enhancing the protection of beneficiaries. The book reserve financing system traditionally used for occupational pension plans is being abolished (except in the financial services sector, for the staff who was employed prior to 1999) in favour of external funds to enhance the safety of pensions in the event of bankruptcy of the employer company.

Individuals can have a choice of personal pension plans (made up of individual pension plans and group pension plans) and individual insurance contracts, enjoying the same fiscal treatment as pension plans.

2 SITUATION AND PERSPECTIVES IN LIGHT OF COMMON OBJECTIVES

2.1 Current situation

The living standard of people aged 65 or more represents 78% of the 0-64 population, with a small gap between men (75%) and women (81%) (albeit not in terms of individual pension entitlements). Inequality of income is comparable among the population of 65 and more than among the 0-64 population (as measured by the ratio of the fifth quintile to the first quintile of income).

The statutory scheme provides a high replacement rate for low or average wages (about 91% of gross replacement rate and 97% of net replacement rate for a worker retiring at 65 after 40 years of contributions), which decreases for higher wages, due to the ceiling.

The risk of poverty for people aged more than 65 was 28% in 2002 (at the 60% threshold), which is higher than for the general population (19%), although the share of pensioners that are not eligible to the earnings related pension is decreasing. Poverty is slightly higher among older pensioners (31% for people aged 75 and more).

The general employment rate has increased by more than 10 p.p. since 1996 up to 61% in 2004, mainly driven by an increase in women's' employment and foreign workers entering the system and employment growth is expected to continue, according to recent national sources.[10] In the meantime the employment of workers aged 55-64 increased by 8 p.p., with a 2004 level of 413%, still below the Lisbon target. The Spanish employment rates for women remains amongst the lowest, thus providing considerable potential for employment growth and hence a stronger contribution base for financing pensions. The large numbers of foreign workers are expected to continue to sustain the relatively fast employment growth in Spain.

Measures to reduce women's unemployment focus on promoting education and training and on reducing employers' social contributions if women are given open-ended contracts. Moreover, some steps have been made to facilitate the reconciliation of family and work responsibilities through measures such as the extension of the right to a reduced working day or leave for people who are caring for dependent people (not only children) and through the facilitation of paternity leave (as an alternative to maternity leave).

In recent years, some steps were taken with the aim of increasing the employment rate of older people notably through better opportunities for flexible and gradual retirement. Working beyond the age of 65 now allows an individual to accrue higher pension entitlements, whilst it is also possible to draw a (partial) pension while continuing to

[10] According to recent national data, the number of foreigners covered by the Social Security system increased from around 330 000 in 1999 to around 1 700 000 in 2005, the increase being essentially from non EU25 foreigners.

work after 65. It is also possible to receive an early retirement pension at the age of 61, for people who are registered as unemployed, are actively looking for a job and have long contributions histories. Furthermore, Spain seeks to promote the employment of people over 45 through considerable reductions of social security contributions.

Thanks to sustained economic growth and the discipline required by the budgetary stability law, Spain has made major efforts to achieve balanced budgets both at the level of the central government and in the sub-sectors of the general government (autonomous communities and local authorities). Moreover, the Social Security system shows surpluses since 1999. These surpluses have been transferred to the reserve fund created in 1997 to help to cover increased future pension expenditure. In July 2005, the assets of the fund amounted to 3.2% of GDP. The accumulation of funds will continue as long as the social security system produces surpluses, which is projected to be until 2015.

Although eligibility requirements and ways of calculating pensions awarded are neutral according to genders, poverty rates are slightly higher among women (30% for women and 26% for men) and the proportion of women receiving minimum pensions is greater than that of men (the difference is reducing mainly due to the increasing number of women in the labour market). Contributions are provided during the first year of unpaid leave for the care of children (or dependent family members). Moreover, minimum contribution periods entitling a worker to a pension are calculated by multiplying the time worked by a factor of 1.5 for part-time workers, which increases the pension entitlements of part time workers (about 3% of men and 18% of women in employment).

In terms of transparency and information for citizens, workers are being offered substantial information on their pension rights, in particular through the social security website which is continuously updated.

2.2 Outlook

Due in particular to low fertility rates, Spain faces one of the largest increases in the old-age dependency ratio in the EU over the coming 50 years: the old-age dependency ratio will increase from 25% in 2004 (in line with the EU25 average) to 67% in 2050 (above EU25 average of 52%). In recent years important regularisations of migrants have occurred and future demographic developments (and hence the old-age dependency ratio) will also depend on migratory flows which are projected to stabilise at a lower level in the future compared with the recent high flows but are difficult to predict. However, as a consequence of low birth rates during the Spanish Civil War, Spain will experience the impact of ageing somewhat later than most other Member States.

Spain is trying to tackle the issue of adequate and sustainable pensions on the basis of a large political consensus. The Toledo Pact concluded in 1995, put into law in 1997 and renewed in 2003 and the Declaration for Social Dialogue of July 2004 represent important steps forward in facilitating the management of the financing of the social security system, in particular by separating contributory from non-contributory benefits, the latter being financed through the general budget.

According to the new projections of replacement rates of the ISG, the replacement rate provided by the earnings related scheme for average earning workers, retiring at 65 after 40 years of contributions, should decrease by 6 p.p. in 2050, reaching a level of about 85% of gross replacement rate for the average wage in 2050 (92% of net replacement rate).

Recent reforms should reduce poverty rates amongst pensioners in the near future. In January 2004, survivor's pensions and minimum pensions were increased (on average by about 6%.), while in January 2005, the government initiated an increase in minimum

pensions (ranging from 6% to 8%, depending on why the recipient was entitled to the benefit) as part of an overall announced increase of 26% of minimum pensions over the legislature. It is expected that reforms of minimum and survivor's pensions will translate into a reduction of gender differences in living standards and poverty risks.

In 2005 the government also modified the means test of minimum pensions, by taking into account increases in value of personal assets. The government also wishes to increase coverage of occupational pension provision, notably through changes to fiscal incentives for pension funds, in order to encourage the use of annuities after retirement age, instead of lump sums.

Low participation rates and high unemployment, particularly among older people and women, are being addressed by a number of new reform efforts. Exemptions of social contributions for older workers range from around 50% and can reach 100% for workers aged 60 or over, who are on permanent contracts and who have been with the company for at least five years. Furthermore, the unemployment protection system has been reformed allowing workers aged over 52 to draw unemployment benefit while working. A draft law has been approved regarding work beyond the normal retirement age, reflecting the clauses of collective agreements, limiting the scope for employers to terminate a contract when a worker reaches legal retirement age (65), subject to several conditions linked to quality of employment. The government plans to propose measures that could contribute to significantly strengthen incentives to work longer, through establishing a closer link between the level of contributions and the level of benefits for earnings related pensions, and to simplify early retirement schemes and bring them closer to the legal retirement age. Moreover, the government proposes calculating the level of permanent incapacity pensions according to the number of years of contributions in cases where the pension is for a non-work related accident or illness. It also plans to tighten controls of temporary incapacity and to overhaul the widow's pensions system, by reducing payment in cases where the recipient has a high level of personal income, or is receiving large social security pensions.

Demographic trends are expected to translate into pressure on the public finances in Spain. According to projections made by the AWG in 2005, public spending on pensions is set to increase from 8.6% to 15.7% of GDP, far more than the EU average[11]. Nearly all the increase is projected to occur after 2020, due to Spain's relatively late ageing profile. Surpluses of the Social security should accumulate in the reserve fund until 2015; while between 2015 and 2020, the fund should cover any deficits but not beyond this point. Further measures proposed by the government would open the possibility to prolong this period. All age-related expenditure is projected to increase from 19.6% to 27.9% of GDP, somewhat more than spending on pensions alone.

The conclusions of the renewed Toledo Pact underline the importance of dialogue with the social and economic players involved when it comes to monitoring both present and future reform measures. They also recommend that after five years parliament should revise compliance with the recommendations using specific parliamentary instruments, in order to offer an ongoing assessment of the problems and variables associated with an ageing population. A Permanent Observatory of the evolution of the Social Protection System is to be created to carry out an ongoing analysis of the system and to make proposals for the legislative changes necessary to address the problems caused by the ageing population.

[11] According to projections of the 2005 NSR public spending on pensions is set to increase from 7.7% in 2005 to 14.5% of GDP in 2050.

3 CONCLUSION

Recent reforms, in particular through strengthened link between contributions and benefits and the gradual implementation of the reform of minimum pensions should translate into improvement of adequacy.

Spain faces a major challenge with regard to financial sustainability due to demographic trends. Nearly all the pension expenditure increase is projected to occur after 2015. Although according to the National Strategy Report, the reserve fund will cover any deficits until 2020, additional reforms to ensure the financial sustainability of the pension system in the long term will soon be necessary to ensure a smooth transition. In this regard, actual work in the Social Dialogue Table on social Protection has been recently intensified.

Given the low female employment rate and the low participation rate of older people, further efforts are also necessary in order to enable a higher participation in the labour market. This could be achieved through further measures proposed by the government, notably a closer link between the level of contributions and the level of benefits for the earnings related pensions and further facilitating of flexible and gradual retirement, as well as further restrictions of early retirement schemes.

4. BACKGROUND STATISTICS

	ES			EU25		
Adequacy						
Current situation						
	Total	Men	Women	Total	Men	Women
At-risk-of-poverty rate [1]	20	19	21	16	15	17
0-64	18	18	18	16	16	17
65+	30	27	32	18	15	20
75+	34	32	35	Nd	Nd	Nd
Income inequality [1]						
0-64	5,2					
65+	4,2					
Income of people aged 65+ as a ratio of income of people aged 0-64 [1]	0,77	0,79	0,76			
Median pensions relative to median earnings [2]	0,49	0,49	0,61			
Long-term projections						
Theoretical replacement rates[3]	2005	2030	2050			
Total net replacement rate	97	92	92			
Total gross replacement rate	91	85	85			
Gross repl. rate 1st pillar	91	85	85			
Gross repl. rate 2nd/3rd pillar	*	*	*			
Financial sustainability						
Current situation						
ESSPROS Pension expenditure [4], % of GDP	***1995***	2000	***2003***	***1995***	2000	***2003***
	10,3	9,6	9,2		12,5	12,6
Employment (2004) [5]	Total	Men	Women	Total	Men	Women
Employment rate ***(25-54)***	72,7	86,1	58,9	76,8	85,2	68,5
Employment rate (55-64)	41,3	58,9	24,6	41,0	50,7	31,7
Effective labour market exit age (2004)[6]	62,2	61,5	62,9	60,7p	60,9	60,4p
Public finances (2003) [7]						
Public debt, % of GDP	50,7			63,3		
Budget balance, % of GDP	0,4			-2,8		

Long-term projections (EPC 2006)

	ES Level			ES increase	EU25 Level			EU25 increase
	2004	2030	2050	2004-50	2004	2030	2050	2004-50
Old-age dependency ratio [8]	24,6	38,2	65,6	+167%	25	40	52	+108%
Public pensions expenditure, % of GDP [9]	8.6	11.8	15.7	+7.1	10,6	11,9	12,8	+2,2

Factors determining the evolution of public pensions expenditure (2000-2050) [10]	ES: Contribution to change in percentage points of GDP	EU25: Contribution to change in percentage points of GDP
Demographic dependency	12,4	8,6
Employment	-1,8	-1,1
Eligibility	-2,3	-2,1
Level of benefits	-0,8	-2,7
Total (including residual)	7,0	2,2

Notes:

1. Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, Income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).
2. Source: Eurostat. Median individual pension income of retirees aged 65-74 in relation to median earnings of employed persons aged 50-59 excluding social benefits other than pensions.
3. Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first and second pillar pension schemes, retiring at the age of 65 years in 2005.
4. Source: ESSPROS, EUROSTAT. Includes expenditure by certain private social protection schemes.
5. Source: European Labour Force Survey, 2004.
6. Source: European Labour Force Survey, 2004.
7. Source: European Commission, DG ECFIN.
8. Source: EUROSTAT (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15-64.
9. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.
10. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.

* proportion negligible

FRANCE

1 MAIN CHARACTERISTICS OF THE PENSIONS SYSTEM

The French retirement system is essentially made up of statutory pay-as-you-go schemes, which account for about 98% of total pension expenditure and are financed by social security contributions and taxes.

The functioning of these schemes varies according to the sector of activity. The scheme covering employees of the private sector absorbs about 63% of total expenditure. This general scheme, with strong solidarity elements, cohabits with statutory supplementary schemes established by collective agreements and are pay as you go financed, in which benefits are calculated on the basis of a point system, ensuring a close link between benefits and contributions. Financial equalisation mechanisms exist between the various schemes.

Compulsory schemes for farmers and liberal professions also have a two tier architecture. Civil servants and the employees of public-sector companies are covered by several special schemes organised in one tier only,which account for 28% of pension expenditure.

Elderly people and the households to which they belong benefit from a minimum pension in the form of a means tested complement (to pensions paid by other arrangements). The level of the minimum gross pension for one person was 599 € per month in 2005, corresponding to about 45% of the median equivalised income at the time. The number of beneficiairies has been declining for decades, due to the progressive increase of pension rights in the statutory schemes; in 2003 about 630 000 people (5% of people aged more than 65) benefited from the minimum pension.

The extensive role that the statutory pay as you go scheme in France leaves little room for the development of voluntary, individual or sectoral schemes, which nevertheless benefit from tax incentives. The most recent reforms also encouraged the development of privately managed pension provision. Introduced in 2004, in the framework of collective investment undertakings directives, the PERCO is a plan created at the enterprise or branch level, while social partners are to negotiate professional branches agreements on the creation of PERCOs. Two types of individual pension provisions are encouraged by tax deductions: life insurance and since 2004, the PERP, an individual retirement plan, both under insurance directives.

2 SITUATION AND PERSPECTIVES IN THE LIGHT OF THE COMMON OBJECTIVES

2.1 Current situation

Concerning **adequacy**, pension income accounts for more than 80% of all income of persons aged 65 and over. When one takes all sources of income into account, it is noticeable that the living conditions of pensioners are very close (90%) to those of the working population.

The general poverty risk at 14% is close to that of the European average. Pensioners are exposed to a slightly higher risk of poverty (16% in 2003) than people in the age group 0-64 (13%).

Achieving **financial sutainability** in the light of the projected increase of demographic dependency ratio during the coming decades can be seen as a key challenge. According

to ESSPROS figures, pension expenditure was at 13% of GDP in 2003, slightly above the EU average (12.6% of GDP).

Reforms of the pension system in 1993 were widened to the public sector in 2003. These reforms limit the increase in pension expenditure by increasing the number of years of service required to obtain a full pension, from 37.5 to 40 years and by confirming pensions indexation (based on prices only, while in 2003 the rules of indexation of the ARRCO statutory complementary scheme were reformed, the accumulation value of points being indexed on wages, while the decumulation value being indexed on prices). These reforms should encourage an increasing number of people to retire after 60 (in order to obtain a higher pension).

Incentives to extend working lives have been strenghtened and will gradually be harmonised between public and private sectors (system of *décote-surcote*): the reform introduces a bonus (of 1.5 p.p. of replacement rate for every year worked beyond 60 with 40 years of service in the general statutory scheme), while a progressive harmonisation towards a malus (of 2.5 p.p. of replacement rate per missing year is foreseen by 2015 in the general statutory scheme).[12] The 2003 reform also includes the possibility for an individual retiring before 60 where they have at least 42 years of service (under certain conditions).

In addition, the latest reform envisages a rise of 0.2 p.p. of contributions to old age pensions from 2006 and the use of unemployment contributions within the pension system, if unemployment falls sufficiently, while assets of the general statutory scheme are planned to be accumulated until 2020 (*Fonds de réserve des retraites*, FRR).

The reform also proposes a further rise of one year to the number of contributory years required for a full pension, between 2009 and 2012 for employees of the public and private sectors. Thereafter, the length of contribution will periodically be revised (every four years) so as to develop in line with increases in life expectancy.

Employment rates for 55-64 years old are far below the Lisbon target (37.3% in 2004), in spite of an increase in recent years. It should be noted that recent reforms will only achieve their full effectiveness if they are accompanied by a concurrent increase in the employment rates of older workers. This is also linked to the evolution of entry flows in schemes enabling early exit from the labour market (in particular through early retirement and unemployment).

With the reform of 2003, an important step was taken for the **modernisation** of the retirement system, especially by reducing differences between the pension schemes of the public and private sectors and by proposing a rise inthe number of contribution years necessary to obtain a full pension in accordance with increases of life expectancy. There are no significant gender differences in relation to pension adequacy. Nevertheless, the important diversity among pension schemes (in particular in relation to the accrual of rights and the formulae of calculation of pensions for some of the special schemes) makes it important to improve the transparency of the pension system as a whole.

There are plans to develop information to be provided to active persons regarding the future level of their pensions. The latest reforms will see the development of pension forecasts for active people by late 2005-early 2006 and it is planned that individual information and estimation of pension rights will be provided from 2007.

[12] The decrease corresponds to 1.25 by quarter and the increase to 0.75 by quarter. As this applies on the "taux plein" of 50%, this corresponds for the replacement rate to yearly decreases of 2.5 percentage point and yearly increases of 1.5 percentage point in the general statutory scheme.

2.2 Outlook, reform measures and policy debates

French demographics: even if fertility rates remain high in comparison with European levels, life expectancy is also high and the projections are for a continuation of this rising trend. On the whole, projections reveal a slight population fall from 2040. The demographic dependency ratio should increase somewhat slower than the average EU, from 25% in 2003 to 46% in 2050 (while the EU average is projected to be 52% in 2050).

According to the calculations carried out in the framework of the ISG, total net Theoretical replacement rates represent 80% of net income (66% gross) for a worker retiring at 65 after 40 years of contributions at the average wage. However, projected replacement rates are expected to significantly decline in the future. For instance, in the case of a worker retiring at 65 after 40 years of career at the average wage, the net replacement rate will decrease from 80% in 2005 to 63% in 2050 (gross replacement rate would decline from 66% to 49%). This decline is due in the main to the latest reforms of the general statutory scheme and to the latest reforms of the statutory complementary schemes.

Pensioners on lower incomes should nevertheless be partly protected from this adverse trend as the latest reforms forsee an increase of net replacement rates for those earning the minimum wage of up to 85% by 2008. However, in the case of a worker retiring at 65 after 40 years of career at two thirds the average wage, current projections show a decline of the net replacement rate from 81% in 2005 to 62% in 2050 (from 66% to 49% for the gross replacement rate). As a consequence, the future level of pensions should be monitored closely, in particular for the most vulnerable groups of the population.

Despite the major pension reform in 2003, France is expected to face pressure on its public finances due to its ageing population resulting in growing age-related public expenditure. According to the budgetary projections made by the AWG in 2005, public spending on pensions is expected to increase by a further 1.9 p.p. between 2004 and 2050, in contrast with the level of 3.7 p.p. increase projected in the 2001 AWG projections between 2005 and 2040.[13]

3 CONCLUSION

The financing of the pension system for the decades ahead has been significantly improved by the 2003 reform, which preserved the basic architecture of the current system and contributed to a more equitable treatment of members of different schemes, and, in particular, of public and private sector employees. However, further measures will be needed in order to put the pension system on a financially sustainable footing in the long run.

Current adequacy does not constitute a key issue as pensioners have a living standard and rates of poverty close to the average.However, projected replacement rates are expected to decline significantly in the future. As a consequence, the level of pensions will have to be closely monitored, in particular for the most vulnerable groups of the population.

The employment rate of older workers remains relatively low, in spite of recent increases. Current reforms will only have their optimal effect, for ensuring both adequacy and sustainability, if they are actually accompanied by a significant increase of older workers in employment. While incentives to work longer have been strengthened by the last reform, further steps may be necessary as regards early exits from the labour market.

[13] In the 2001 exercise of the AWG projections, pension expenditures for France were projected until 2040.

It will be important for the government to develop an effective and sustainable strategy to guarantee a greater participation of older workers in the labour market and to raise employment in general. Ensuring better opportunities for older workers is clearly an area in which social partners have an important responsibility.

4. BACKGROUND STATISTICS

	FR			EU25		
Adequacy						
Current situation						
	Total	Men	Women	Total	Men	Women
At-risk-of-poverty rate [1]	14	13	14	16	15	17
0-64	13	13	14	16	16	17
65+	16	14	17	18	15	20
75+	18	15	19	Nd	Nd	Nd
Income inequality [1]						
0-64	4,2					
65+	4,2					
Income of people aged 65+ as a ratio of income of people aged 0-64 [1]	0,90	0,93	0,75			
Median pensions relative to median earnings [2]	0,75	0,76	0,73			
Long-term projections						
Theoretical replacement rates[3]	2005	2030	2050			
Total net replacement rate	80	66	63			
Total gross replacement rate	66	53	49			
Gross repl. rate 1st pillar	66	53	49			
Gross repl. rate 2nd/3rd pillar	*	*	*			
Financial sustainability						
Current situation						
ESSPROS Pension expenditure [4], % of GDP	*1995*	2000	*2003*	*1995*	2000	*2003*
	13,4	13,0	13,0		12,5	12,6
Employment (2004) [5]	Total	Men	Women	Total	Men	Women
Employment rate (25-54)	79,6	86,9	72,5	76,8	85,2	68,5
Employment rate (55-64)	37,3	41,0	33,8	41,0	50,7	31,7
Effective labour market exit age (2004)[6]	58,9	58,4	59,4	60,7p	60,9	60,4p
Public finances (2003) [7]						
Public debt, % of GDP	63,7			63,3		
Budget balance, % of GDP	-4,1			-2,8		

Long-term projections (EPC 2006)

	FR Level			FR increase	EU25 Level			EU25 increase
	2004	2030	2050	2004-50	2004	2030	2050	2004-50
Old-age dependency ratio [8]	25,2	40,2	46,4	+84%	25	40	52	+108%
Public pensions expenditure, % of GDP [9]	12.8	14.3	14.8	+2.0	10,6	11,9	12,8	+2,2
Factors determining the evolution of public pensions expenditure (2000-2050) [10]	Contribution to change in percentage points of GDP				Contribution to change in percentage points of GDP			
Demographic dependency	8,7				8,6			
Employment	-0,9				-1,1			
Eligibility	-1,8				-2,1			
Level of benefits	-3,5				-2,7			
Total (including residual)	2,0				2,2			

Notes:

1. Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, Income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).
(it can be noted that 6 Member States already use EU-SILC surveys, BE, DK, EL, IE, LU, AT: SILC 2003, Income data 2002; Other Member States rely on national sources, income data 2002, apart MT (2000), FR, IT and PT (2001), CY, SE and SI (2003).
2. Source: Eurostat. Median individual pension income of retirees aged 65-74 in relation to median earnings of employed persons aged 50-59 excluding social benefits other than pensions.
3. Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first and second pillar pension schemes, retiring at the age of 65 years in 2005.
4. Source: ESSPROS, EUROSTAT. Includes expenditure by certain private social protection schemes.
5. Source: European Labour Force Survey, 2004.
6. Source: European Labour Force Survey, 2004.
7. Source: European Commission, DG ECFIN.
8. Source: EUROSTAT (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15-64.
9. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.
10. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.

* proportion negligible

IRELAND

1. MAIN CHARACTERISTICS OF THE PENSION SYSTEM

The first pillar basic pension provides for flat rate payments and is financed through pay-related contributions from employers, employees and the self-employed. Non-contributory pensions (slightly lower benefits) are payable on a means-tested basis to those without a sufficient social insurance record. Pensions paid out of this pillar are not related to previous income and are intended to provide for basic living expenses. Supplements are payable for dependants, for those living alone and to pensioners over 80. The pension payments are adjusted each year in line with targets set periodically by Government and taking account of budgetary considerations. That said, pensions have been increasing faster than both the consumer price index and gross earnings, since the last NSR in 2002, (over 20 %,) while the rise in CPI over the period amounted to approximately 8%.

The old-age (insurance-based) pension currently pays an amount equivalent to approximately 32% of gross average industrial earnings. The means-tested pension pays slightly less. Payments have increased significantly in recent years and the government has committed itself to a policy of ongoing real increases to the basic pension rates until 2007 in order to reach a target rate of €200 per week. At the same time, the share of those claiming means-tested pension payments has fallen since 1994 to 2004 from 45% to 30% and is projected to fall to 14% in 2017. The overall target is an income in retirement of 50% of gross pre-retirement income -, including income from other sources (first pillar pension, income from a supplementary pension, investments and other income).

Voluntary supplementary pensions account for approximately one quarter of overall income in retirement (2000). The role of supplementary pensions in the Irish system is to supplement the basic rate pensions provided through the social welfare system to ensure that income in retirement is related to the income received by a person when they were employed. The pensions can be provided through a person's employment or directly through pension providers such as banks or insurance companies. The State facilitates and encourages second and third-pillar pensions through favourable tax treatment of contributions and investment returns and by a regulatory system designed to safeguard pension entitlements. 33% of existing pensioners have an occupational or personal pension which contributed to about 25% of post retirement income. However, the numbers with supplementary pensions are likely to grow in the years ahead due to the higher proportion of people in work participating in pension schemes (just over 59% of the workforce who are older than 30 years of age or 52.4% of all workers).

Approximately 69% of members of occupational pension schemes are in Defined-Benefit (DB) type with the remainder in Defined-Contribution schemes. Ireland has not seen the same level of shift from Defined Benefit to Defined Contribution pension provision as has been seen elsewhere, though the trend is still very apparent in the Irish system with most new schemes operating on a defined contribution basis. In 2004 the Pensions Board reviewed the Funding Standard by which the health of defined benefit schemes is measured. The Board's recommendation was to continue the current Funding Standard, which is a discontinuance standard, including the retention of temporary measures, introduced in 2003, for an extended funding period in certain circumstances, together with a modification of the calculation of the standard for active and deferred members.

2. Situation and perspectives in light of common objectives

2.1 Current situation

Concerning **adequacy**, partly as a result of the quick rise of average wages and increases in household income resulting from improved labour force participation and reduced taxes, the incomes of older people have generally lagged behind those of the working age population. Pensioners' incomes are among the lowest in the EU25, relative to the overall population. The relative income situation of older people (61% of 0-64 living standards) reflects the level of the basic pension paid by the State and the fact that Ireland is currently the only Member State without some form of compulsory income-related pension provision for a majority of workers.

Persons aged 65+ are more than twice as likely than those aged 0-64 to be in poverty. In 2003 it stood at 40% (men 34% women 45%) and for those aged 75+, it was 44% (men 35% and women 50%). With lower thresholds, the differences in poverty rate are significantly smaller, although the poverty rate in Ireland remains among the highest in EU25 probably reflecting the fact that the 60% threshold is higher than the flat rate pension. This high risk of poverty for elderly persons can be partly explained by the uniquely rapid increase in household incomes over the last decade (around 100% from 1994 to 2001).[14]

The expansion of occupational pension coverage seems not to have developed as the Irish government expected. It is considered that supplementary pension cover is essential for up to 70% of the workforce who are over 30 years of age (currently only 59%), if they are to obtain a pension that will maintain a reasonable replacement of their pre-retirement standard of living. The coverage target for workers in general is 60% and currently stands at 52.4%. Introduction of PRSAs in 2003, enabling individuals with no supplementary pension cover or with inadequate cover to begin saving, led to 59,000 opening a PRSA account by September 2005.

Concerning **financial sustainability**: Employment rate of older persons rose in the past ten years by 10% to 50% in 2004 and stays in line with the Lisbon target. This rise was driven by an increase in the movement of non-employed into jobs rather than by a delay in retirement. The increase was mainly due to women entering jobs from home duties, though previously unemployed men made a significant contribution as well. However labour participation of women in the 55-64 cohort is 31.3 p.p. lower than their male counterparts. Early retirement is common in Ireland. Two thirds of people who had already retired had left employment before age 65. The most common reason, which accounted for one-third of early retirements, was illness or disability.

Concerning **modernisation**, equal treatment between men and women in the context of occupational pensions was introduced under Part VII of the Pensions Act 1990. Legislation permits the different treatment of men and women in schemes, based on actuarial factors to enable the achievement of equality of outcomes. Recent research shows that the overall average income of women in retirement is much lower than that of men. The difference between gender incomes is due to the differences in supplementary provision. Women tend to have lower earnings than men over their working lives and have consequently lower private pension coverage rates (which contribute to 18% of their income, as compared to 41% for men).

[14] The underlying adjustments in the basic pensions from more than 20% since 2002 could not reduce the risk of poverty but consistent poverty. The overall percentage of persons aged over 65 experiencing consistent poverty (percentage below 70% of median income, national figures) fell from 8.4% in 1997 to 3.9% in 2001.

In view of the important role of occupational schemes in the Irish pension system, it will be important to ensure not only improved access for all workers, but also greater portability of pension rights, particularly under defined-benefit schemes. The Pensions (Amendment) Act 2002 reduced maximum vesting periods to two years and also improved transfer, preservation and the revaluation of entitlements for members of occupational pension schemes. PSRAs pension entitlements can be maintained without penalty when an account holder changes or ceases employment.

2.2 Outlook, reform measures and policy debates

Regarding demographic developments, Ireland is expected to face more favourable demographic trends than most other EU Member States. The old-age dependency ratio is projected to grow from the EU25 lowest 16% in 2004 to 45% in 2050, still among the lower ratios in the European Union, while the currently high fertility rate is assumed to decrease to EU15 level. Theoretical pension replacement rates are expected to stay stabile until 2050 (67% total gross and 78% total net).

The government has declared its obligation to raise basic pensions and supplements for dependent spouses and partners significantly, so that the lowest pension will reach 200€ per week by 2007. The two main challenges for financial sustainability arises firstly from the ageing of the population resulting in greater public pension costs and a declining ratio of contributors to pensioners and secondly from the maturing of the social insurance scheme as the extension of cover in recent decades translates into a growing proportion of those who reach pension age qualifying for a non means-tested pension in their own right.

According to the AWG 2005 projections, public spending on first-pillar pensions (including public service pensions) is projected to rise from 4.6% of GDP in 2004 to 11.1% in 2050. The rise is relatively continuous and stable over the whole period. Ireland is expected to experience growing pressures from ageing populations on its public finance system, but somewhat later than most of the EU countries while in the first part of the projection period the increasing pension level due to the maturing of the social security pension system will push expenditure level up. However, the current stance is far from being alarming and significant reserves have been and are being accumulated with the aim of preparing to deal with the ageing of the population.

A key element of the Irish strategy is to build up a reserve fund to partially pre-finance public pensions to be paid out after 2025. The assets of the Reserve Fund will be drawn down from 2025 until at least 2055. The government is required by law to contribute 1% of GNP to the fund each year. The current amount of assets, at 9.6% of GNP, is estimated to reach a level of 43 % by 2025.

In order to reduce early retirement, Ireland may consider tightening the conditions for early retirement, increasing the contributions required for full pensions, providing for flexibility in the retirement age, creating incentives for workers who want to remain in the labour market after age 65 and facilitating a gradual move into retirement through changed working arrangements. There are no plans at present to increase the retirement age. Increasing female participation in the labour market is likely to reduce the differential between male and female retirement incomes in the longer term.

Recognising the need to monitor the sustainability of the Irish pension system, the government decided in 1998 to carry out regular actuarial reviews of the financial situation of the Social Insurance Fund (SIF); the capacity of the National Pension Reserve Fund to meet future pension liabilities is also to be assessed regularly. The second review of the SIF covered the period 2001–56 and focused on the adequacy of

current contribution rates under alternative scenarios for indexation and target levels of pensions.

The adequacy of DC arrangements needs to be closely monitored. Quality information needs to be furnished to such members in order to protect their rights and allow them to make informed decisions. Further proposals for measures to increase the participation in supplementary schemes are expected from the Pension Board at the end of 2005. These, and related issues are addressed, through the provision of better information at a general level. In addition, disclosure regulations are currently being amended to further protect members through the compulsory provision of better quality information.

3. CONCLUSION

Ireland has made progress in making provisions for increasing the adequacy of pensions and further steps have been announced by the government. Pensions (and in particular lowest pensions) have been increasing faster than both the consumer price index and gross earnings, since the last NSR in 2002. Nevertheless, an extended coverage of supplementary pension provisions is important to ensure the effectiveness of the income replacement function of pension systems.

The government is committed to accumulating a considerable reserve fund in order to partially pay for future liabilities. The public system therefore appears to be, in broad terms, financially sustainable despite projected major increases in future pensions expenditure. The commitment to monitoring the adequacy of contribution rates through regular actuarial reviews should help to react to indications of a need for adjustments, and thus help to keep the system on a sustainable footing.

The national strategy report pointed out that early retirement is common in Ireland, though the effective retirement age of workers remains higher than in most other EU countries. The main reasons for early retirement include illness or disability and the availability of occupational retirement pensions which allow for retirement before age 65. Although employment rates of older workers have already reached the European target of 50%, further strengthening of incentives to work longer would contribute to ensure future adequacy and sustainability.

4. BACKGROUND STATISTICS

	IE			EU25		
Adequacy						
Current situation						
	Total	Men	Women	Total	Men	Women
At-risk-of-poverty rate [1]	21	19	23	16	15	17
0-64	19	17	20	16	16	17
65+	40	34	45	18	15	20
75+	44	35	50	Nd	Nd	Nd
Income inequality [1]						
0-64	5,1					
65+	3,4					
Income of people aged 65+ as a ratio of income of people aged 0-64 [1]	0,62	0,63	0,61			
Median pensions relative to median earnings [2]	0,52	0,52	0,57			
Long-term projections						
Theoretical replacement rates[3]	2005	2030	2050			
Total net replacement rate	78	78	78			
Total gross replacement rate	67	67	67			
Gross repl. rate 1st pillar	31	34	34			
Gross repl. rate 2nd/3rd pillar	36	33	33			
Financial sustainability						
Current situation						
ESSPROS Pension expenditure [4], % of GDP	***1995***	2000	***2003***	***1995***	2000	***2003***
	5,0	3,6	3,9		12,5	12,6
Employment (2004) [5]	Total	Men	Women	Total	Men	Women
Employment rate ***(25-54)***	76,8	87,8	65,8	76,8	85,2	68,5
Employment rate (55-64)	49,5	65,0	33,7	41,0	50,7	31,7
Effective labour market exit age (2004) [6]	62,8	63,4	62,3	60,7p	60,9	60,4p
Public finances (2003) [7]						
Public debt, % of GDP	32,1			63,3		
Budget balance, % of GDP	0,1			-2,8		

Long-term projections (EPC 2006)

	IE Level			IE increase	EU25 Level			EU25 increase
	2004	2030	2050	2004-50	2004	2030	2050	2004-50
Old-age dependency ratio [8]	16,4	28,3	45,2	+176%	25	40	52	+108%
Public pensions expenditure, % of GDP [9]	4.6	7.9	11.1	+6.4	10,6	11,9	12,8	+2,2

Factors determining the evolution of public pensions expenditure (2000-2050) [10]	IE: Contribution to change in percentage points of GDP	EU25: Contribution to change in percentage points of GDP
Demographic dependency	7,9	8,6
Employment	-0,5	-1,1
Eligibility	-1,4	-2,1
Level of benefits	0,8	-2,7
Total (including residual)	6,5	2,2

Notes:
1. Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, Income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).
(it can be noted that 6 Member States already use EU-SILC surveys, BE, DK, EL, IE, LU, AT: SILC 2003, Income data 2002; Other Member States rely on national sources, income data 2002, apart MT (2000), FR, IT and PT (2001), CY, SE and SI (2003).
2. Source: Eurostat. Median individual pension income of retirees aged 65-74 in relation to median earnings of employed persons aged 50-59 excluding social benefits other than pensions.
3. Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first and second pillar pension schemes, retiring at the age of 65 years in 2005.
4. Source: ESSPROS, EUROSTAT. Includes expenditure by certain private social protection schemes. The value of pension expenditure for Ireland is underestimated as data on occupational pension from private sector employees with consytituted reserves are not available.
5. Source: European Labour Force Survey, 2004.
6. Source: European Labour Force Survey, 2004.
7. Source: European Commission, DG ECFIN.
8. Source: EUROSTAT (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15-64.
9. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.
10. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.
* proportion negligible

ITALY

1 MAIN CHARACTERISTICS OF THE PENSIONS SYSTEM

In 2004 Italy undertook new pension reforms, building on previous reforms of those in 1992, 1995 and 1997. The reforms of the 1990s have progressively unified the basic rules of a previously fragmented **statutory pension system**. Most of the schemes are administered by the social security institution for the private sector (INPS) which accounts for two thirds of expenditure and insures the majority of private sector employees and the self-employed. Public sector employees' pensions are administered by a separate institution (INPDAP).

100 % of the registered employed population in Italy are covered by the statutory pension schemes, including old age, invalidity and survivors' pensions. The pension contributions amount to 32.7% of employees' gross remuneration (8.9% paid by the employee and 23.8% paid by the employer). The self-employed and some workers with atypical contracts (*parasubordinati*) pay around 17.5%, gradually increasing to 19%.

The 1995 reform of the statutory pension is leading to a gradual shift from the current defined-benefit scheme to a notional defined-contribution scheme, applied fully to all entrants in the labour market from 1996.

Under the new system, benefits are calculated on the basis of the amount of contributions paid throughout the entire career, capitalised at the average growth rate of GDP over the previous five years. Such notional capital is multiplied by age-of-retirement-specific transformation coefficients (similar to the annuity rates in private schemes) to obtain the final pension settlement.

To workers with a contributory record equal to or exceeding 18 years on 31.12.1995 the previous defined benefit system applies, as amended by the reforms. Accordingly (till the end of 2007) entitlements to the old-age pension are acquired at the age 65 for men and 60 for women (with a minimum requirement of 20 years of payments); entitlement to the seniority pension is acquired at age 57 (58 for self-employed workers) with 35 years of contributions, or at any age, with 38 years of contributions (2005, rising to 39 in 2006 and 40 in 2008).

Workers with less than 18 years of contribution at the end of 1995 have their pension calculated in part with the old (taking into account both old age and seniority pensions) and the new system (mixed system), according to the proportion of working life spent in the both regimes.

The pension reforms of 2004 introduced an increase in the legal retirement age for seniority pensions and in the new defined contribution system in 2008, from 57 to 60 years (the additional requirement of 35 years of contributions remains unchanged and the age requirement is 1 year higher for the self-employed). The age requirement will increase further for men to 61 from 2010 to 2014, and to 62 from 2014 (still with 35 years of contributions). Women will be allowed until 2015 to retire on seniority pensions at 57 years with 35 years of contribution, although in that case, they will have to choose to have their pension entirely calculated by the new notional defined contribution system. Nevertheless, even after the 2004 reform it will be possible to retire regardless of age, with 40 years of contributions.

The 2004 reform also doubles the time a worker has to wait between the moment they attain the right to a seniority pension and the moment they can actually retire: 9 months on average for employees, and from 7.5 to 15 months on average for the self-employed.

In the old system top-up benefits are available to raise the lowest contributory pensions to a **minimum** level, while older people without sufficient income can claim a social assistance pension. In the new system the minimum mirrors the social assistance pension, which can be claimed after 65 and is means tested. The minimum and social assistance pensions are increased for those aged 70 and over by € 7.069/year.

Occupational schemes are represented by supplementary, voluntary funded pensions. The reformed system (created in 1993) is based on three options: closed (negotiated) funds regulated by collective agreements; open funds managed by financial intermediaries that can be joined by workers individually or in groups; and pension insurance policies. According to the 2004 reform (applied from 2008), the TFR (*Trattamento di Fine Rapporto*) 'end-of-service allowance' (a portion of the worker's pay set aside by the employer and then paid as a lump sum at the end of employment) will be automatically transferred to occupational pension schemes (except in the case the employee refuses it, according to the so called 'silent-assent' mechanism). This should favour the development of supplementary benefits. In 2001, the participation rate in supplementary schemes (both open and closed) was around 10 % of the employed population. In 2003, occupational open and closed funds assets represented about 3 % of GDP.

All forms of private pension arrangements are favoured by tax incentives. Contributions up to 12% of gross earnings (with a cap of € 5164.57) are tax exempt while pension funds' financial returns are taxed at 11% and private pension benefits are taxable only for the part not already subject to taxation at the previous stages (hybrid ETT system). The 2004 reform aims at further strengthening fiscal incentives to private pension funds. Pension insurance policies cover around a further 2.3% of the working force.

2 SITUATION AND PERSPECTIVES IN THE LIGHT OF THE COMMON OBJECTIVES

2.1 Current situation

Adequacy: Older people experience close to average living standards (the living standard of people aged 65 or more is 95% of those aged 0-64). Inequality of income distribution among people aged 65+ is lower than among the overall population. In 2003, the risk of poverty of people aged 65+ was, at 16%, slightly below the average rate of the age group 0-64 (of 20%). But regional differences remain vast with poverty still overwhelmingly concentrated in the South (two thirds of all families at risk of poverty live in the South, which accounts for only one third of all families). Besides, the poverty rate of people aged 75 and more is close to the one of people aged 65 and more, partly reflecting the increase in the minimum pension and social assistance pension for people aged 70 and over introduced in 2002.

According to ISG calculations, a current worker, on average earnings, retiring in Italy today at 65 after 40 years of contributions can expect a gross replacement rate of 79% with all pension income arising from the statutory scheme (net replacement rate of 88%). Due to the index-linking of pensions in payment to prices , the replacement rate after ten years in retirement is lower (68% of gross replacement rate). Replacement rates for a worker on average earnings retiring today at 60 after 35 years of contributions are about 10 percentage points lower. This is relevant as actual data show that the average insurance record amounts to not more than 32.1 years for the new flow of retirees in

2004 while the effective age of withdrawal from the labour force was, in the same year, around 61.

Sustainability: Italy spends about 14 % of its gross domestic product on pensions. The social insurance pension system currently runs a deficit of 0.8 % of GDP. The 2004 reform aims to make annual savings of 0.7 % from about 2013 to the early 2030s.

The large numbers of undeclared jobs — many of them held by pensioners — remain an issue. To tackle this issue the possibility of cumulating, without losses, work and pension income was extended in 2001 and 2002. Italy acknowledges that late entry into the labour market is a challenge that needs to be addressed by appropriate policies.

In spite of recent increases, a major challenge — and an opportunity for ensuring future adequacy and financial sustainability — is the low employment rate in general (57,6% in 2004) and for 55-64 year old workers in particular (30.5% in 2004). As long as the old rules apply, disincentives to continue to work are strong. The gradual increase of minimum eligibility requirements for public pensions coupled with new incentive mechanisms (introduced in 2004), are a concerted attempt to incentivise work for this particular cohort. Until the end of 2007, private sector employees have the opportunity to continue working, while freezing their pension benefits and cashing their pension contributions on a tax exempt base.

Concerning **modernisation**, the 2004 reform improves portability of pension rights within the statutory pensions system, and increases transparency of the private pension system and information on costs and prospective returns, aiming at guaranteeing full transferability among private pension schemes and competition in the private pension sector. It also continued to pursue the harmonization process of the different statutory pension schemes rules. Although there is a trend towards equalisation of retirement ages, differences will remain after 2008.

Preventing future adequacy problems will also require improvements in the social protection of workers in flexible forms of employment, and with a special status of self-employment, mainly characterised by a close and continuous relation to a single company (*parasubordinati*).

2.2 Outlook, reform measures and policy debates

Italy is expected to face strong adverse demographic trends in coming decades, due in particular to one of the lowest fertility rates in EU and the highest life expectancy, (82.8 for men and 87.8 years for women by 2050). The demographic changes will lead to a sharp rise in the old-age dependency ratio, which is already now the highest in the EU. Between 2004 and 2050 it is expected to increase from 29% (compared to the EU25 average of 25%) to 65% (compared to the EU25 average of 52%).

The gradual transition to the new notional defined contribution public pension scheme will lead to a progressive decline in the gross replacement rate from the statutory scheme. According to ISG calculations, for a worker contributing 40 years on average earnings and retiring at 65, the gross replacement rate will decline from 79% today to 64% in 2050. For people retiring at 60 after a career of 35 years, the decline in replacement rates is even more pronounced (about 20 p.p. between 2005 and 2050). For the self-employed, due to the low level of pension contributions (19% of earnings as against 32.7% for the employees), the decline of the replacement rate would be even sharper.

As a result of this decline in replacement rates in the statutory scheme, future adequacy of pensions will depend, in addition to longer working lives, on the development of the supplementary social security entitlements. The diversion of the TFR towards private

pension funds is indeed expected to complement public pension gross replacement rates by 16 p.p. by 2050. According to ISG calculations, for a worker retiring at 65 after 40 years of contributions and under the assumption of contribution rates of 6.9%, the total gross replacement rate would in that case stay stabile (today 79% and 80% in 2050) while the total net replacement rate would even increase (88% to 92%). As mentioned in the Italian NSR, it should be borne in mind however, that the diversion of the entire TFR to private pension funds means that the future private provision is obtained at the cost of workers losing their lump-sum end-of-service allowance (TFR).

Despite unfavourable demographic trends, Italy is as a result of the four pension reforms undertaken since 1992, expected to face only small additional budgetary pressures due to ageing populations. According to the budgetary projections made by the AWG in 2005, public expenditures on pensions will increase only marginally, from 14.2% of GDP in 2004 to 14.7% in 2050 and all age-related expenditure from 24.7% to 25.7% of GDP. Both increasing trends are considerably slower than those of the EU average.

Under the reformed public pension scheme, once fully in force the incentive to work longer is achieved in part by the close link between contributions and benefits and actuarial adjustment mechanisms. More and longer employment will be important to allow increasing benefit entitlements that help address potential adequacy issues.

3 CONCLUSION

Recent reforms complement the reforms enacted in the 90s, which are projected to stabilise the public pension spending, in particular through the gradual maturation of the notional defined-contribution pension scheme. Nevertheless, the high overall level of expenditure and contributions to the pension system remain major challenges.
The 1995 reform created a stronger link between contributions and benefits, thus providing appropriate incentives for new entrants to the labour market to work longer. New measures were introduced in 2004 with the aim of strengthening further longer working incentives that also affect those who still have the right to retire early under the old rules.

However, these measures are predicated on long transition periods and raising employment rates particularly of women and older workers, remains crucial for meeting future challenges. Ensuring that older workers can effectively remain in employment would benefit from further labour market measures. One measure to be considered could be a gradual reduction of the gender gap of the legal retirement age for men and women which would help to increase employment rates of women. Ensuring adequacy will also require tackling the issue of pension rights for workers with atypical contracts and future adequacy could gain from anticipating entry into the labour market.

As recent reforms are projected to result in a decline of replacement rates provided by the statutory scheme, future adequacy of pensions will also depend on the development of the supplementary social security entitlements, through the transformation of the end-of-service allowance TFR. The mechanism of automatic transfer of the TFR to occupational pension-schemes (except in cases where the employee refuse it, according to the so called ‘silent-assent’ mechanism) could contribute strongly to the development of supplementary pensions. It remains to be seen whether expectations will be reached by this voluntary measure or not.

4. BACKGROUND STATISTICS

	IT			EU25		
Adequacy						
Current situation						
	Total	Men	Women	Total	Men	Women
At-risk-of-poverty rate [1]	19	18	20	16	15	17
0-64	20	20	19	16	16	17
65+	16	13	18	18	15	20
75+	15	12	17	Nd	Nd	Nd
Income inequality [1]						
0-64	6,0					
65+	4,2					
Income of people aged 65+ as a ratio of income of people aged 0-64 [1]	0,95	0,98	0,94			
Median pensions relative to median earnings [2]	0,78	0,82	0,71			
Long-term projections						
Theoretical replacement rates[3]	2005	2030	2050			
Total net replacement rate	88	90	92			
Total gross replacement rate	79	80	80			
Gross repl. rate 1st pillar	79	71	64			
Gross repl. rate 2nd/3rd pillar	0	9	16			
Financial sustainability						
Current situation						
ESSPROS Pension expenditure [4], % of GDP	***1995***	2000	***2003***	***1995***	2000	***2003***
	14,5	14,7	15,1		12,5	12,6
Employment (2004) [5]	Total	Men	Women	Total	Men	Women
Employment rate ***(25-54)***	72,2	86,7	57,8	76,8	85,2	68,5
Employment rate (55-64)	30,5	42,2	19,6	41,0	50,7	31,7
Effective labour market exit age (2004)[6]				60,7p	60,9	60,4p
Public finances (2003) [7]						
Public debt, % of GDP	106,2			63,3		
Budget balance, % of GDP	-2,4			-2,8		

Long-term projections (EPC 2006)	IT				EU25			
	Level			increase 2004-50	Level			increase 2004-50
	2004	2030	2050		2004	2030	2050	
Old-age dependency ratio [8]	28,9	44,4	62,2	+115%	25	40	52	+108%
Public pensions expenditure, % of GDP [9]	14.2	15.0	14.7	+0.4	10,6	11,9	12,8	+2,2
Factors determining the evolution of public pensions expenditure (2000-2050) [10]	Contribution to change in percentage points of GDP				Contribution to change in percentage points of GDP			
Demographic dependency	11,5				8,6			
Employment	-2,0				-1,1			
Eligibility	-3,2				-2,1			
Level of benefits	-5,3				-2,7			
Total (including residual)	0,4				2,2			

Notes:

1. Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, Income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).

(it can be noted that 6 Member States already use EU-SILC surveys, BE, DK, EL, IE, LU, AT: SILC 2003, Income data 2002; Other Member States rely on national sources, income data 2002, apart MT (2000), FR, IT and PT (2001), CY, SE and SI (2003).

2. Source: Eurostat. Median individual pension income of retirees aged 65-74 in relation to median earnings of employed persons aged 50-59 excluding social benefits other than pensions.

3. Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first and second pillar pension schemes, retiring at the age of 65 years in 2005.

4. Source: ESSPROS, EUROSTAT. Includes expenditure by certain private social protection schemes.

5. Source: European Labour Force Survey, 2004.

6. Source: European Labour Force Survey, 2004.

7. Source: European Commission, DG ECFIN.

8. Source: EUROSTAT (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15-64.

9. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.

10. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.

* proportion negligible

CYPRUS

1 MAIN CHARACTERISTICS OF THE PENSIONS SYSTEM

The pension system in Cyprus is almost entirely public, with Private provision playing a minor role. The statutory **General Social Insurance Scheme**, compulsory for every person gainfully employed or self-employed, consists of two parts: a basic part replacing 60% of the lower part of earnings and a supplementary part replacing earnings in excess of this limit at an accrual rate of 1.5%. The basic part is based on insured earnings since October 1964 whereas the supplementary part is based on earnings since October 1980.

The financing of the basic part is on a pay-as-you-go basis and the financing of the supplementary part on a partially funded basis. The pension system has traditionally been financed by tripartite contributions. The employer pays 6.3%, the employee 6.3% and the State 4% of earnings up to a ceiling of € 3205 per month (2003 figures). The contribution rate for the self-employed is 15.6% of which 4% is paid by the State. The Social Insurance Scheme covers in addition to old age, invalidity pensions, widow's pensions, orphan's pensions and disability pensions as well as short term benefits (sickness, unemployment, maternity and work injuries). Basic pensions increase in line with earnings, whereas supplementary pensions are linked to the price index. Persons with insufficient insurance records are entitled to a minimum pension.

The **Social Pension Scheme**, that is also part of the statutory pillar, guarantees an old age pension to everyone over the age of 65 who is not entitled to a pension from the General Social Insurance Scheme or from any other source and fulfils residence eligibility conditions.

Under the General Social Insurance Scheme the pensionable age is 65. However, old age pension can be paid at the age of 63, under specific contribution conditions. Incentives for postponing retirement translate into an increase in pension benefits (in particular, increase by 0.5 % for every postponed month from the date the beneficiary is entitled to a pension, up to a maximum at age 68). The payment of a pension is not conditional on retirement from regular employment and is not subject to any reduction on account of earnings from employment.

A 'Self-employment scheme' has also been established, that provides grants to people over 63 in order to support them being involved in economic activity when self-employed.

Employees in the public sector enjoy supplementary mandatory pension schemes (that of the **Government Employees Pension Scheme** or the **Semi-Government Employees Pension Schemes**). The statutory retirement age is 60, but early retirement is allowed after 55 without any reduction of benefits. As from July 2005 the age of retirement for civil servants will gradually increase to 63 by July 2008. Participation of the employees in the financing of Government schemes is limited to a share in the cost of survivors' pensions, which is 2.4% of the total of all pensions.

A major proportion of the private sector's employees have supplementary coverage in the form of lump sum payments under non-statutory **provident funds** established by collective agreements.

2 SITUATION AND PERSPECTIVES IN THE LIGHT OF THE COMMON OBJECTIVES

2.1 Current situation

Adequacy: The risk of poverty of the 65+ age group is the highest among all member states, reaching as high as 52% in 2003. The highest incidence of poverty occurs amongst persons living in one-adult households, while the gender gap is moderate (48% for men and 55% for women). The main reason for the very high poverty risk of older persons seems to be the low level of flat rate minimum pension and the fact that the level of social insurance pensions is still influenced by the insurance record accrued under the scheme in force before October 1980. In addition, access to second pillar schemes is limited and lump sums are paid out each time the employee changes or looses their job. Moreover, the self-employed people contribute on the basis of notional incomes fixed by category of occupation without any obligation to declare the actual income where this is higher. This leads to lower than expected replacement rates in the future.

Current replacement rates are rather low. According to the ISG theoretical replacement rate calculations, the gross replacement rate from the statutory pillar in the case of a worker retiring at 65 after 40 years of employment at the average wage is 46% in 2005, leading to a net replacement rate of 52 %. However, the replacement rates are expected to increase as the earnings-related insurance of 1980 approaches maturity.

Financial sustainability: The employment rate (68.9%) almost reaches the Lisbon target and unemployment is low (5.2% in 2004). The employment rate for workers aged 55-64 was 49.9%, in line with the Lisbon target, although the gender gap is significant (70.8% for men and 30% for women). The average exit age from the labour force was 62.7 in 2004. There is an accumulate reserve fund that amounts to 37% of GDP. In order to improve financial sustainability, several reform measures are under consideration with the social partners.

Modernisation: On gender equality, although most pension rights in the General Social Insurance Scheme appear gender neutral, the eligibility to widower's pension rights is restricted to cases of permanent incapacity for self-support.

Informing the public about their pension rights is increasingly important. Currently transparency of pension benefits is pursued by regular triennial actuarial studies, presented to Social Partners. These actuarial studies involve information on levels of pension benefits and contributions.

2.2 Outlook, reform measures and policy debates

According to Eurostat projections Cyprus will see an increase in population over the coming decades, as a consequence of high life expectancy and total fertility rate (around 1.8 in the period 1995-2000, although dropping to 1.5 during the period 2001-2003). Hence, although the overall demographic situation still appears relatively favourable, demographic ageing will play a crucial role in Cyprus in the next decades. It is expected that the old-age dependency ratio will more than double between 2004 and 2050 from the present very low 17% to 43% (staying well below the EU25 average of 52% in 2050).
According to the ISG theoretical replacement rate calculations the gross replacement rate from the statutory pillar in the base case is 46% (net 52 %) in 2005, increasing to 57% (net 66 %) by 2030 and 57% (net 70%) by 2050.
The Cyprus economy grew at approximately 3.7% per year during 1995-2003, when there occurred a sudden widening of the fiscal deficit in 2003, as the real GDP growth slowed down. Due to the strong impact of fiscal consolidation measures both on the expenditure and revenue side, the deficit has declined to 4.2% of GDP in 2004, down from 6.3% of GDP on the previous year. A further decline of deficit is projected as an

outcome of the recent successful negotiations with social partners on a number of key planned consolidation measures and the ongoing implementation of other measures planned for 2005. According to the AWG projections, Cyprus is expected to increase its spending on public pensions (including public sector employees' pensions) from 6.9% of GDP in 2004 to 19.8% of GDP in 2050. The projected growth of 12.9 percentage points of GDP is the largest in EU25 countries and will exhaust the reserve fund by about 2040.

A major concern for the pension system in Cyprus is its sustainability in the face of the ageing population. As today's contribution rates do not seem to be sufficient to maintain the financial balance beyond 2010, the Social Insurance Scheme in Cyprus will require further reforms. In order to improve the financial sustainability of the Social Insurance Scheme, reform measures are under discussion with the Social Partners. These include the gradual increase of the Social Insurance contributions, the increase of the minimum qualifying period for pensions under the Social Insurance Scheme, the reconsideration of the method of indexation of the basic part of pensions and the right to an early pension between the ages 63 and 65. In addition the increase of the notional incomes of the self-employed persons is being considered, in order to make their insurable income become more representative of their actual income.

3 CONCLUSIONS

Although the coverage by the pension system is practically universal, further efforts are needed to ensure adequacy, as the poverty rate of the elderly remains high. The main reason for the very high poverty risk of older persons seems to be the low level of flat rate minimum pension. Another reason lies in the build-up of the occupational pension scheme that offers lump sum payouts in the case of job mobility, thus leading to an outcome, where in case of repetitive changes of employment no pension capital is accumulated. Furthermore the low contribution levels of the self employed are likely to lead to low pensions in retirement.

While Cyprus currently reaches the European employment targets, a major concern for the pension system is its sustainability, as projections show that the social insurance fund with the current rate of contributions is only viable until 2010 (according to the AWG projections, pension spending will grow significantly only after 2025 (from 10.8% GDP to 19.8% by 2050) and the reserve fund would be exhausted by about 2040).

Large pension reforms in Cyprus took place in 1964 and 1980, making it one of the few countries with no recent reforms. Currently the Government has taken an active position regarding the pension system and several steps have been planned in order to improve the adequacy of pensions and the financial sustainability of the system. Reforms under consideration refer mainly to the General Social Insurance Scheme and include the gradual increase of Social Insurance contributions, the increase of the minimum qualifying period for pensions and the re-examination of the indexation formula.

4. BACKGROUND STATISTICS

	CY			EU25		
Adequacy						
Current situation						
	Total	Men	Women	Total	Men	Women
At-risk-of-poverty rate [1]	15	14	17	16	15	17
0-64	10	10	11	16	16	17
65+	52	48	55	18	15	20
75+	67	67	67	Nd	Nd	Nd
Income inequality [1]						
0-64	3.7					
65+	4.3					
Income of people aged 65+ as a ratio of income of people aged 0-64 [1]	0,55	0,58	0,54			
Median pensions relative to median earnings [2]	0,41	0,41	0,41			
Long-term projections						
Theoretical replacement rates[3]	2005	2030	2050			
Total net replacement rate	52	66	70			
Total gross replacement rate	46	57	57			
Gross repl. rate 1st pillar	46	57	57			
Gross repl. rate 2nd/3rd pillar	*	*	*			
Financial sustainability						
Current situation						
ESSPROS Pension expenditure [4], % of GDP	***1995***	2001	***2002***	***1995***	2000	***2003***
		6.4%	7.0%			
Employment (2004) [5]	Total	Men	Women	Total	Men	Women
Employment rate ***(25-54)***	82,4	92,5	72,8	76,8	85,2	68,5
Employment rate (55-64)	49,9	70,8	30,0	41,0	50,7	31,7
Effective labour market exit age (2004) [6]	62.7			60.7p	60.9	60.4p
Public finances (2003) [7]						
Public debt, % of GDP	70,9			63,3		
Budget balance, % of GDP	-6,4			-2,8		

Long-term projections (EPC 2006)	CY				EU25			
	Level			increase 2004-50	Level			increase 2004-50
	2004	2030	2050		2004	2030	2050	
Old-age dependency ratio [8]	17,5	32,9	43,2	+147%	25	40	52	+108%
Public pensions expenditure, % of GDP [9]	6.9	12.2	19.8	+12.9	10,6	11,9	12,8	+2,2
Factors determining the evolution of public pensions expenditure (2000-2050) [10]	Contribution to change in percentage points of GDP				Contribution to change in percentage points of GDP			
Demographic dependency	10,2				8,6			
Employment	-1,2				-1,1			
Eligibility	1,2				-2,1			
Level of benefits	2,5				-2,7			
Total (including residual)	12,8				2,2			

Notes:
1. Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, Income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).
(it can be noted that 6 Member States already use EU-SILC surveys, BE, DK, EL, IE, LU, AT: SILC 2003, Income data 2002; Other Member States rely on national sources, income data 2002, apart MT (2000), FR, IT and PT (2001), CY, SE and SI (2003).
2. Source: Eurostat. Median individual pension income of retirees aged 65-74 in relation to median earnings of employed persons aged 50-59 excluding social benefits other than pensions.
3. Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first and second pillar pension schemes, retiring at the age of 65 years in 2005.
4. Source: ESSPROS, EUROSTAT. Includes expenditure by certain private social protection schemes.
5. Source: European Labour Force Survey, 2004.
6. Source: European Labour Force Survey, 2004.
7. Source: European Commission, DG ECFIN.
8. Source: EUROSTAT (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15-64.
9. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.
10. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.
* proportion negligible

LATVIA

1 MAIN CHARACTERISTICS OF THE PENSIONS SYSTEM

Statutory social security PAYG pillar: A fundamental reform of the PAYG pension scheme was implemented in Latvia in January 1996.[15] Social insurance contributions for pensions (20% of gross wage) are recorded in **notional individual accounts**, and are accumulated at a given rate of return (indexed with increase in average social insurance contributions' wages) until retirement. Pensions are calculated by dividing the amount accumulated in the notional account by projected cohort unisex life expectancy at retirement.

The statutory minimum retirement age will gradually increase until it reaches 62 for both men and women. Men reached this point in January 2003, and women will reach it in 2008. A benefit can be claimed at any time from the minimum pension age and it is possible to receive a full pension whilst continuing work after retirement.[16] It is also possible to retire 2 years before the minimum retirement age, receiving 80% of the pension calculated according to the general formula. In addition, working and receiving benefits is not allowed during this early retirement period. As of July 2008 (postponed from 2005) the possibility of early retirement will be eliminated.

Pensions are indexed in Latvia - until 2002 this is based on the consumer price index and from 2002 to a combination of changes in consumer price index and increases in the average wage on which contributions are paid. The level of indexation depends on the level of pensions. It is higher for low pensions (the actual consumer price index (CPI) plus 50% of the average real increase of wages on which contributions are paid), while average pensions are indexed by the CPI only. The highest pensions (1.5% of all pensions) are not indexed at all.

There is a guaranteed minimum pension that establishes a base income guarantee for pensioners. From January 2002 the level of the minimum pension also depends on the length of the individuals' pension insurance record. By the end of 2006, the minimum pension will be equal to the State social security benefit multiplied by the coefficient 1.1 if a person's insurance record does not exceed 20 years, 1.3 in case of 20 -30 years and 1.5 in case of insurance records of more than 30 years.

Mandatory funded pillar: The funded defined contribution pension scheme started operation in July 2001. It is a fully funded statutory pension scheme, where a part of the social insurance contributions are invested in privately managed pension funds or a pension plan of the State Treasury.

The contribution rate to the mandatory funded pillar will gradually increase: 2% from 2001 to 2006, to 4% in 2007, 8% in 2008, 9% in 2009 and 10% from 2010 onwards. As these contributions are part of the total social insurance contributions for old-age pensions, an increase of contributions paid into the mandatory funded pillar results in a decrease of contribution revenues for the notional defined contribution pillar (NDC). That will result in equal shares going to both pillars by 2010 and onwards. Membership in the funded pillar is mandatory for those under 30 and voluntary for the age group 30 to 49 on 1st July 2001.

[15] Pensions awarded before 1996 were not affected by the introduction of the new scheme.
[16] Working pensioners continue to contribute and accumulate additional notional pension capital. This newly accrued pension capital also yields a rate of return, and the benefit is recalculated upon final retirement.

In the first phase, assets were only invested by the State Treasury, but since January 2003, participants are able to choose among State or private asset managers. Upon retirement members can either convert their capital into annuities provided by life insurance companies or add their accumulated capital to their NDC pension capital to increase their PAYG pension benefits.

The pension funds managing the mandatory funded scheme held total assets of 0.6% of GDP at the end of 2004. Scheme assets (together with the higher number of participants as well as increased contributions) are projected to reach 95% of GDP by 2070.

The **Voluntary private pension pillar** is incentivised by some income tax exemptions. In 2004 there were five private pension funds operating in Latvia. When members of voluntary private pension funds reach the retirement age, they can either take the accumulated capital as a lump sum (and purchase an annuity) or take phased withdrawals from the fund.

This type of pension provision covered around 3% of the working age population at the end of 2004. Private pension funds held total assets of around 0.3% of GDP at the end of 2004. 88% of contributions into voluntary funds are made by employers and the rest by individual participants.

2 SITUATION AND PERSPECTIVES IN THE LIGHT OF THE COMMON OBJECTIVES

2.1 Current situation

Adequacy: The risk of poverty of the 65+ age group is rather low, 14% (in 2003), but there is a gender gap: 7% for men (one of the lowest in EU) and 17% for women. The risk of poverty of the elderly is much lower than that of the age group 0-64 (17% in 2003).

Although the risk of poverty is currently among the lowest in EU25, the new pension formula, which establishes a strong link between personal contributions to the system and benefits, could lead to an increase of poverty among the lower income earners and people with breaks in their careers, notably women. To mitigate that problem, pension rights were granted in 2002 for employment periods without contribution payments, and pension accrual was ensured for people who were unemployed or had very low incomes between 1996 and 1999. A minimum pension related to the total length of the career is available to those with low pension entitlements.

The closer link between contributions and benefits resulting from the introduction of the (compulsory) funded pension component may help to increase declared work, implying increased contributions to the State scheme and thus improved pension adequacy. Currently the grey economy is still an issue as its size has been estimated to be between 20-40% of GDP.

Financial sustainability: The employment rate in Latvia was 62.3% in 2004, which is far below the Lisbon target. Meanwhile, the employment rate of the age group 55-64 was 47.9%, which is higher than the EU average but still below the Lisbon target for older workers (50%). In order to encourage employment of older workers, the Latvian labour law stipulates that in case of redundancies the selection criteria are performance and qualifications of employees. However, if employees have similar performance and qualification levels, then employees who are within 5 years of their retirement should preferably be retained. It remains to be seen, whether this measure will improve the employment situation of the elderly.

Despite efforts to increase the elderly employment rate, early retirement options for certain professional groups (as for artists, workers of the system of internal affairs etc.) were reintroduced recently. Although the number of recipients of these pensions is low

(around 1% of all old-age pensions), this may lead to re-establishing, more widely, long-service pensions, abolished in the mid-1990s.

Total pensions expenditures accounted for 7.5% of GDP in 2003, below the EU average of 12.6%. As the pension contribution directed into the mandatory funded pillar will increase gradually (reaching half the total contribution rate in 2010), it will be important to monitor the financing of PAYG pensions. While the social security PAYG scheme currently produces a surplus, remaining surpluses will depend on whether future improvements in employment materialise.

Modernisation: The pension system in Latvia is neutral with regard to different employment forms, mobility and individual choice. Equal treatment of men and women is being introduced and retirement ages are to be equalised by 2008. Changes in the demographic and economic situation will lead to automatic adjustments in Latvia's statutory pension pillar.

2.2 Outlook, reform measures and policy debates

According to Eurostat projections Latvia will encounter the fastest decrease in population among the EU25: population is expected to decrease by 10.8% by 2025 and 19.2% by 2050. Low fertility rates are the main reason for this steep decrease (combined with low migration). However, there are no strong imbalances in the population structure compared to other Member States and the share of the 65+ age group is expected to remain lower than for EU25. Consequently, absolute falls in the population size are only accompanied by a moderate increase in the old-age dependency ratio, from 23% in 2003 to 44% in 2050, noticeably slower than the EU10 average rising from 19 to 50%.

Currently the gross replacement rate of pensions is 61% (78% net replacement rate) for a worker retiring at 65 after 40 years of contributions at the average wage. According to the ISG projections, the net replacement rate will fall from 78% in 2005 to 67% in 2030 and then increase to 72% in 2050 (gross replacement rates will decline from 61% in 2005 to 51% in 2030 and then increase to 55% in 2050).

While the risk of poverty of those aged 65 and older is comparatively low in Latvia, an important share of newly granted pensions in recent years were minimum pensions. Moreover, within the age group of older workers, the risk of poverty is relatively high, mainly due to long-term unemployment. These cohorts will probably receive low or only guaranteed minimum pensions when they retire.

Ageing, notably regarding pensions, does not seem to constitute a major risk to the sustainability of public finances in Latvia because, in the future, the longevity risk is shared between the State and the individuals through the two-tier statutory pension system and both schemes provide defined-contribution benefits. According to the AWG projections of 2005, Latvia forecasts a decrease in public pension expenditure from 6.8% to 5.2 % between 2004 and 2009 and thereafter a marginal increase from 5.2 % to 5.6% of GDP over the period 2009-2050, an overall fall of 1.2 p.p. in public pension spending over the period 2004-2050. Taking into account pension expenditures from the mandatory funded scheme, expenditures are projected to increase from 6.8% of GDP in 2004 to 8.3% of GDP in 2050. A similar fall of 1.3 p.p. is projected in all age-related public expenditure as well.

3. CONCLUSIONS

Latvia introduced an NDC pension system in 1996 and supplemented the pension system with mandatory and voluntary funded tiers. A gradual increase of the retirement age is foreseen until harmonisation of retirement ages between men and women by 2008. Early retirement options are planned to be eliminated according to present plans by 2008.

Regarding the impact of ageing on pensions, policy aims at a balanced budget position in the long rather than medium term. The government expects to compensate the decline in contribution rate in the NDC scheme by increased employment and an increase in the declaration of work. Pension expenditures are projected to decline as a share of GDP over the next 50 years, while the share of mandatory private pensions will increase. The risk of poverty in Latvia is currently lower than for the working-age population. Still the new pension formula, which establishes a strong link between personal contributions to the system and benefits, could lead to adequacy issues as the overall replacement rate is expected to fall until 2030, then increasing again when the mandatory private pensions come to fruition. This could affect the lower income earners and people with breaks in their careers, notably women. Thus attention has to be made regarding the development of poverty rates.

4. BACKGROUND STATISTICS

	LV			EU25		
Adequacy						
Current situation						
	Total	Men	Women	Total	Men	Women
At-risk-of-poverty rate [1]	16	16	16	16	15	17
0-64	17	17	17	16	16	17
65+	14	7	17	18	15	20
75+	16	5	21	Nd	Nd	Nd
Income inequality [1]						
0-64	6,6					
65+	3,5					
Income of people aged 65+ as a ratio of income of people aged 0-64 [1]	0,80	0,84	0,78			
Median pensions relative to median earnings [2]	0,54	0,62	0,54			
Long-term projections						
Theoretical replacement rates[3]	2005	2030	2050			
Total net replacement rate	78	67	72			
Total gross replacement rate	61	51	55			
Gross repl. rate 1st pillar	61	46	36			
Gross repl. rate 2nd/3rd pillar	0	6	19			
Financial sustainability						
Current situation						
ESSPROS Pension expenditure [4], % of GDP	***1995***	2000	***2003***	***1995***	2000	***2003***
		9,6	7,5		12,5	12,6
Employment (2004) [5]	Total	Men	Women	Total	Men	Women
Employment rate ***(25-54)***	77,9	80,4	75,5	76,8	85,2	68,5
Employment rate (55-64)	47,9	55,8	41,9	41,0	50,7	31,7
Effective labour market exit age (2004)[6]	62,9			60,7p	60,9	60,4p
Public finances (2003) [7]						
Public debt, % of GDP	14,4			63,3		
Budget balance, % of GDP	-1,5			-2,8		

Long-term projections (EPC 2006)

	LV Level			LV increase	EU25 Level			EU25 increase
	2004	2030	2050	2004-50	2004	2030	2050	2004-50
Old-age dependency ratio [8]	23,6	33,4	44,1	+87%	25	40	52	+108%
Public pensions expenditure, % of GDP [9]	6.8	6.0	8.3	+1.5	10,6	11,9	12,8	+2,2

Factors determining the evolution of public pensions expenditure (2000-2050) [10]	LV: Contribution to change in percentage points of GDP	EU25: Contribution to change in percentage points of GDP
Demographic dependency	3,4	8,6
Employment	-0,7	-1,1
Eligibility	-1,3	-2,1
Level of benefits	-2,4	-2,7
Total (including residual)	-0,9	2,2

Notes:
1. Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, Income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).
2. Source: Eurostat. Median individual pension income of retirees aged 65-74 in relation to median earnings of employed persons aged 50-59 excluding social benefits other than pensions.
3. Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first and second pillar pension schemes, retiring at the age of 65 years in 2005.
4. Source: ESSPROS, EUROSTAT. Includes expenditure by certain private social protection schemes.
5. Source: European Labour Force Survey, 2004.
6. Source: European Labour Force Survey, 2004.
7. Source: European Commission, DG ECFIN.
8. Source: EUROSTAT (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15-64.
9. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.
10. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.

* proportion negligible

LITHUANIA

1 MAIN CHARACTERISTICS OF THE PENSIONS SYSTEM

Lithuania's statutory **social insurance pension system** consists of two tiers: the State pay-as-you-go defined benefit pensions and a mandatory funded defined contributions scheme. The **State social insurance pension system** was reformed in 1995 introducing the insurance principle, extending the requirement for contributory years, abolishing early retirement provisions and increasing the retirement age. The 1995 reforms created the two tier system which functions in different ways: the main part (basic pension) is almost flat rate and dependent entirely on years of service. The supplemental part is calculated using a formula comprising years of service, individual wage coefficient and average insurable income in the country.

In principle all those employed are covered by the pension social insurance to receive old-age, disability and survivors' social insurance pensions. Nevertheless some categories of self-employed persons (farmers, sportspeople, persons working under authorship agreements) are not mandatorily insured (although they may insure themselves on voluntary basis), and some are only covered for the main part of the social insurance pensions scheme (those taking care of children under three or other dependent family members and soldiers in their compulsory primary military service).

The pension system is contributory, 23.5% of gross wage paid by the employer and 2.5% by the employee (data as of 2005). The regular legal retirement age for men is 62.5 years and for women 59.5 (rising to 60 by 2006). The qualifying period to receive full pension is 30 full years (a minimum qualifying period being 15 years), with a full year consisting of at least 12 minimum monthly salaries. The average old age pension received at retirement amounted to 31% of average gross income, 44% of net salary in 2002 and adjustments are made in line with wage increases. No tax is applied to pension benefits.

While early retirement provisions for certain professions were terminated in 1995, an early retirement pension scheme was introduced for the long-term unemployed in 2004. Under that scheme pensions are reduced by 0.4% for every full month remaining until the retirement age and the reduced pension is fixed at this level. Staying longer in the labour force is rewarded by pension benefit increases of 8% per annum.

The mandatory funded pension scheme was introduced on 1st January 2004. The second tier of the statutory system is actually voluntary though opting out from the scheme after joining is not permitted. There are no restrictions for participation except being insured by the State social insurance pension system and aged below the legal retirement age. Currently, already 54% of eligible persons have joined a funded scheme. This scheme is a defined contribution scheme financed by a fraction of the social insurance contribution (increasing from 2.5% to 5.5% of gross wage by 2007). At retirement, the participant has to purchase a pension annuity from an insurance company. Only in cases of very small annuities (half the amount of the basic pension) or for sums exceeding the annuity being three times larger than the basic pension, can an individual choose to receive pension benefits as a lump sum or as phased withdrawals from the fund.

Supplementary voluntary pension provision is possible through either pension insurance or special voluntary pension funds (these started operating in 2004, although the law was adopted in 1999). The voluntary pillar can take two different forms: DC if supplemental contributions are invested into pension funds or unit-linked life insurance, or DB when purchasing a classical life insurance product. Contributions to the system

may be made by the individual or his employer, and tax allowances are available, providing contributions do not exceed 25% of the person's annual earnings.

It is possible to establish **occupational pension schemes** though as yet none have been created.

Those not having the minimum qualifying period for entitlement to social insurance pensions may receive a social **assistance pension** when they reach old age. This is also available for those disabled in youth (under 24 years of age) and orphaned children. The amount of the social assistance pension in case of old age is equal to 90% of the basic pension which equates to 31% of the minimum monthly salary or 18.5% of the average net wage as of 2004. No minimum old-age social insurance pension is provided for in law.

2 SITUATION AND PERSPECTIVES IN THE LIGHT OF THE COMMON OBJECTIVES

2.1 Current situation

Adequacy: The poverty risk of the elderly is rather low: for 65+ it was 12% in 2003, but the gender difference is significant: for older (65+) men it was 5% and 15% for women. The risk of poverty for the elderly is lower than that of the age group 0-64, which was 15%.

Adequacy is threatened by rather high level of unemployment (10.9% in 2004), the minimum requirement for contributions made (more than 12 minimum monthly salaries), low coverage rate (83% of labour force) and undeclared work. All of which could contribute to difficulties earning adequate pension rights, which may result in greater reliance on social assistance (minimum) pension in the future. However, the closer link between contributions and benefits resulting from the reform of the PAYG system and the introduction of the funded pension components should improve incentives to contribute.

Financial sustainability: Employment rates of older workers aged 55-64 in 2004 are higher in Lithuania (47.1%) than in the EU25 average; but below the Lisbon target. There are also gender differences – employment rate of older men is higher (57.6%) than that of older women (39.3%). Early retirement option has been reintroduced in 2004, although only for the long-term unemployed. Deferred retirement is rewarded. The latter fact may cause problems in the future, if the legal retirement age is not raised resulting in larger cohorts benefiting from deferred pension benefit enhancements.

The Level of pension's expenditure was 6.8% of GDP in 2003 and is one of the lowest in the EU25. As the total contribution to the mandatory funded pension pillar will be increased only gradually and constitute only a relatively small share of the total pension insurance (5.5 p.p. of the total 26% contribution rate), transition costs to the public PAYG scheme are expected to remain low as well. Moreover, the State social insurance fund has started to produce surpluses, thanks to improved employment.

Modernisation: The pension system in Lithuania is neutral regarding different employment forms, mobility issues, as well as individual choice. There is still inequality in retirement ages.

Information about the pension system in general is widely available to the public. The Ministry of Social Security and Labour provides comprehensive information to the public and institutions about any reform in its annual Social Report. The public is also informed about developments and changes to the pension system through the Ministry's web-site. A special public awareness raising campaign was implemented when preparing

for the establishment and launching of the private pension system in 2003-2004. Pension companies have an obligation to inform their clients about the investment performance of the 2nd tier of the 1st pillar. However, predicting pension outcomes remains problematic.

2.2 Outlook, reform measures and policy debates

According to Eurostat projections Lithuania is facing one of the fastest decreases in population amongst the EU25. The total population (3.4 million) is expected to decrease by 9.1% by 2025 and by 16.4% by 2050. Reasons for the decrease are low fertility rates and negative net migration. However, life expectancy compared to other EU countries is projected to remain rather low. The share of both 0-14 and 15-64 remains higher than the EU25 average and the 65+ age group is expected to be less of a factor than for the EU25 (15.0% in 2004 compared to the EU25 average of 16.4% and 26.7% in 2050 while EU25 average is projected to be 29.9%). Consequently, the increase in the old-age dependency ratio is projected to be moderate, from 22% in 2003 to 45% in 2050, noticeably smaller than the EU10 average.

While the risk of poverty of the 65 and older cohort is currently lower than for the working-age population, Lithuania may face a risk of an increase in the number of those dependant on social assistance pensions only. Furthermore, the State social insurance scheme does not cover farmers.

According to the AWG projections of 2005, Lithuania is projecting a moderate 1.9 p.p. of GDP increase in public pension expenditure (3.7% of GDP when taking into account the funded tier of the statutory scheme) over the period 2004-2050 and a somewhat lower rise in overall age-related public spending (1.4%) over the same period. As the total contribution to the mandatory funded pension pillar remains rather low (contributions at 5.5 p.p. of gross wages), transition costs are expected to remain low as well. The State social insurance fund is expected to be in balance or surplus up to 2020. Thereafter, a deficit is anticipated, peaking at 0.7 % of GDP in 2030. The Government is considering the strategies to tackle the financing gap, including further reforms in the public PAYG scheme such as increasing the retirement age and employability and employment opportunities for older workers.

Conclusion

Since the 2004 reform, the State-managed statutory pay-as-you-go pension scheme is associated with a privately managed funded pension scheme. These schemes cover gainfully employed persons while social assistance pension provides a minimum retirement income to those not entitled to a social insurance pension, including farmers and other self-employed. However, the introduction of the minimum retirement income could lead to disincentives to work or to not declaring income.

Financial sustainability of the public pension scheme will have to be closely monitored although the transition costs are not expected to cause problems before 2020. However, the ageing of the population beyond this point risks a deficit in the social insurance pension scheme. Further measures with the aim of increasing employment rates as well as the retirement age would contribute to both the future adequacy and sustainability of pensions. In that respect, while early retirement provisions were terminated in 1995, the introduction of an early retirement pension scheme for the long-term unemployed in 2004 seems to be in contradiction to the general trend.

Regarding the modernisation of the system, equalising statutory retirement ages for men and women would help to reduce the gender gap in pension entitlements and would also contribute to increasing employment rates of older workers.

4. BACKGROUND STATISTICS

	LT			EU25		
Adequacy						
Current situation						
	Total	Men	Women	Total	Men	Women
At-risk-of-poverty rate [1]	15	14	15	16	15	17
0-64	15	15	15	16	16	17
65+	12	5	15	18	15	20
75+	15	6	19	Nd	Nd	Nd
Income inequality [1]						
0-64	4,8					
65+	3,0					
Income of people aged 65+ as a ratio of income of people aged 0-64 [1]	0,89	0,96	0,85			
Median pensions relative to median earnings [2]	0,63	0,68	0,61			
Long-term projections						
Theoretical replacement rates[3]	2005	2030	2050			
Total net replacement rate	41	50	50			
Total gross replacement rate	31	42	42			
Gross repl. rate 1st pillar						
Gross repl. rate 2nd/3rd pillar						
Financial sustainability						
Current situation						
ESSPROS Pension expenditure [4], % of GDP	***1995***	2000	***2003***	***1995***	2000	***2003***
		7,8	6,8		12,5	12,6
Employment (2004) [5]	Total	Men	Women	Total	Men	Women
Employment rate ***(25-54)***	79,4	81,7	77,3	76,8	85,2	68,5
Employment rate (55-64)	47,1	57,6	39,3	41,0	50,7	31,7
Effective labour market exit age (2004)[6]	60,8			60,7p	60,9	60,4p
Public finances (2003) [7]						
Public debt, % of GDP	21,6			63,3		
Budget balance, % of GDP	-1,9			-2,8		

Long-term projections (EPC 2006)

	LT Level			LT increase	EU25 Level			EU25 increase
	2004	2030	2050	2004-50	2004	2030	2050	2004-50
Old-age dependency ratio [8]	22,3	33,4	44,9	+101%	25	40	52	+108%
Public pensions expenditure, % of GDP [9]	6.7	8.3	10.4	+3.7	10,6	11,9	12,8	+2,2
Factors determining the evolution of public pensions expenditure (2000-2050) [10]	Contribution to change in percentage points of GDP				Contribution to change in percentage points of GDP			
Demographic dependency	5,4				8,6			
Employment	-1,0				-1,1			
Eligibility	-2,1				-2,1			
Level of benefits	-0,2				-2,7			
Total (including residual)	1,9				2,2			

Notes:

1. Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, Income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).
2. Source: Eurostat. Median individual pension income of retirees aged 65-74 in relation to median earnings of employed persons aged 50-59 excluding social benefits other than pensions.
3. Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first and second pillar pension schemes, retiring at the age of 65 years in 2005.
4. Source: ESSPROS, EUROSTAT. Includes expenditure by certain private social protection schemes.
5. Source: European Labour Force Survey, 2004.
6. Source: European Labour Force Survey, 2004.
7. Source: European Commission, DG ECFIN.
8. Source: EUROSTAT (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15-64.
9. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.
10. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.

* proportion negligible

LUXEMBOURG

1 MAIN CHARACTERISTICS OF THE PENSIONS SYSTEM

The **statutory pension system** consists of a general scheme for private sector employees and the self-employed and a special scheme for civil servants. Pension benefits are related to earnings and survivors and invalidity pensions are also provided.

The general pension scheme is financed through a contribution on wages of 24% which is paid in equal shares by employers, employees and the state budget. The contribution rate is determined for a period of seven years on the basis of an actuarial evaluation of the scheme. This medium-term commitment aims at stabilising the contribution rate at a level which allows maintaining a minimum reserve fund of the magnitude of 1.5 times the annual amount of benefit payments over the seven year period. Presently the reserve fund of the general pension scheme amounts to more than 3 times annual expenditures of the system (24% of GDP).

The net replacement rates for a full insurance career under the general scheme are high, reaching almost 100% of the pre-retirement income for a worker on about average earnings after 40 years of insurance. A minimum pension of EUR 1.353 per month (October 2005) is guaranteed after 40 insurance years.

The monthly old age pension consists of two parts:

- a basic part, equivalent to around 12% of average earnings, subject to 40 years' coverage and an 'end-of-year allowance'. For incomplete insurance, these benefits are reduced proportionally. Coverage periods include contributory periods as well as non-contributory periods (educational training or child education).
- an income related part with an accrual rate of one twelfth of 1.85% of the sum of all incomes from work. The earnings measure used in the formula is lifetime average pay revalued in line with nominal earnings. The accrual rate is higher for older workers and those with longer contribution periods.[17]

Under current legislation, pensions in payment are automatically adjusted to price evolution each time prices increase by more than 2.5%. In addition, pensions are reviewed every two years in the light of the evolution of real wages. Whereas price indexation is automatic, the adjustment of pensions to wage development is to be decided by government and approved by parliament. Index-linking to wages was common practice in the past.

The means-tested **guaranteed minimum** income (RMG) scheme ensures a basic income for those without adequate pension entitlements or other resources. The monthly amount for a single person is EUR 1.071 per month (October 2005).

This leaves only a limited need for **supplementary schemes**. Occupational pension schemes are voluntary for employees and have developed mainly in foreign or very large industrial and commercial companies, as well as in the banking sector. In 2002, new legislation on individual old-age savings was introduced, favouring their development through tax incentives. They are fully funded and their assets amount to about 0.6% of GDP.

[17] For each year of work after age 55, the accrual rate is increased by 0.01 percentage points. Furthermore, each year of contributions beyond 38 also attracts an additional accrual of 0.01 percentage points. The maximum accrual rate is 2.05% per year.

2 SITUATION AND PERSPECTIVES IN THE LIGHT OF THE COMMON OBJECTIVES

2.1 Current situation

In 2003, the risk of poverty of people aged 65+ was 6% (close for men and women and 12% for the 0-64 population), while the living standard of people aged 65 or more was nearly equal (100%) to the one of those aged 0-64.

The theoretical gross replacement rate from the general pension scheme amounts to nearly 91% for a worker on average earnings retiring at 65 after 40 years of contributions. The corresponding net replacement rate is just over 98%. Replacement rates are higher for workers on 2/3 of average earnings (107% net) and lower for people with rising earnings during their careers (74% net for a worker with earnings rising from 100 to 200% of the average).

There is scope for raising employment rates so as to widen the contribution base for the resident population. In spite of a very low rate of unemployment, the employment rate of residents aged between 15 and 64 years was 62.6% in 2003. Employment rates of women were also comparatively low. In spite of recent increases, about 31% of residents between 55 and 64 are in employment, which is significantly below the Lisbon target (50%).

According to ESSPROS data, pension expenditures were 10.9% of GDP in 2003, below the EU15 average of 12.6% of GDP. The Luxembourg pension system's financial sustainability hinges not only on the contribution of relatively high rates of economic growth in the future, but also on the major contribution of non-resident workers to the economy. Currently, about 40% of beneficiaries are non residents. Fluctuations in the number of foreign workers will have much larger effects on the long-term financial sustainability of the pension system than demographic ageing of the resident population. Two reforms were introduced in 2002, aiming at addressing the problem of the low employment rates of older workers. One is the reform of the disability pension system with the aim of promoting rehabilitation instead of retirement. The other measure was the introduction of a new mechanism of staggered pension increments, based on age and contribution history, for workers aged at least 55 years and with a contribution history of 38 years, intending to encourage people to extend their working lives.

2.2 Outlook, reform measures and policy debates

Luxembourg is expected to experience favourable demographic developments over the coming decades, mainly due to the sharp increase in the total population leading up to 2050, due in particular to net migration inflows (among the highest in the EU25). The old-age dependency ratio (21% in 2004 and 36% in 2050) is already somewhat lower than the EU average of 24% and is projected by 2050 to become the far lowest in the whole European Union (respectively 36% and 52%).

According to ISG calculations, projected replacement rates will remain at current levels, on average, about equal to the net wage level.

The 2005 projections of the AWG show an important increase of 7.4 p.p. of GDP in public pension expenditures over the projection period, from 10% of GDP in 2004 to 17.4% of GDP in 2050, while the increase in other age-related expenditure is expected to be relatively minor, resulting in only an increase of 7.6 p.p. of GDP in total age-related expenditure.

3 CONCLUSION

The Luxembourg pension system is based on a strong political consensus and ensures a high level of adequacy. Its financial sustainability hinges, however, not only on relatively high rates of economic growth in the future, but also on the major contribution of non-resident workers to the Luxembourg economy and the pension scheme.

Although the reserve fund of the general pension scheme is projected to increase up to 40% of GDP by 2025, the long-term financial sustainability of the pension system is not ensured in the long run. In the event of a decline of non-resident employment the deterioration of the financial balance of the scheme would accelerate.

Financial sustainability would depend less on the availability of non-resident workers if the employment rates of residents were raised - and in particular those of women and people over 55. In spite of recent increases and strengthening of incentives to work longer, employment rates of 55-64 year olds remain significantly below the Lisbon target.

4. BACKGROUND STATISTICS

	LU			EU25		
Adequacy						
Current situation						
	Total	Men	Women	Total	Men	Women
At-risk-of-poverty rate [1]	11	11	11	16	15	17
0-64	12	12	12	16	16	17
65+	6	6	6	18	15	20
75+	8	7	9	Nd	Nd	Nd
Income inequality [1]						
0-64	3,8					
65+	3,0					
Income of people aged 65+ as a ratio of income of people aged 0-64 [1]	1,00	0,99	1,01			
Median pensions relative to median earnings [2]	0,77	0,75	0,83			
Long-term projections						
Theoretical replacement rates[3]	2005	2030	2050			
Total net replacement rate	98	98	99			
Total gross replacement rate	91	90	91			
Gross repl. rate 1st pillar	91	90	91			
Gross repl. rate 2nd/3rd pillar	*	*	*			
Financial sustainability						
Current situation						
ESSPROS Pension expenditure [4], % of GDP	***1995***	2000	***2003***	***1995***	2000	***2003***
	12,7	9,7	10,9		12,5	12,6
Employment (2004) [5]	Total	Men	Women	Total	Men	Women
Employment rate ***(25-54)***	78,7	92,5	64,6	76,8	85,2	68,5
Employment rate (55-64)	30,8	38,5	22,9	41,0	50,7	31,7
Effective labour market exit age (2004) [6]	57,7			60,7p	60,9	60,4p
Public finances (2003) [7]						
Public debt, % of GDP	5,4			63,3		
Budget balance, % of GDP	0,8			-2,8		

Long-term projections (EPC 2006)

	LU Level			LU increase	EU25 Level			EU25 increase
	2004	2030	2050	2004-50	2004	2030	2050	2004-50
Old-age dependency ratio [8]	21	31,6	36,1	+72%	25	40	52	+108%
Public pensions expenditure, % of GDP [9]	10.0	15.0	17.4	+7.4	10,6	11,9	12,8	+2,2

Factors determining the evolution of public pensions expenditure (2000-2050) [10]	LU: Contribution to change in percentage points of GDP	EU25: Contribution to change in percentage points of GDP
Demographic dependency	7,2	8,6
Employment	-4,4	-1,1
Eligibility	2,5	-2,1
Level of benefits	2,1	-2,7
Total (including residual)	7,4	2,2

Notes:
1. Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, Income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).
2. Source: Eurostat. Median individual pension income of retirees aged 65-74 in relation to median earnings of employed persons aged 50-59 excluding social benefits other than pensions.
3. Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first and second pillar pension schemes, retiring at the age of 65 years in 2005.
4. Source: ESSPROS, EUROSTAT. Includes expenditure by certain private social protection schemes.
5. Source: European Labour Force Survey, 2004.
6. Source: European Labour Force Survey, 2004.
7. Source: European Commission, DG ECFIN.
8. Source: EUROSTAT (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15-64.
9. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.
10. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.

* proportion negligible

HUNGARY

1 MAIN CHARACTERISTICS OF THE PENSIONS SYSTEM

Since the 1997 pension reform the mandatory public pension system consists of two tiers. The **first tier** is a publicly managed, pay-as-you-go financed, defined-benefit, social security pension scheme, which covers all employees and the self-employed. It provides earnings-related old-age, disability and survivors benefits, which are financed mainly from separate pension contributions. The statutory retirement age for claiming a full pension was 55 for women and 60 for men under the former system and is being gradually raised to 62 years (for men by 2002 and for women by 2009).

About 30% of the population receive a public pension. About a quarter of pensions are disability pensions with a majority (57%) of recipients being younger than the statutory pensionable age. Old-age pensions, disability pensions, survivor's pensions and accident related benefits are indexed by the average of wage and price increases (weighted 50:50).

Statutory contribution rate for employers and individuals went down from 31% in 1998 to 26.5% in 2003. The 18 percent pension insurance contribution paid by employers goes into the Pension Insurance Fund. Participants of the second tier pay 8 p.p. of these contributions into the funded scheme. Non-members of the second tier contribute exclusively to the public pension scheme. Employees are only required to pay contributions on income up to a certain level (in 2005 that level was over three times average earnings). There is no ceiling on the wage in which an employer is required to pay contributions. In 2004, revenues from contributions covered 76.4% of Pension Insurance Fund pension-related expenditures. The rest came from the central budget.

The pension scheme combines with other supplementary provisions of the social safety net that are means tested. At least 20 years of contribution payments are required for a minimum pension from the statutory pension scheme. Equalising the legal retirement age for men and women would help in reducing the gender gap in pension entitlements and contribute to increasing employment rates of older workers. An individual is entitled to a partial pension, for which there is no set minimum, after 15 contributory years. In 2004 the minimum pension amounted to 40% of the average old-age pension and only 2% of people are in receipt of this benefit. Individuals who are not entitled to a pension in their own right, or if the amount of that pension is below a certain level, then, based on need, they may be entitled to an old age allowance.

The **second tier of the statutory scheme** will, in the long term, cover all who are engaged in gainful employment. Those entering the labour market for the first time are automatically enrolled into this two-tier scheme and those who had already acquired pension rights before 1998 could voluntarily opt for the new system at the time of its inception (about 50% of the labour force did, although they lost 25% of their accumulated rights for future pay-as-you-go pillar benefits). Those who did not join the second tier of the system remain in the pure PAYG scheme (paying a higher level of contributions and receiving higher benefits). Currently about 60% of the labour force are members of the second tier. As a consequence of mandatory membership for new entrants, the coverage will progressively increase.

The second tier of the statutory pension system is composed of fully-funded, defined-contribution, private pension funds (MPPFs). Funds accumulate and invest contributions paid by their members into individual accounts. At retirement the accumulated units are converted into a life annuity (provided by either the fund itself or a life insurance company). Benefits are also provided in case of death (right to a lump sum payment of

the individual endowment to a previously designated person) or disability (benefit calculated according to general rules of annuity calculation).

Occupational schemes are not common in Hungary, but voluntary **individual schemes** have been in existence since 1994 in the form of *Voluntary Mutual Benefits Funds* (VMBFs). At present, 32 % of the employed population are members of a voluntary pension plan (increases are expected in the future). Contribution rates vary widely. In 2004, the average membership fee payment amounted to 3.6% of gross earnings (from which two thirds are paid by employers). There are tax incentives provided in the scheme and by the end of 2000, about 320 VMBFs had been established, but their numbers have declined rapidly. In 2005 only 75 voluntary supplementary retirement funds are in operation. Assuming an average of 30 years of membership to the voluntary pension schemes, the expectation would be for a supplementary pension of to be worth 8-10% of earnings.

2 SITUATION AND PERSPECTIVES IN THE LIGHT OF THE COMMON OBJECTIVES

2.1 Current situation

Adequacy: The relative living standard of older people is around 90% of that of the 0-64 population. Hungary's poverty rates are relatively low and slightly lower for the 65+ cohort (10%) than for the 0-64 population (12%). According to ISG calculations, the theoretical net replacement rate for a worker retiring at 65 after 40 years of contributions at the average wage in 2005 is 102%, total theoretical gross replacement rates 66%. The net replacement rate calculations on a more typical case (retiring at 62, after 38 years of employment) though, show a lower level of 83% (for 2005).

The number of those who joined the funded scheme voluntarily was higher than expected. A motivation of voluntary membership was the expectation of higher pensions from private funds in addition to those from the PAYG scheme. This hope could be frustrated in the case of those who will have only a short accumulation period. Moreover, legislation describes several types of annuities, but there are currently no annuity products on the market that satisfactorily fit the law's requirements.

After years of ad hoc increases, a wage indexation formula was introduced in 1991, but was then changed several times. In general, lower pensions were increased at higher rates. Medium and higher pensions received low and irregular increases and the new indexation rules of 1998 were changed again in 1999. Since 2001, the net wage indexation has gradually been replaced by the so-called 'Swiss indexation'.

In 2003, over 30 % of contributors made payments on minimum wages, which could significantly raise the risk of future poverty if this becomes a permanent phenomenon. In addition a significant portion of those whose main economic activity is private farming stay outside the mandatory pension insurance system (their taxable income is insufficient to qualify for contribution payments).

Financial sustainability: In 2003, pension expenditures represent 9.3% of GDP, below the EU25 average of 12.6%, while the total spending on social protection was significantly lower (21.4% vs. 28%). During the 1990's, the pension system was also used to cover people who became redundant due to the industrial restructuring that withdrew large groups from the labour market (thus being an important factor explaining the high rate of inactivity). This measure poses major problems for the financial sustainability of the system, reinforced by the decline of wage share in GDP (whereas in 1992 the wage share was at 40% of GDP, it dropped to 34% by 2000).

Employment rates, in particular those of older workers (in 2004 at 31.1%), are far below the Lisbon target and risk the system's long run sustainability. Moreover, contribution

evasion attributed to undeclared work remains a problem. Previous combinations of a short minimum contributory period of 15 years for obtaining an old age pension and declining accrual rates were disincentives to prolong working lives which has led to an increase in early retirement today.

Several measures have been introduced to reduce the incentives for early exit from the labour market. In particular, the accrual rates for the old-age pension formula will be made linear from 2013[18], and the minimum contributory period to be eligible for an old age pension has been raised to 20 years

Modernisation: The poverty rate of older women stays at a significantly higher level than for men (10% for women (65+), against 5% for men in 2002), reflecting more favourable career records for men and possibly low levels of survivor's benefits.

In the more complex mixed private-public system there is ample need for information. Employers are obliged to report the contribution of each employee yearly, but there were some mismatches between actual contribution revenues and contributions reported by employers. Moreover, reports on individuals and their records are incompletely computerised.

2.2 Outlook, reform measures and policy debates

Hungary is projected to face similar demographic trends to the other Member States. The old age-dependency ratio is expected to more than double from 22% to 48% between 2003 and 2050.

Prospective ISG replacement rates resulting from reforms adopted (including the two tiers of the mandatory scheme) are expected to remain nearly constant for workers at the average wage (about 100% as a net replacement rate for a 40 years career length retiring at 65 and about 80% for a 38 years career length retiring at 62). Also replacement rates for people at 2/3 of average earnings are expected to be rather constant with a slight increase from 90% in 2005 to 92% in 2050. Total theoretical gross replacement rates rise from the current level of 66% to 78% by 2050 due to the significant contribution of the funded elements of the system (which are expected to compensate for the reduced level of public pensions), while no significant change is expected in the total net replacement rate (it will slightly decrease from 102% to 98 %).[19]

The 1997 reform introduced a funded tier in the statutory social security scheme, causing a deficit in the first tier when a proportion of the contributions were redirected to the funded scheme. Moreover, contribution evasion seems to remain an issue in both the Pension Insurance Fund and private funds. The reform also gradually reduced employers' pension contributions from 24% of gross wages to 18% while employees' contributions were increased from 6% to 8.5% by 2003, thus reducing the total contribution rate from 31% of gross wages to 26.5% (for the two tiers of the mandatory scheme). This reduction of contributions was intended to increase employment but since employment did not react flexibly to this incentive, the decreasing wage share of GDP has resulted in reduced contribution revenues, thereby aggravating the financial balance of the Pension Insurance Fund. The introduction of linear accrual rates in the pension formula, by enhancing transparency and fairness, will provide incentives to work longer. However, it will only be introduced from 2013 onwards.

[18] This will correspond to 1.65% of earnings for every service year for those who stay 100% in the pay-as-you-go tier and to 1.22% for those who partially opt out and join the second tier (from which they will receive an additional pension)

[19] Currently, pension benefits are exempt from tax and as from 2013, pensions will be taxed. Therefore their gross amount will exceed their net amount. As a result, the gross replacement rate will increase but the net replacement rate will remain roughly the same.

Hungary is facing relatively small additional budgetary pressures on pension spending, mainly thanks to the recently enacted pension reform. According to the national budgetary projections included in 2004 in the context of the assessment of the long-term sustainability of public finances, Hungary is expected to be spending a broadly constant amount of around 7.5% of GDP between 2009 and 2050.[20]

Moreover, according to the AWG 2005 projections, public spending on pensions is projected to increase from 10.4% of GDP to 17.1% between 2004 and 2050, despite the partial switch to funded schemes (taking into account the development of the mandatory funded scheme, pension expenditures are projected to increase from 10.4% in 2004 of GDP to 20.3% of GDP in 2050). The increase is driven by the dynamic effect of the increasing wage level on the level of new pensions. This projected increase is amongst the highest in the EU and is strongly contributing to the overall projected increase in age-related public expenditure (increasing from 20.7% of GDP to 27.7% between 2004 and 2050).

3 CONCLUSIONS

Hungary has implemented major reforms in the last decade. The early reforms of the 1990s increased the statutory retirement age and strengthened the link between contributions and benefits. Moreover, the 1997 reform introduced a funded tier in the statutory social security scheme, which will contribute to the sustainability of the pension system in the long run. However, this will cause transition costs which will constitute a major challenge for the Pension Insurance Fund and public finances as a whole. Further reforms may be required in the public PAYG scheme, in particular with the aim of tightening early retirement options in order to encourage longer working. Better management and co-operation, in particular regarding contribution collection, between the Pension Insurance Fund, Tax and Financial Control Administration (APEH) and private funds could reduce contribution evasion. The efficiency of the second tier contribution collection might also be improved by better cooperation amongst the funds as well as by an enhanced centralization of contribution collection.

Hungary has managed to maintain adequate pensions in recent years - Relative poverty is quite low amongst older people, who enjoy on average almost a comparable income to the active population. However, some measures of the recent reforms may pose adequacy risks in the future. In addition a significant portion of people whose main economic activity is private farming are not covered by the mandatory pension insurance system at all.

Employment rates are low in Hungary, especially for older workers, despite recent improvements. Policy efforts to further increase the employment rates of older people could make a strong contribution to future adequacy and sustainability. The introduction of linear accrual rates in the pension formula will enhance incentives to work longer as well as fairness, but this will be only introduced from 2013 onwards. An acceleration of this process may be desirable

[20] The NSR foresees the total spending on pension (including first and second tiers of the statutory system and disability pensions) to grow from 9.5% in 2004 to about 11% of GDP in 2050.

4. BACKGROUND STATISTICS

	HU			EU25		
Adequacy						
Current situation						
	Total	Men	Women	Total	Men	Women
At-risk-of-poverty rate [1]	12	12	12	16	15	17
0-64	12	12	12	16	16	17
65+	10	6	12	18	15	20
75+	14	11	15	Nd	Nd	Nd
Income inequality [1]						
0-64	4,0					
65+	2,5					
Income of people aged 65+ as a ratio of income of people aged 0-64 [1]	0,87	0,92	0,84			
Median pensions relative to median earnings [2]	0,71	0,68	0,72			
Long-term projections						
Theoretical replacement rates[3]	2005	2030	2050			
Total net replacement rate	102	96	98			
Total gross replacement rate	66	73	77			
Gross repl. rate 1st pillar	66	59	59			
Gross repl. rate 2nd/3rd pillar	0	14	19			
Financial sustainability						
Current situation						
ESSPROS Pension expenditure [4], % of GDP	***1995***	2000	***2003***	***1995***	2000	***2003***
		8,7	9,3		12,5	12,6
Employment (2004) [5]	Total	Men	Women	Total	Men	Women
Employment rate ***(25-54)***	73,6	80,5	67,0	76,8	85,2	68,5
Employment rate (55-64)	31,1	38,4	25,0	41,0	50,7	31,7
Effective labour market exit age (2004)[6]	60,5	60,3	60,7	60,7p	60,9	60,4p
Public finances (2003) [7]						
Public debt, % of GDP	59,1			63,3		
Budget balance, % of GDP	-6,2			-2,8		

Long-term projections (EPC 2006)

	HU Level			HU increase 2004-50	EU25 Level			EU25 increase 2004-50
	2004	2030	2050		2004	2030	2050	
Old-age dependency ratio [8]	22,6	35,1	48,3	+114%	25	40	52	+108%
Public pensions expenditure, % of GDP [9]	10.4	13.9	20.3	+9.9	10,6	11,9	12,8	+2,2

Factors determining the evolution of public pensions expenditure (2000-2050) [10]	HU: Contribution to change in percentage points of GDP	EU25: Contribution to change in percentage points of GDP
Demographic dependency	10,5	8,6
Employment	-1,1	-1,1
Eligibility	-4,5	-2,1
Level of benefits	-7,5	-2,7
Total (including residual)	6,4	2,2

Notes:

1. Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, Income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).
2. Source: Eurostat. Median individual pension income of retirees aged 65-74 in relation to median earnings of employed persons aged 50-59 excluding social benefits other than pensions.
3. Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first and second pillar pension schemes, retiring at the age of 65 years in 2005.
4. Source: ESSPROS, EUROSTAT. Includes expenditure by certain private social protection schemes.
5. Source: European Labour Force Survey, 2004.
6. Source: European Labour Force Survey, 2004.
7. Source: European Commission, DG ECFIN.
8. Source: EUROSTAT (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15-64.
9. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.
10. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.

* proportion negligible

MALTA

1 MAIN CHARACTERISTICS OF THE PENSIONS SYSTEM

In Malta the mandatory earning related pension scheme covers old-age pensions, survivor's benefits and invalidity pensions for employed people. It is called "two-third pension" because the initial benefits at the moment of retirement are calculated as two-thirds of the average income of the best three years during the ten last years prior to retirement, after a contribution period of 30 years. For self-employed people the income averaging period is extended to the last ten years. The contribution base is such that all income higher than 133% of average annual earnings (2004) is not taken into account when calculating pension entitlement. Retirement age is 61 for men and 60 for women (equalisation is proposed to take place by 2007).
Presently, the full rate of a pension is payable to a person who has paid (or has been credited) contributions over a 30 year period. The lower the number of years of contribution, the lower the pension will be. At least nine years of contributions are required.

So far voluntary **occupational pension schemes** and **individual provision** are still in the initial stages of development. However, occupational schemes existed before the "Two-Thirds-Pension" was introduced in 1979.
The 2004 **Minimum Pension** Guarantee stood at around 50% of the average wage and is calculated at 80% of the National Minimum Wage in the case of married persons and two thirds for single pensioners. In addition there is a non contributory means-tested assistance, called "age pension" which is payable to those aged more than 60 with little or no other means to support themselves.

2 SITUATION AND PERSPECTIVES IN THE LIGHT OF THE COMMON OBJECTIVES

2.1 Current situation

Concerning **adequacy**, the current relative income of older persons (aged 65 or older) is on average about 90% of the relative income of the age group 0-64, (96% for men and 86% for women). Presently, according to the Indicator Sub-Group (ISG) calculations, theoretical total gross replacement rates stand at around 72% (net 88%) for a worker retiring at 65 after 40 years of contributions at the average wage. The risk of poverty of people aged more than 65 is 20%, significantly higher than the one of people aged 0-64 (14%). The risk of poverty for the oldest pensioners aged 75 and over is higher for women than for men (24% compared to 18%).
Sustainability: The Maltese government regards its statutory pension scheme with reference to the deteriorating old-age dependency ratio as potentially financially unsustainable in the future. Pension expenditure increased in the last years from 8.5 % of GDP in 2000 to 9.5 % of GDP in 2003. In 2003 it was due to increasing old age and survivors' outlay. Moreover, a high proportion of Maltese people claim invalidity benefits: in 2004 the number of beneficiaries in this category stood at 8.824 while in 2002 this number stood at 7.560 i.e. a 16.7% increase in only two years, which represents 10.7% and 12.84%[21] of the total cost of old age pensions.
The employment rates for both genders and all age cohorts is currently much lower than in almost all other new Member States. The 2004 employment rate for women (32.7%) is considerably below the Lisbon target (60%), as is the employment rate of older

[21] Based on ESSPROS statistics

workers (31.5%). Female older workers employment rate (11.5%) is among the lowest in EU25 and decreased from 2003 to 2004 by 1.5 p.p.. However, the female employment rate in the youngest group of 15-24 years is equal to that of men, suggesting that there are strong cultural reasons for current low employment rates for older women and that a strong cohort effect will lead, over time, to an equalisation of employment rates between men and women.

Concerning **modernisation**, Malta is the country with the widest gender gap in EU 25 concerning employment rates (except for the youngest group of people). It amounts to 54 p.p. at the age 25-54 and 41.9 p.p. by age 55-64. In addition more women are working part time than men (3.5% men and 19.9% women). The Maltese government expects an increase of female labour participation rate over time, but also a decrease in the black economy. Nevertheless, the gender gap in regards to the risk of poverty in the age group of 65+ is negligible, but does increase for those 75+, up to 6 p.p..

2.3 Outlook, reform measures and policy debates

Malta is expected to face similar demographic trends as most other new Member States, due to a current[22] falling fertility rate (1.48 in 2003). The old-age dependency ratio is projected to increase between 2004 and 2050 by 22 p.p., noticeably less than for the EU10 (31 p.p.).

The Maltese government shortly plans to introduce reforms to improve the financial sustainability and **adequacy** of the pension system, notably by gradually raising the retirement age to 65 for both men and women, gradually increasing the contribution period for the accumulation of the PAYG pension and changing the calculation base to achieve more equivalence. A "White Paper on pension reform" was published in November 2004, indicating that the underpinning objective of the pay-as-you-go pension should be to guarantee a minimum decent standard of living and to prevent social exclusion (providing flat rate contributions and flat rate benefits), while a second pillar (SPPS) still to be introduced would allow for the improvement of the pension benefit entitlement. Moreover voluntary third private saving schemes would be introduced.

The calculation of the theoretical replacement rates shows a range of outcomes under different scenarios. In the absence of pension reforms and under the assumption that the ceiling for the accrual of the benefit level will be indexed only to prices, the gross replacement rates would fall from today's 72% to 53% in 2030 and 31% in 2050 (net today 88%, 61% in 2030 and 34% in 2050). The introduction of a mandatory SPPS by 2010 is expected to contribute to an increase in future replacement rates from 2030 onwards.

Concerning **sustainability**, adjustment of pension scheme parameters are planned, such as an increase in the contribution period required for the statutory scheme and equal treatment between the self-employed and employed persons regarding the contribution period upon which pensions are calculated.

According to the AWG 2005 projections, public spending on pensions is projected to slightly decrease from 7.4% of GDP in 2005 to 7.0% of GDP in 2050. However, there will be an increase until 2020 when the spending would peak at 10.2% of GDP and decrease thereafter. This decrease is due to the current rules regarding pension levels, which are subject to a ceiling, indexed on the rise in cost of living only, thus resulting in a decrease of the initial pension level relative to wages and making the pension more flat-rate than it is currently. At the same time, overall age-related spending are projected to remain at their current level (17.3% of GDP).

[22] The unpublished figure for 2004 is 1.37.

According to the Maltese National Strategy report, taking into account the new reform options - following the implementation of the reforms contemplated in the White Paper - the pension expenditures in the PAYG scheme are expected to peak at 10.0% in 2013 and then decline to 4.3% by 2050, the share of total expenditure on the second pillar SPPS is projected to be rising over the period, reaching 4.2% of GDP in 2050.

Concerning **modernisation**: Retirement age is 61 for men and 60 for women (equalisation to 61 is proposed by 2007). The current pension system is earnings related and does not include a credit system for child care and elderly care, which is likely to penalises women. Reform plans include measures such as credits for child care and elderly care either by introducing a "credit system" for parents with children up to the age of four years or reducing the contributory period with each child.

3 CONCLUSION

The timing of the second round of National Strategy Reports coincides in Malta with the adoption of the recommendations of the reform strategy within the White Paper and thus fell in the middle of the decision-making process. However, Malta stated that the OMC was very helpful for the reform process, especially the calculation of the future replacement rates within the current system.

The likely evolution of the current statutory pension scheme is, in this context, still uncertain. The government has to decide, whether the system will develop in the direction of more flat-rate benefits or of a strengthening the link between contributions and benefits. In case of flat-rate minimum pensions a reasonable level should be foreseen in order to cope with the poverty risk of older persons, especially women. In order to ensure adequate replacement incomes and sustained incentives to contribute to the scheme, easy access to the new mandatory scheme SPPS is essential.

Malta is the country with the widest gender gap in employment rates. Although the cohort effect can be expected to change this over time, further plans to increase incentives in order to retain women in employment might be a prior political issue.

4. Background statistics

	MT			EU25		
Adequacy						
Current situation						
	Total	Men	Women	Total	Men	Women
At-risk-of-poverty rate [1]	15	15	15	16	15	17
0-64	14	14	14	16	16	17
65+	20	19	20	18	15	20
75+	21	18	24	Nd	Nd	Nd
Income inequality [1]						
0-64	4,6					
65+	4,5					
Income of people aged 65+ as a ratio of income of people aged 0-64 [1]	0,90	0,96	0,86			
Median pensions relative to median earnings [2]	0,67	0,75	0,53			
Long-term projections						
Theoretical replacement rates[3]	2005	2030	2050			
Total net replacement rate	88	61	34			
Total gross replacement rate	72	53	31			
Gross repl. rate 1st pillar	72	53	31			
Gross repl. rate 2nd/3rd pillar	*	*	*			
Financial sustainability						
Current situation						
ESSPROS Pension expenditure [4], % of GDP	***1995***	2000	***2003***	***1995***	2000	***2003***
	8,1	8,2	9,4		12,5	12,6
Employment (2004) [5]	Total	Men	Women	Total	Men	Women
Employment rate ***(25-54)***	62,1	88,8	34,8	76,8	85,2	68,5
Employment rate (55-64)	31,5	53,4	11,5	41,0	50,7	31,7
Effective labour market exit age (2004)[6]	57,7			60,7p	60,9	60,4p
Public finances (2003) [7]						
Public debt, % of GDP	71,1			63,3		
Budget balance, % of GDP	-9,7			-2,8		

Long-term projections (EPC 2006)

	MT Level			MT increase 2004-50	EU25 Level			EU25 increase 2004-50
	2004	2030	2050		2004	2030	2050	
Old-age dependency ratio [8]	19	36	40,6	+114%	25	40	52	+108%
Public pensions expenditure, % of GDP [9]	7.4	9.1	7.0	-0.4	10,6	11,9	12,8	+2,2
Factors determining the evolution of public pensions expenditure (2000-2050) [10]	Contribution to change in percentage points of GDP				Contribution to change in percentage points of GDP			
Demographic dependency	7,3				8,6			
Employment	-1,2				-1,1			
Eligibility	-1,0				-2,1			
Level of benefits	-5,0				-2,7			
Total (including residual)	-0,5				2,2			

Notes:

1. Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, Income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).
2. Source: Eurostat. Median individual pension income of retirees aged 65-74 in relation to median earnings of employed persons aged 50-59 excluding social benefits other than pensions.
3. Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first and second pillar pension schemes, retiring at the age of 65 years in 2005.
4. Source: ESSPROS, EUROSTAT. Includes expenditure by certain private social protection schemes.
5. Source: European Labour Force Survey, 2004.
6. Source: European Labour Force Survey, 2004.
7. Source: European Commission, DG ECFIN.
8. Source: EUROSTAT (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15-64.
9. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.
10. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.

* proportion negligible

THE NETHERLANDS

1 MAIN CHARACTERISTICS OF THE PENSIONS SYSTEM

The **statutory** social security (state) old age Pension (AOW) is financed by contributions levied on earnings at a rate that is statutorily limited to a maximum of 18.25% and provides all residents of the Netherlands at the age of 65 with a flat-rate pension benefit that in principle guarantees net benefits of 70 % of the net minimum wage (this is equivalent to a gross replacement rate of around 30% for a career at the average wage). As there is no means-test for the eligibility of benefits, other forms of income have no effect on the AOW benefit.

All residents of the Netherlands between the ages of 15 and 65 are insured by the AOW (no distinction is made between men and women, between civil servants, employees, self-employed and housewives). During the period of insurance, i.e. the person lives in the NL, entitlement is accrued by 2% every insured year. This leads to a 100% entitlement when reaching the age of 65, provided there are no gaps in the period of insurance (a gap occurs when a person resides outside the Netherlands). On 1st January 2005, the gross pension rates (for the full rate of pension after 50 years of insurance) for singles are about 925 € gross per month, while both partners in a couple (either married or living together officially) are independently entitled to a pension of about 632 €, which clearly contributes to lowering the risk of poverty among the elderly.

People who are not entitled to the full AOW benefit (i.e. not lived in the NL for a period of 50 years) and who have, together with other sources of income, a total income below the subsistence level (i.e. less than 70% of the legal minimum wage) are entitled to receive social assistance.

Occupational schemes are very well developed in the Netherlands, thanks to collective branch agreements that ensure mandatory[23] coverage of over 90% of all employees. Occupational pensions are subject to negotiation between social partners and have to be financed by capital funding. In 2001, the amount of assets held by pension providers was 131% of GDP. It is expected to grow to about 195% in 2040.

Characteristically, final salary schemes and average pay schemes in general promise a yearly replacement rate of 1.75% to 2% of the final salary or average career salary (including AOW benefits), while the total pension benefit in general corresponds to around 70% of the final or average career salary. Occupational pension schemes are considered supplementary to the AOW state pension. The AOW benefit is therefore included in most calculations of occupational pension schemes in order to achieve the 70% target after 40 years of contributions (the part of the income over which no additional pensions are built up because it is expected to be covered by the AOW is known as the franchise).[24]

On January 1st 2002, some 93% of all active members were participating in a defined benefit scheme. There is a shift from pension schemes based on final wage to pension schemes based on average wages of the whole career: in 2000, 60% of pension funds

[23] Mandatory participation in a branch pension scheme is imposed by the Ministry of Social Affairs and Employment after a request from the branch.

[24] The franchise can be different for different pension schemes in the second pillar. In fact, there are a few branch pension funds which don't have a franchise at all and so everyone accrues pension rights. When there is a franchise and the wage is below the franchise, there is no accrual of pension rights.

were final wage and 32% average wage, while in 2004 the shares was 13% final wage and 77% average wage (expressed as a percentage of active pension scheme members). The way contributions are divided among social partners varies from one pension scheme to another.

The Dutch pension system also includes **individual pension provisions**, either through annuity insurance or endowment insurance (providing a lump sum), encouraged by tax rebates up to certain limits (annuity contributions to compensate gaps in pension accrual in a certain calendar year are, in principle, deductible and the payments taxed).

2 SITUATION AND PERSPECTIVES IN THE LIGHT OF THE COMMON OBJECTIVES

2.1 Current situation

Adequacy: Due to the AOW, which guarantees 70% of the net minimum wage, the poverty rate is one of the lowest in the EU: at7 %, the poverty risk of people aged 65 or more (7% for people aged 75 or more) is significantly lower than for the general population (13 % for people aged less than 65). The living standards of people aged 65 or more are high and represents 84% of that of the 0-64 cohort and 76% of those aged 45-54. It is noticeable that these figures remain stable for people aged 75 or more.

For a worker on average earnings, the flat-rate public pension represents a gross replacement rate of nearly one third. As AOW is flat rate, the associated replacement rate is higher for people on lower incomes, and lower for people on high earnings. Occupational pensions generally supplement AOW pension to achieving a replacement rate of about 70%. They are gradually shifting from benefits based on final earnings to benefits based on career average earnings. This will not affect workers with flat earnings profiles, but it will lead to lower replacement rates for people with rising earnings profiles especially at the end of their career.

Social security pensions are linked to minimum wages, while the indexation of occupational pension schemes varies from prices to wages. Indexation is generally not guaranteed in occupational schemes and the adjustment of pensions in payment can be suspended or lag behind inflation or earnings if this is required by the financial situation of the scheme.

Due to the AOW, (that provides a flat rate benefit based on residence) the risk of poverty is very similar between men (6%) and women (7%) aged 65 and older. In contrast, because of the Netherlands' large number of part-time workers, who are predominantly women, the gender difference in the relative income of elderly persons is among the highest in the EU. To counter this, since 1994 part-time workers can not be excluded from participation in a supplementary pension scheme and since 2002, no distinction can be made in any pension scheme upon the length of contract.

Financial sustainability: The 2004 employment rate for people aged 55-64 (45.2%) has increased significantly in the past decade (from 36.4% in 1999). The share of part-time employment is important (about 10 % of older people work less than 12 hours a week) and the government has defined an objective of a 40% employment rate of 55-64 year olds in 2007 (45% in 2010) , taking into account only 'bigger jobs' (at least 12 hours a week). A series of measures favour greater employment for older people , such as: Employers do not pay WAO (disability insurance) basic contributions for employees of 55 years or older who are already employed, and for employees of 50 years and older who are taken on. Moreover, if an employee changes to a part-time job or a job with lower pay than the current job in the ten years before reaching pensionable age, the pension accrual can continue, on the basis of the previous (higher) wage. And since

2002, it has been more attractive for older people to continue working, with the introduction of the increase in the employed person's tax deduction for this group.

To cope with its ageing population and the financial sustainability of the social security scheme, Governments have been pursuing a three fold policy, based on the reduction of public debt, an increase in labour market participation, and an adjustment of collective schemes other than the AOW. The reduction of government debt aims at reducing the interest burden and at financing rising public expenditure as a consequence of the ageing population. The AOW Savings Fund was established in 1997 to pave the way for a broad base of support within society for the reduction of government debt before increases of public expenditure linked with ageing, although in recent years, this strategy has been difficult to pursue due to deficits in public finances. The government remains committed to the strategy of reducing government debt with the aim of building up a 'virtual' old-age pension savings fund consisting of allocations earmarked for financing public pensions from 2020 onwards when around €125 billion should be available.

Since 2001, the situation on the financial markets has changed substantially, in particular with low interest rate level and low returns on shares. This had unfavourable consequences for the Dutch pension funds, because the required coverage ratios came under pressure. To improve the coverage ratio, in many schemes, pension contributions were increased, indexing was limited, and pension scheme parameters were adapted.

2.4 Outlook, reform measures and policy debates

Adequacy: Private occupational pensions are expected to make a major contribution to adequacy as they are of an almost equal magnitude with public pensions. Their financial sustainability depends largely on stable macroeconomic developments. The headlines for a new Financial Assessment Framework (FTK) for supplementary pensions were established in 2004. Implementation of this framework will take place by law. The FTK will increase the surveillance of private funds and tighten the requirements for their financial sustainability. An important aspect of the FTK stems from the criteria for the financial solvency of the pension funds (in particular valorisation of obligations of pension funds at market value, as well as conditions on the size of the reserves). It should be noted however, that contribution rates necessary to maintain replacement rates in the future are very sensitive on assumptions made on future rates of return and conditional indexation.

The linkage between the basic State pension and earnings (both for the level of the flat rate benefit and for indexation) and the still maturing occupational schemes, should ensure persisting good records for adequacy. Moreover, the government and social partners are committed to raising the participation rates in occupational pensions. To ensure that every employee has a supplementary old age pension, the employers' organizations and trade unions want to reduce the no coverage from 7% to 3.5% through collective bargaining. If this approach does not prove effective, the government will decide in 2007, whether it is necessary to make it mandatory for an employer who offers pensions (for 2% of employed people, the employer does not have a pension plan), to offer the possibility to take part in a pension scheme to all his employees.

Financial sustainability: The Netherlands will remain one of the Member States with the lowest old-age dependency ratio (population 65+ as a share of 15-64). It currently lies at a relatively low level in comparison to the EU25 average (respectively 21 and 25 in 2004), and is projected to remain below the EU25 average (respectively 41 and 52 in 2050), due to moderate fertility and low increases in life expectancy. The negative effects of ageing populations will be somewhat smoothed by the labour market performance, as

according to the AWG labour force projections to be used in its 2005 budgetary projection exercise, average employment rates in the Netherlands are projected to remain among the highest in the EU25 by 2050, though the share of part time work is currently also among the highest the projected increase would be slower than the average.

In 2002, total pension expenditures, including occupational pensions, were on a relatively high level of 13.1 % of GDP, slightly above the EU average, and are projected to rise to 20% of GDP in 2050. Also regarding public expenditure, the Netherlands can expect relatively strong budgetary pressures due to the ageing population. According to the AWG 2005 projections, the public spending on pensions is expected to increase by 3.5 p.p. to reach 11.2% of GDP in 2050

In spite of the significant increase in public spending caused by ageing, the Netherlands is committed to maintaining the basic pension in its present form. The financing is to be secured through transfers from the general budget as soon as the maximum contribution rate of 18.25% is no longer able to cover expenditures. The government remains committed to the strategy of reducing government debt in order to reduce the interest burden and with the aim of building up a 'virtual' old-age pensions savings fund consisting of earmarked allocations for financing public pensions from 2020 onwards when around 125€ billion should be available (the AOW Savings Fund was established in 1997). Moreover, in the coming decades, tax revenues are expected to rise because of the increase of pension payments due to many more people receiving supplementary pensions.

Raising labour market participation in general and of older workers in particular will also have to make a significant contribution to securing the future funding of the pension system. In order to raise the level of participation in the labour market, all tax facilities for early retirement schemes will be abolished by the 1st of January 2006 (there is more favourable treatment for people over 55 years of age at the 1st of January 2005). Moreover, the initiative to introduce a life-course arrangement, aiming at a better combination of work with e.g. care and education, could contribute to slowing flows into early retirement benefits.

In addition to plans aimed at reducing the use of early exit from the labour market, it is planned to remove obstacles preventing people from working after they reach the current retirement age of 65. The government will respond early 2006 to advice from the SER (Social and Economic Council), the Labour Foundation (STAR) on the question of what adjustments are desirable and necessary to remove obstacles to continuing to work longer.

Moreover, eligibility conditions for occupational disability have been reformed. Since January 1st 2004, the primary responsibility for dealing with leave during the first two years of illness lies with the employer and the worker. Employers now have to continue to pay a sick worker's salary for two years instead of one as was previously the case: this is intended to intensify reintegration efforts and to reduce the number of cases of occupational disability. A new reform will come into effect in 2006 and plans to provide incentives to employers and employees to stimulate the reintegration of people who are partially incapacitated for work. People who are fully and permanently incapacitated for work receive a benefit amounting to 70% of their former wage. People who are partially incapacitated for work who do not find work end up with a benefit based on the minimum wage. If they do find work, they will receive, a supplement of their income from work to 70% of the difference between the former and new wage.

Modernisation: Increasing transparency in the implementation of pension schemes may increase support for maintenance of the current pension system. A key aim here is to raise the public's 'pension awareness'. The provision of information and the collection of data on supplementary pensions are currently strongly linked to the supervisory function, and

take place on a fragmentary and ad hoc basis. The new Pension Act will establish a legal basis for setting up and maintaining a pension database and the government plans to improve the information furnished by pension providers about individual entitlements. Moreover, there is a discussion about pensioners' participation in the decision-making process and accountability structures of supplementary pension schemes either through agreements or statutory regulations.

3 CONCLUSION

The Dutch strategy for the first pillar relies on an ambitious goal of achieving budgetary surpluses over a long period of time, supported by intensified employment policies and a reform of disability pension schemes designed to reduce incentives for early exit from the labour market. However, public finances have been in deficit in 2002 and 2003 and are expected to remain in deficit for some years, which gives rise to a concern over the likelihood of success of this policy. Regarding second-pillar pensions, the strategy relies on conducting sound macroeconomic policies and safe funding margins. The new Financial Assessment Framework lays down tighter requirements for the financial sustainability of private funds and will increase surveillance on these funds.

The Dutch pension system performs well in terms of adequacy, as it is based on a universal flat-rate public pension and on earnings-related supplementary pensions which cover a very large share of the population. However, it remains to be seen whether increased labour-force participation and the inclusion of part-time workers in occupational pension schemes will allow women to catch up with men in terms of incomes in old age.

While employment rates for people aged 55-64 have increased significantly in the past decade, an important share reflects part-time employment. The government has defined an objective of 40% in 2007 (45% in 2010) of employment rates of 55-64 year olds, taking into account only 'bigger jobs' (of at least 12 hours a week). While further steps are planned in order to remove obstacles preventing people from working after they reach the current retirement age of 65, measures introduced aimed at reducing the use of early exit from the labour market (early retirement and disability schemes) are gradual and could be further strengthened.

4. BACKGROUND STATISTICS

	NL			EU25		
Adequacy						
Current situation						
	Total	Men	Women	Total	Men	Women
At-risk-of-poverty rate [1]	12	12	12	16	15	17
0-64	13	12	13	16	16	17
65+	7	6	7	18	15	20
75+	7	7	7	Nd	Nd	Nd
Income inequality [1]						
0-64	4,2					
65+	3,2					
Income of people aged 65+ as a ratio of income of people aged 0-64 [1]	0,84	0,88	0,83			
Median pensions relative to median earnings [2]	Nd	Nd	Nd			
Long-term projections						
Theoretical replacement rates[3]	2005	2030	2050			
Total net replacement rate	92	90	90			
Total gross replacement rate	71	68	69			
Gross repl. rate 1st pillar	30	30	30			
Gross repl. rate 2nd/3rd pillar	41	39	39			
Financial sustainability						
Current situation						
ESSPROS Pension expenditure [4], % of GDP	***1995***	2000	***2003***	***1995***	2000	***2003***
	14,1	13,0	12,6		12,5	12,6
Employment (2004) [5]	Total	Men	Women	Total	Men	Women
Employment rate ***(25-54)***	82,5	90,2	74,6	76,8	85,2	68,5
Employment rate (55-64)	45,2	56,9	33,4	41,0	50,7	31,7
Effective labour market exit age (2004)[6]	61,1	61,1	61,1	60,7p	60,9	60,4p
Public finances (2003) [7]						
Public debt, % of GDP	54,1			63,3		
Budget balance, % of GDP	-3,2			-2,8		

Long-term projections (EPC 2006)

	NL Level			NL Increase 2004-50	EU25 Level			EU25 increase 2004-50
	2004	2030	2050		2004	2030	2050	
Old-age dependency ratio [8]	20,5	41,1	40,6	+98%	25	40	52	+108%
Public pensions expenditure, % of GDP [9]	7.7	10.7	11.2	+3.5	10,6	11,9	12,8	+2,2

Factors determining the evolution of public pensions expenditure (2000-2050) [10]	NL: Contribution to change in percentage points of GDP	EU25: Contribution to change in percentage points of GDP
Demographic dependency	6,3	8,6
Employment	-0,2	-1,1
Eligibility	-1,6	-2,1
Level of benefits	-0,4	-2,7
Total (including residual)	3,8	2,2

Notes:

1. Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, Income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).
2. Source: Eurostat. Median individual pension income of retirees aged 65-74 in relation to median earnings of employed persons aged 50-59 excluding social benefits other than pensions.
3. Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first and second pillar pension schemes, retiring at the age of 65 years in 2005.
4. Source: ESSPROS, EUROSTAT. Includes expenditure by certain private social protection schemes.
5. Source: European Labour Force Survey, 2004.
6. Source: European Labour Force Survey, 2004.
7. Source: European Commission, DG ECFIN.
8. Source: EUROSTAT (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15-64.
9. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.
10. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.

* proportion negligible

AUSTRIA

1 MAIN CHARACTERISTICS OF THE PENSIONS SYSTEM

The key elements of the pension reform 2004 (which came into force on 1 January 2005) were the introduction of a uniform pension law and personal defined benefits pension account for blue-collar workers, white-collar workers, the non-farm self-employed, farmers and federal civil servants aged 49 years and younger. For people having accrued rights before 1 January 2005 and who had not reached the age of 50 on 1 January 2005, their entitlement will be calculated on the basis of the old and the new law, according to the proportions of their active life spent before and after this date. Further major reform elements has been the introduction of a "pension corridor" in combination with a gradual phase out of early retirement possibilities and a new – inflation orientated – indexation of pensions.

The key elements of the 2003 reform were raising the retirement age for men to 65 (woman 60) by 2017, the gradually extension of the assessment period for pension calculation from 15 years up to 40 years by 2028, the gradually reduction of increment points from 2 to 1,78 by 2009 (a pension of 80% after 45 insurance/contribution years instead of 40), the modification of the provisions on actuarial additions and deductions. Any losses occurring through these reforms are to be limited. Occupational retirement provisions are developing but so far only 13% of employees are covered. Since 1 July 2002 the Occupational Staff Provision Act (“Betriebliches Mitarbeitervorsorgegesetz”) – better known as “new severance pay” – has been in force in Austria. In accordance with the new law, every employer has to transfer 1.53% of an employee's monthly salary to a staff provision fund (Mitarbeitervorsorgekasse/MVK). After termination of employment the employee can keep the capital in this fund, transfer it to another fund or take a cash sum.

Private pensions are considered an individual option for the maintenance of a person’s living standard. Traditionally, life insurance has played a major role and these contracts have shown a significant upward trend over the past years (in 2004 plus 8.5%). Austria has always promoted specific private old-age pension schemes by granting tax incentives (e.g. the capital earnings of the retirement provision are tax-free). A new premium-aided pension savings scheme "Zukunftsvorsorge" has been available since early 2003 and is already successfully established.

A compensation supplement is provided to those receiving a pension below a specific threshold (as well as a possible other income) to ensure a minimum income in retirement.

2 SITUATION AND PERSPECTIVES IN THE LIGHT OF THE COMMON OBJECTIVES

2.1. Current situation

Concerning adequacy, people aged 65 have a living standard (disposable income) close to that of the 0-64 population (with a relative equivalised income of 93%). Poverty risk for elderly persons are higher (17% for 65+ people with equivalised income of less than 60% of overall median equivalised income) than for persons aged 0-64 (12%). The gap between men and women aged more than 65 is more important (20% for women and 13% for men). Replacement rates are currently relatively high, notably due to the calculation of the pension from the best 15 years of income. According to calculations made in the framework of the ISG, the gross theoretical pension replacement rate for a

worker retiring at 65 (after 40 years of contributions at the average wage) is 64% (total net 80%) after 2003/2004 pension reforms.

Concerning **sustainability**, the 2003-2004 pension reforms strengthened the actuarial principle. In addition, labour market policy prioritises keeping older persons employed or re-integrated in the labour market. The employment rate for older people has been stable over the last decade, and remains at 29% in 2004 significantly below the Lisbon target.

Early retirement possibilities will be phased out by 2017. The "corridor pension" allows retirement for men between 62 and 65, but with a deduction of 4.2% (2006) per year of retirement before the age of 65. To prevent the corridor pension from developing into a new early retirement pension, losses resulting from actuarial deductions are excluded from the loss limit described earlier (of maximum 10% by 2024).

Concerning **modernisation**, the 2004 reform introduced a pension account, where pension rights are now credited for child-rearing periods (4 years per child and 5 years in the event of multiple birth) at a level of € 1,350.- per month. Since these periods are also recognised in addition to any existing employment, the disadvantages of part-time employment may be outweighed at least partly. A better – income based – revaluation of former earnings and fewer restrictions on acquiring pension rights (previously 15 years of contributory economic activity are required, this has been reduced to 7 and for the remaining 8 years child care periods are sufficient) will particularly affect pensions of women with periods of child care. For each period of child care there is also the possibility of a voluntary pension splitting. The pension reforms of 2003 mean that child care (36 month per child) shortens the assessment period that is used for calculating an individual's pension.

2.2. Outlook, reform measures and policy debates

Concerning **adequacy**, the latest reforms extend the period of an individual's earning history that is used for calculating the pension to 40 years (gradually implemented by 2028) and the reduction in yearly accrual, from 2 percentage points to 1.78 percentage points, which can translate into decreases in individual's pensions. From 2006 pensions will be indexed according to the consumer price index (previously indexation was linked to wage increases). On the other hand, the pension reform of 2004 replaced the inadequate (inflation-oriented) revaluation of pension entitlements by a method based on the average increase of the respective contribution basis (income). In addition, periods of childcare or unemployment are recognised by crediting pension rights based on a special contribution basis, which may raise the individual pension level especially of those taking career breaks. In 2006 the minimum pension for unmarried pensioners will rise to the poverty threshold from € 663 in 2005 to € 690 (in 2003 the poverty threshold was € 673).

According to projections elaborated in the framework of the ISG, before the 2004 pension reform, the theoretical pension replacement rate was expected to decrease smoothly for a worker retiring at 65 after 40 years of contributions at the average wage from a level of 74% to 67% (2050) due in particular to the introduction of a loss limit of 10% for pension entitlements gained out of the unreformed system. After the last reform Austria expects, despite a decreasing accrual rate, that the theoretical gross replacement rate will decrease to 69% (94% net) by 2050.

To secure the long-term **sustainability** of the pension system a monitoring mechanism (starting in 2007) has been introduced. An expert committee will start to monitor developments in the system from several perspectives every three years. There is no automatic adjustment mechanism but in case of increasing life expectancy the expert

committee has to make proposals, concerning the ways to finance the expected expenditure increase - sharing this in a balanced way between contributions, pension adjustments and retirement ages. In case of deviations from other assumptions, such as lower participations rate or productivity growth, the government is to report this to parliament with legislative recommendations.

Thanks to the major pension reform of 2004, Austria is expected to mitigate considerably the pressure on its public finances due to an ageing population. From a spending level of 13.4% of GDP in 2004, an increase of 0.6 p.p. of GDP is expected between 2004 and 2030, while thereafter a decrease of 1.7 p.p. between 2030 and 2050 is projected, resulting in an overall lower level of public pension spending in 2050 by 1.2 p.p. than in 2004. Also, total age-related expenditure is projected to decline from the level of 24.5% of GDP in 2004 to 23.7% in 2050. These projections would allow the elimination of general government debt by 2050.

Modernisation: As pensions will be calculated in a more actuarial way, many women though, will probably not have enough contribution years in order to reach the aimed replacement rates calculated on the basis of 45 contribution years. This will remain an issue at least until 2024/2033 when the equalisation of the legal retirement age between women and men will start/end. Nevertheless the increasing pension rights for child care and the better revaluation of former earnings will increase pensions for many women.

3 CONCLUSION

The 2004 reform makes a major step towards modernised and more sustainable pensions. By introducing a uniform pension law for all professions for those under 50, Austria has harmonised the pension systems of blue-collar workers, white-collar workers, self-employed, farmers and especially federal civil servants. In addition, the pension reform contains a rather thorough redesign of the calculation of the benefits leading to a much stronger link between contributions and benefits, including a bonus/malus system for deferred/earlier retirement and a switch of the indexation of pensions to consumer prices as of 2006. To review the long-term sustainability of the pension system a triennial monitoring mechanism will begin in 2007. At the same time long transition periods are foreseen for the phasing in of the measures including the earlier adopted harmonisation of retirement ages by sex. There is a possibility that such long phasing in periods could weaken the message that change is necessary.

There is agreement that the pension reform need to be accompanied by a significant increase of older workers employment in order to ensure both, adequacy and sustainability of future pensions. This could lead to a further decrease of the poverty risk for pensioners, as well as to a stabilization of the future replacement rates at its current level. It will be important to monitor the poverty risk for pensioners as well as replacement rates in particular for women and review policy options if necessary.

4. BACKGROUND STATISTICS

	AT			EU25		
Adequacy						
Current situation						
	Total	Men	Women	Total	Men	Women
At-risk-of-poverty rate [1]	13	11	14	16	15	17
0-64	12	11	13	16	16	17
65+	17	13	20	18	15	20
75+	18	10	21	Nd	Nd	Nd
Income inequality [1]						
0-64	3,7					
65+	4,5					
Income of people aged 65+ as a ratio of income of people aged 0-64 [1]	0,93	0,98	0,90			
Median pensions relative to median earnings [2]	0,79	0,81	0,77			
Long-term projections						
Theoretical pension replacement rates[3]	2005	2030	2050			
Total net replacement rate	80	92	94			
Total gross replacement rate	64	66	69			
Gross repl. rate 1st pillar	64	66	69			
Gross repl. rate 2nd/3rd pillar	*	*	*			
Financial sustainability						
Current situation						
ESSPROS Pension expenditure [4], % of GDP	***1995***	2000	***2003***	***1995***	2000	***2003***
	14,3	14,2	14,7		12,5	12,6
Employment [5]	Total	Men	Women	Total	Men	Women
Employment rate ***(25-54)***	82,6	89,4	75,8	76,8	85,2	68,5
Employment rate (55-64)	28,8	38,9	19,3	41,0	50,7	31,7
Effective labour market exit age (2004)[6]				60.7p	60.9	60.4p
Public finances (2003) [7]						
Public debt, % of GDP Budget balance, % of GDP						

Long-term projections (EPC 2006)

	AT Level 2004	AT Level 2030	AT Level 2050	AT increase 2004-50	EU25 Level 2004	EU25 Level 2030	EU25 Level 2050	EU25 increase 2004-50
Old-age dependency ratio [8]	22,8	40,6	52,4	+130%	25	40	52	+108%
Public pensions expenditure, % of GDP [9]	13.4	14.0	12.2	-1.2	10,6	11,9	12,8	+2,2

Factors determining the evolution of public pensions expenditure (2000-2050) [10]	AT: Contribution to change in percentage points of GDP	EU25: Contribution to change in percentage points of GDP
Demographic dependency	11,3	8,6
Employment	-1,3	-1,1
Eligibility	-5,8	-2,1
Level of benefits	-4,3	-2,7
Total (including residual)	-1,0	2,2

Notes:

1. Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, Income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).
2. Source: Eurostat. Median individual pension income of retirees aged 65-74 in relation to median earnings of employed persons aged 50-59 excluding social benefits other than pensions.
3. Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first and second pillar pension schemes, retiring at the age of 65 years in 2005.
4. Source: ESSPROS, EUROSTAT. Includes expenditure by certain private social protection schemes.
5. Source: European Labour Force Survey, 2004.
6. Source: European Labour Force Survey, 2004.
7. Source: European Commission, DG ECFIN.
8. Source: EUROSTAT (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15-64.
9. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.
10. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.

* proportion negligible

POLAND

1 MAIN CHARACTERISTICS OF THE PENSIONS SYSTEM

Poland has introduced significant reforms of its pension system since 1999. The **statutory pension system**, fully implemented in 1999 consists of two elements, both of which are mandatory and universal (there are special schemes for farmers and some civil servants such as the military, police, judges and prosecutors): a pay-as-you-go notional defined contribution (NDC) scheme, administered by the Social Insurance Institution (ZUS) and a fully funded scheme, managed by independent private investment companies, supervised by the State. The retirement age is 65 for men and 60 for women.

The statutory pension is based on the defined contribution principle, dependent on the accumulated capital in ZUS and the open pension funds (hereafter OPFs) and on the average unisex life expectancy at the age of retirement. (Pensions accumulated in the previous system were based on the defined-benefit principle). Contributions are collected by ZUS, and are transferred to OPFs, (chosen by the insured individual - in 2005, 15 OPFs could be chosen from). According to the reform programme, benefits of the funded pillar should take the form of a life-time annuity (however the law on annuities has not been legislated yet).

The statutory scheme is financed from the old-age pension contribution (19.52% of gross salary), equally shared between employers and employees (12.22% of it is for NDC pensions and 7.3% for the statutory funded scheme). An additional contribution of 13% of wages is paid for disability and survivor pensions.[25] A ceiling was introduced in 1999 on maximum earnings on which contributions are collected (250% of the average national earnings).

A Demographic Reserve Fund was created in 2002 to accumulate resources in order to finance future deficits of the pension system, and is financed by a part of old-age contributions (0.2% of wages in 2005 to increase to 0.4% in 2009). In the future the fund will also accumulate future possible surpluses of the old-age statutory pension scheme.

Guaranteed minimum pension is paid if the total pension amount of the statutory system is below the legal minimum old-age pension, conditional to a contributory requirement – 25 years of insurance for men and 20 years for women. The guaranteed minimum pensions are covered by public funds.

The recent reforms also introduced options for **voluntary pension insurance**, offering the possibility of creating supplementary employees' pension plans. This can take the form of group insurance, joint stock or life insurance, occupational funds or open investment funds. Participation is very low (only 100.000 in 2004) and in 2004 a new scheme offering tax incentives - **voluntary individual retirement accounts** (*Indywidualne Konta Emerytalne*, hereafter IKE) was set up. Persons may choose among four institutions participating in IKEs (investment funds, brokerage institutions, insurance agencies and banks) and transfer the IKE between them.

2 SITUATION AND PERSPECTIVES IN THE LIGHT OF THE COMMON OBJECTIVES

2.1 Current situation

Adequacy: The ratio of average statutory pension to average wage (net of social security contributions) was 58% in 2004 (64% for old-age pensions, 47% for disability pensions

[25] There is also a separate sickness and maternity contribution (2.45% of wages) and work injury contribution which size varies depending on the risk of a work injury in given branch of industry and company.

and 55% for survivor pensions). The risk of poverty of people in the 65+ age group stands at 6% in 2002 (4% for men and 7% for women), lower than the 0-64 age group whose poverty rate stands at 18%. The difference in poverty rates reflects high unemployment rates among the active population, translating in their lower relative income.

In order to save resources, the yearly indexation of all pension benefits was replaced in 2004 by a rule of adjustment of pensions every three years (or earlier if cumulative inflation reaches 5%), which may however expose older retirees to the risk of lagging behind the overall standard of living.

In 2003 the unemployment rate reached 19% and it is higher for the young, older workers and women. The low level of employment threatens the future adequacy and sustainability of pensions. While some of those who pay no contributions may be employed informally, they still do not accumulate an employment-related pension and consequently will be more likely to be entitled to minimum guarantee pensions only. Moreover, while the 1999 reform aimed at withdrawing privileges given to certain occupational groups, there seems to be a tendency to continue with the schemes that may have wider consequences on the labour market.

Financial sustainability: The number of contributors to the pension system has been decreasing over time due to falling employment levels. The employment rate in the age group 55-64 was only 26% in 2004, far below the Lisbon target. The effective age of withdrawal from the labour market though has increased from 56.6 in 2001 to 57.7 in 2004.

A large number of individuals entered early retirement in the beginning of the 90's as a side effect of lay offs. It has added to the steep increase in pension spending from 6.5% of the GDP in 1989 to 15.6% in 1995. In 2003, according to ESSPROS figures, total pension expenditures were at 14.3% (slightly above the EU average 12.6%). As the early retirement option was limited in 1997, more people entered into pre-retirement schemes. Pre-retirement benefits could be paid to persons who were laid off and fulfilled the criteria for unemployment benefits. From 1997 to 2002, more than 500 000 persons received such benefits.

Around 9% of Polish citizens aged between 20 and 64 (around 2.4 million people), receive disability benefits. Only about 20% of the recipients are above the retirement age (as of January 2005, they will be transferred into the old-age scheme). However, following the introduction of restrictions and thus the reduction in the number of disability pensioners, expenditures on disability pensions and survivors are falling (from 4.9% of GDP in 2002 to 4.2% of GDP in 2004).

I t should be noted that 7.3 p.p. of the 19.52% pension contribution is directed into the mandatory funded pillar, the financing of the current PAYG pensions, which will be placed under considerably pressure over the coming decades due to transition costs, as well as disability and other early pension cost. According to 2003 projections from ZUS reported in the National Strategy Report that the statutory PAYG pension is projected to show deficits until around the mid 2030s. However, the elimination of early retirement from 2008 and a new form of pensions indexation, could ease projected deficits (the change in indexation rules is estimated to save 0.3% of cumulated GDP between 2005 and 2007). Since 1999 ZUS has also drawn commercial bank credits to finance the costs, but servicing these is costly.

Furthermore, the State is subsidising more than 90% of the farmers' pension scheme, which accounts for about 1.8 % of GDP. Contributions paid by farmers and benefits received are flat rate (corresponding to around half of the average PAYG system pension

benefits). The system provides very broad coverage for people who claim to work on a farm.

Modernisation: Mobility between the three different pension schemes - employees' pension scheme, farmers' scheme and the Security Provision System (for the army, police etc.) is a concern. Moving from one scheme to another is problematic. Moreover, reliable information on the long-term prospects of the new system, both funded and PAYG should be developed, that would, in particular, prepare the ground for a broad consensus on further reforms.

Unisex life tables in the NDC contribute to gender equality. Although the statutory retirement age for women, at 60 is below that of men (65). The attempt to phase out these differences by a bill in 2004 was opposed by trade unions and some political parties. Although the system allows flexible retirement, the employment rate among women remains low, in particular for those aged 55-64, which translates into lower accrual of pension rights.

ZUS is working on a backlog of transfers to the private funds as a result of an initial high rate of reporting errors.[26] In addition the conversion of accumulated contributions into benefits as not yet been agreed. This is despite the first benefits under the new system becoming payable in 2009.

2.2. Outlook, reform measures and policy debates

According to Eurostat projections Poland's demographic profile will follow the EU average. The elderly dependency ratio will grow from a current level of 19% to 33% by 2025 and to 51% by 2050.

Overall, the ratio of average net pension to average net wage in statutory pension schemes is expected to fall (from 58% in 2004), while the expected time in retirement will increase due to the increases in life expectancy. For a worker retiring at 65 after 40 years at the average wage, ISG theoretical replacement rate calculations show a gradual decline from 2005 to 2050 of the net replacement rate from 78% (gross 63%) to 44% (gross 36%) unless the balance between the years in employment and retirement is maintained (the decrease is lower for people retiring at 67 after 42 years of contributions). These calculations are based on wage growth in line with relatively strong productivity growth and with an interest rate uniform for the EU, departing from these assumptions can translate into a less marked decline in replacement rates.[27]

In addition ISG calculations indicate that the level of replacement rate for a worker retiring in 2005 declines from a current level of 78% (net) to 53% in 2015, in relation to the average wage of the economy in the respective years, reflecting the indexation of benefits, according to the price developments every three years.[28] Moreover, low activity rates may threaten adequacy of pensions, especially for women, due to shorter contribution periods and lower average earnings. At the same time the closer link between contributions and benefits resulting from the introduction of the NDC system as

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[26] The backlog for years 2001 onwards had been processed already. Currently ZUS is working on processing the backlog for 2000 and 1999. All accounts should be cleared by the end of 2006.

[27] For instance, an increase of 1 percentage point of the real rates of return of individual accounts translates into an increase of 4 percentage points of the net theoretical replacement rate (3% for the gross replacement rate). Moreover, a slower increase in wages of 1.5 p.p. would translate into significant slower levels of final wages and pensions and an increase in the replacement rate of 2 percentage points.

[28] The pension indexation in Poland can be higher, taking into account expected wage developments and the situation of public finance.

well as the funded pension component should help to increase declared work, thus increasing contributions to pension schemes and possibly improving adequacy.

There is a high potential of increasing employment rates among older workers and Poland has already plans to adopt additional measures in that field. Presently, there are two main mechanisms affecting the behaviour of the elderly in the labour market, first trying to reduce early retirement (early pension benefits will be reduced or suspended) and secondly favouring gradual or later retirement (further contributions taken into account in the calculation of pension benefits.) Increasing incentives for working longer could be accompanied by a strengthening of vocational rehabilitation. In addition attention should be made not to offer special favourable pension rights for certain occupational groups.

The AWG projections of 2005 show a considerable drop in public pension expenditure from 13.9% to 8.0% of GDP over the period 2004-2050 (pension expenditures decrease to 9.3% of GDP in 2050 when the mandatory funded tier is taken into account). Nevertheless, the calculations indicate that the pay-as-you-go tier is projected to remain in deficit until the mid 30's due to transition costs. Moreover, a major concern is the high level of government spending despite a partial shift to funded schemes, including substantial spending on disability pensions and high subsidies to the farmers' pension scheme, while minimum guarantee pensions and the deficit of the social security scheme are paid out from general government funds. The funding of all pensions requires, in addition to the total contribution rate of 32.52% of wages, a subsidy from general government which amounts to over 3% of GDP.

Greater transparency and adaptability of pension systems should be promoted to strengthen confidence. Moreover, changes in the system of agricultural social insurance are seen as an option to restrict coverage of farmers' pensions to those who are full time employed in the agricultural sector. One could also introduce a link between farmer's income and contributions for pensions in order to reduce the need for the State subsidy. In the long run one could think though of unifying the farmers' pension scheme with the statutory pension system.

3 CONCLUSIONS

Poland has introduced significant reforms in its old-age pension system, the new system being in place since 1999. Further, a Demographic Reserve Fund was created in 2002 in order to accumulate resources for future financing needs. However, only a part of the old-age pension contribution is transferred to the Reserve Fund, while at the same time told-age contributions are not sufficient to cover the pension liabilities of the Social Insurance Institution.

A major challenge is to increase the currently low level of employment (partly linked to undeclared work and high level of unemployment). As the 1999 reform did not affect the pension provision for people over 49, early retirement is still an issue but this should end in 2008. However, pre-retirement schemes continue to exist and care should be taken that they will not be used to replace the early retirement option. A strict implementation of the sharpened disability benefit legislation could help avoid a similar usage of that scheme. To maintain a coherent approach one should avoid granting special pension rights for certain groups of professions.

Following the expected decline in the ratio of average pension to average wage in the statutory pension scheme, adequacy of pensions may translate into an issue in the future, notably when linked with shorter contribution periods and lower average earnings (due to high level of unemployment especially for women). Equalising the legal retirement age

for men and women would help to reduce the gender gap in pension entitlements and could contribute to increasing employment rates of older workers.

The national budgetary projections forecast a considerable drop in public old-age pension expenditure from 7.1% to 4.5% of GDP over the period 2009-2050. Despite the decrease in spending Poland is facing high transition costs due to a rapid introduction of a relatively large funded scheme, financing of which will require major effort over the next decades. Another challenge to the sustainability of the system is the farmers' pension scheme that, although providing low pensions, is nearly entirely funded from the State budget. The scheme is in need of reforms, both from the aspect of mobility of workers (enabling them to transfer pension rights from one pension scheme to another) and rights in the scheme (restricting benefits payment to those working full time on farms). One could also consider in the long run the integration of the scheme in the general system.

4. BACKGROUND STATISTICS

	PL			EU25		
Adequacy						
Current situation						
	Total	Men	Women	Total	Men	Women
At-risk-of-poverty rate [1]	17	17	16	16	15	17
0-64	18	19	18	16	16	17
65+	6	4	7	18	15	20
75+	6	4	7	Nd	Nd	Nd
Income inequality [1]						
0-64	5,2					
65+	3,3					
Income of people aged 65+ as a ratio of income of people aged 0-64 [1]	1,13	1,22	1,07			
Median pensions relative to median earnings [2]	Nd	Nd	Nd			
Long-term projections						
Theoretical replacement rates[3]	2005	2030	2050			
Total net replacement rate	78	64	44			
Total gross replacement rate	63	52	36			
Gross repl. rate 1st pillar	63	52	36			
Gross repl. rate 2nd/3rd pillar	*	*	*			
Financial sustainability						
Current situation						
ESSPROS Pension expenditure [4], % of GDP	***1995***	2000	***2003***	***1995***	2000	***2003***
		13,0	14,3		12,5	12,6
Employment (2004) [5]	Total	Men	Women	Total	Men	Women
Employment rate ***(25-54)***	68,2	73,9	62,6	76,8	85,2	68,5
Employment rate (55-64)	26,2	34,1	19,4	41,0	50,7	31,7
Effective labour market exit age (2004)[6]	57,7	60,0	55,8	60,7p	60,9	60,4p
Public finances (2003) [7]						
Public debt, % of GDP	45,4			63,3		
Budget balance, % of GDP	-3,9			-2,8		

Long-term projections (EPC 2006)

	PL Level			PL increase	EU25 Level			EU25 increase
	2004	2030	2050	2004-50	2004	2030	2050	2004-50
Old-age dependency ratio [8]	18,6	37,1	51	+174%	25	40	52	+108%
Public pensions expenditure, % of GDP [9]	13.9	9.4	9.3	-4.6	10,6	11,9	12,8	+2,2

Factors determining the evolution of public pensions expenditure (2000-2050) [10]	PL: Contribution to change in percentage points of GDP	EU25: Contribution to change in percentage points of GDP
Demographic dependency	10,4	8,6
Employment	-3,2	-1,1
Eligibility	-4,5	-2,1
Level of benefits	-7,5	-2,7
Total (including residual)	-5,7	2,2

Notes:

1. Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, Income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).
2. Source: Eurostat. Median individual pension income of retirees aged 65-74 in relation to median earnings of employed persons aged 50-59 excluding social benefits other than pensions.
3. Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first and second pillar pension schemes, retiring at the age of 65 years in 2005.
4. Source: ESSPROS, EUROSTAT. Includes expenditure by certain private social protection schemes.
5. Source: European Labour Force Survey, 2004.
6. Source: European Labour Force Survey, 2004.
7. Source: European Commission, DG ECFIN.
8. Source: EUROSTAT (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15-64.
9. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.
10. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.

* proportion negligible

PORTUGAL

1 MAIN CHARACTERISTICS OF THE PENSIONS SYSTEM

The statutory regime of the Portuguese pension system consists of a general scheme that is mandatory for all employed and self-employed workers in the private sector. Special schemes exist for civil servants, police and the military, the financial sector and lawyers. There is also a voluntary scheme that is open to residents in Portugal who are not covered by the Portuguese social security system; Portuguese nationals who reside or work abroad can also enrol in this scheme.

Pension contributions to the statutory scheme are not separated from contributions for other benefits provided by the general social security scheme which covers sickness, maternity, occupational diseases, unemployment, disability, old age and survivors (family allowances are residence based). Without a contributory ceiling, the contribution rate is 34.75% of earnings (11 p.p. paid by the worker and 23.75 by the employer) for employees. On the total 34.75% contributed by the insured person and employer, 16.01 % is allocated to old-age benefits, 3.42% to disability benefits and 3.67% to survivor benefits. For the self employed, 25.4% of reference incomes are for mandatory coverage (old age, disability, maternity, occupational diseases and survivors) and 32% for the voluntary scheme (covering sickness). Since 1999, in the general statutory scheme, the legal retirement age is 65 for both men and women, with exceptions at 55 for a limited number of professions. The Government has proposed a law to increase the retirement age for civil servants, currently 60 years, gradually by 6 months a year in the next 10 years until it reaches 65, which would become effective from 2006 onwards.

To be entitled to an old-age pension, social security beneficiaries need to have completed a qualifying period of 15 years of insurance, with at least 120 days per year of registered earnings. Since 2002, the earnings over the whole insurance career will be taken into account for the calculation of the pension level, subject to a maximum of 40 years (since 1994 they were calculated on the basis of the average income of the best ten years over the last 15). There is a transition period during which the most favourable method of calculation will be used to determine the pension level. The possibility of reducing the transition period is being envisaged.

The 2002 reform foresees that pensions will be calculated for public (new entrants from 1993 onwards) and private employees on the basis of contributions made during the whole career, up to 40 years (with a transition period from 2002 to 2016). Concerning the convergence of pension systems, the government proposed to increase the years of insurance for civil servants, currently 36 years, gradually by six months a year until it reaches 40 years.

In the banking and telecommunications sector occupational schemes exist as a substitute for the general scheme (these schemes represent about 4% of the population in employment while about 1.5 % of the population in employment is covered by individual provisions).

Although the pension fund market represents 11.2% of GDP, it is almost inactive. The current tax incentives are not considered satisfactory in order to promote the implementation of new occupational schemes. Also, due to the winding-up of several pension funds (particularly in the last two years), and reductions of the number of employees in several sectors, membership has been declining.

Laws and regulations have been adopted in 2001 and 2002 to define general principles for supplementary occupational pension plans, to define requirements for the diversification of pension fund assets and to strengthen the supervisory powers of the Portuguese Insurance Institute over insurance companies and pension funds' managing companies (the only institutions that can administer pension funds). Also with a view to improving the access to supplementary pension provision, the new framework social security law improves the conditions for the acquisition of supplementary pension rights and establishes the principle of portability. Individual provision can take different forms including the subscription to life insurance policies or voluntary membership in a pension fund or in an investment fund.

A tax-financed non-contributory scheme provides means-tested benefits to persons aged 65 and over without adequate benefits from other sources. People with incomes below 30% of the national minimum wage (50% for a couple) are entitled to a social pension under this scheme. Due to the short contributory careers as well as low reference wages, statutory pensions often fall below minimum pensions leading to a significant group of pensioners receiving the minimum pension (in 2004 about 45% of the contributory scheme pensioners were receiving the corresponding minimum pension). In order to reduce the poverty among the elderly a means-tested benefit ("Solidarity Supplement for the Elderly") has been implemented. Other benefits are also available to older people, in particular health and long term care and housing benefits.

2 SITUATION AND PERSPECTIVES IN THE LIGHT OF THE COMMON OBJECTIVES

2.1 Current situation

Concerning **adequacy**, the current relative income of older persons (aged 65 or older) is on average about 76% of the relative income of the age group 0-64 (77% for men and 75% for women). In the long run, the maturing of the pension system (more pensioners with full careers) and, possibly, the development of supplementary pension schemes should have a positive impact on pensioners' income. According to the calculations carried in the framework of the ISG, current gross replacement rates in the case of a worker retiring at 65 after 40 years of career at the average wage, lie at 75% (91% net).

The level of risk of poverty among the elderly is important (29 %), which is related to the significant proportion of the population with short insurance careers or with very low insured earnings. During the last years, a major priority has been to improve the level of the minimum old-age pension. Minimum guaranteed levels for old-age and disability pensions under the contributory scheme were introduced for the first time in 1998.[29] The minimum level depends on the number of contributions years and has been increased in recent years. According to the new 2002 legislation, this level is indexed to the minimum wage reduced by 11% of contribution rates and has been increased over the period 2003-2006. From 2006, the Solidarity Supplement for the Elderly will be provided to people aged 80 years or more to ensure an income of 300€ (and gradually to those aged 65 years or over until 2009).

The 2004 employment rate is 67.8% for the 15-64 population and 50.3 % for the population aged 55-64 in line with the Lisbon targets. All workers in the private sector can retire at 65 if they have contributed for at least 15 years. Early retirement conditions have been tightened though. In the private sector the possibility of claiming early retirement at the age of 55 was suspended and the measure allowing the early pension at

[29] Previously, a social supplement was paid to people whose statutory pension did not reach the minimum amount of 30% of the average income.

the age of 58 for the long-term unemployed was eliminated. Currently (beyond those professions mentioned in law) the early pension is only possible for long term unemployed people aged at least 55 (who have made contributions for 20 calendar years – their pensions are then decreased by 4.5% a year) or 60 (without reduction). In the public service, people having at least 36 years of service can retire before 65, but experience the same decrease of 4.5% a year. Workers in the private sector may postpone their retirement up to the age of 70 and receive a 10% increase in pension per year of deferral (for people having contributed at least 40 years). Moreover, old-age pensions can be freely combined with earned income. The possibility to cumulate part-time work with partial pension is also planned as well as incentives to employ more vulnerable people being strengthened.

Pension expenditure account for 11.1% of GDP. Concerning financial **sustainability**, during the 1990s, a number of adjustments were made to reduce the future increase in public pension expenditure. In 1993, the rules for calculating pension entitlements under the special scheme for new civil servants became the same for the new entrants to this scheme as in the general social security scheme. In 1994, the conditions for entitlement to an old-age pension and the coefficient for calculating pension benefits were both tightened (this has been confirmed by the legislation adopted in 2002).

Since the latest social security reform of 2002, earnings over the whole insurance career are taken into account for the calculation of the pension amount (subject to a maximum of 40 years). Annual accrual rates are set in accordance to the level of reference earnings, which results in a maximum pension for workers in the private sector of 92% of the reference earnings (used for calculating the pension) while in the public service it is 90% since 2004. The new benefit formula applies in full to those who started working from 2002 onwards.

A reserve fund for social security was created in 1989. According to the social security reform laws of 2000 and 2002, the aim is to constitute, in the medium term, a reserve that is equivalent to 2 years of pension expenditure of the general statutory scheme. In addition to receiving the surpluses of the social security scheme, the fund will receive between two and four percentage points of the employees' social security contributions. At the beginning of 2005, the fund held assets that amounted to 4.3% of GDP. The fund is expected to be used when social security deficits start to emerge to cover increased expenditure and to fill the revenue gap. Considering the current macroeconomic situation it will be difficult to increase these reserves in the short term.

In order to promote the development of supplementary pension schemes, a comprehensive legal framework was introduced in 2000 covering management and investment rules, as well as the tax regime for such private provision. In 2002, further tax benefits were introduced and a supervisory framework was defined for supplementary pension schemes. The IORP directive is currently being transposed, while some efforts are projected to improve portability.

Information to beneficiaries has been improved through the availability of a dedicated website providing pension simulations, while dedicated call-centres are to be developed. In order to improve transparency the Government plans to make public, on a yearly basis, updated long term projections on adequacy and the financial sustainability of the pension system.

2.2 Outlook, reform measures and policy debates

Portugal is projected to face faster ageing than most EU Member States in coming decades. According to latest population forecasts of Eurostat, the elderly dependency ratio is projected to increase from 25% in 2004 to 39% in 2030 and 58% in 2050.

According to the calculations carried in the framework of the ISG, Theoretical replacement rates are projected to remain stable overall. For the case of a worker retiring at 65 after 40 years of career at the average wage, the net replacement rate would be stable at 91% from 2005 to 92% in 2050 (gross replacement rate declines from 75% to 70%).

Portugal is expected to face a significant pressure on its public finance system resulting from ageing populations. According to the AWG projections of 2005, public spending on pensions is projected to rise from 11.1% of GDP to 20.8% between 2004 and 2050 and all age-related expenditure from 23.8% to 33.4% during the same period. The increase in pension spending is one of the highest in the EU, resulting in a serious risk of the long-term sustainability of public finances.[30]

The latest pension reform, especially a set of measures in the scope of the convergence of public sector pensions towards the general level of pensions is expected to make some progress in meeting the financial challenge of the pension system and the former national strategy report explained how Portugal will deal with this challenge up to around 2030, but leaves open how the social security deficit is to be financed thereafter. Thus, there is scope for further reform, while taking account of the fact that the balancing of the central government budget remains difficult. In this context, there also seems to be scope for the development of private pension provision. It remains to be seen whether the modernisation of the legal framework for private pensions (including rules on vesting and portability) will be sufficient to allow occupational pension schemes to play a significant role.

In 2006, the Portuguese government will decide on the overall strategy for the pension system. A detailed study on the sustainability of the social security system is being prepared to enable the Government to decide which measures are considered more apropriate and necessary in order to ensure the long term financial sustainability of the pension system.

3. CONCLUSION

In response to the adequacy challenge, a major priority since the last strategy report has been to improve the level of the minimum old-age pension, which should alleviate poverty risks. To reduce further old age poverty, a new tax financed social benefit – Solidarity Supplement for the Elderly – has been adopted and will be implemented during 2006. Besides, more complete insurance careers in better-paid employment will result in higher pensions for new generations of pensioners.

The most recent reforms will translate into strengthened incentives to work longer and also contribute to a more equitable treatment of members of different schemes. Further harmonisation of the pension system and measures to promote longer working lifes sould contribute to strengthen adequacy and sustainability.

[30] According to the 2004 national budgetary projections (based on different demographic and macreconomic assumptions) prepared in the context of the assessment of the long-term sustainability of public finances, the pension expenditure is expected to increase from 11.5% of GDP in 2005 to 15% in 2050.

The government has prepared the harmonisation of the civil service scheme with the general scheme and it is important to pass this quickly through Parliament to ensure that reforms remain credible and equitable.

Progress has been made in meeting the financial challenge of the pension system, while balancing of the central government budget remains difficult.

The Government intends to create incentives towards the development of supplementary pension schemes. It remains to be seen whether this modernisation of the legal framework for private pensions will be sufficient to allow meeting expectations that the occupational pension schemes could play a significant role in order to ensure future adequacy.

4. BACKGROUND STATISTICS

	PT			EU25		
Adequacy						
Current situation						
	Total	Men	Women	Total	Men	Women
At-risk-of-poverty rate [1]	21	20	22	16	15	17
0-64	19	18	20	16	16	17
65+	29	29	30	18	15	20
75+	35	35	36	Nd	Nd	Nd
Income inequality [1]						
0-64	7,3					
65+	6,5					
Income of people aged 65+ as a ratio of income of people aged 0-64 [1]	0,76	0,77	0,75			
Median pensions relative to median earnings [2]	0,68	0,70	0,67			
Long-term projections						
Theoretical replacement rates[3]	2005	2030	2050			
Total net replacement rate	91	92	92			
Total gross replacement rate	75	71	70			
Gross repl. rate 1st pillar	75	71	70			
Gross repl. rate 2nd/3rd pillar	*	*	*			
Financial sustainability						
Current situation						
ESSPROS Pension expenditure [4], % of GDP	***1995***	2000	***2003***	***1995***	2000	***2003***
	9,8	10,5	11,9		12,5	12,6
Employment (2004) [5]	Total	Men	Women	Total	Men	Women
Employment rate ***(25-54)***	81,1	87,4	74,9	76,8	85,2	68,5
Employment rate (55-64)	50,3	59,1	42,5	41,0	50,7	31,7
Effective labour market exit age (2004)[6]	62,2	61,2	63,1	60,7p	60,9	60,4p
Public finances (2003) [7]						
Public debt, % of GDP	60,3			63,3		
Budget balance, % of GDP	-2,8			-2,8		

Long-term projections (EPC 2006)

	PT Level			PT increase	EU25 Level			EU25 increase
	2004	2030	2050	2004-50	2004	2030	2050	2004-50
Old-age dependency ratio [8]	24,9	39,2	58,5	+135%	25	40	52	+108%
Public pensions expenditure, % of GDP [9]	11.1	16.0	20.8	+9.7	10,6	11,9	12,8	+2,2

Factors determining the evolution of public pensions expenditure (2000-2050) [10]	PT: Contribution to change in percentage points of GDP	EU25: Contribution to change in percentage points of GDP
Demographic dependency	13,7	8,6
Employment	-0,2	-1,1
Eligibility	-0,9	-2,1
Level of benefits	-3,0	-2,7
Total (including residual)	9,3	2,2

Notes:
1. Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, Income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).
2. Source: Eurostat. Median individual pension income of retirees aged 65-74 in relation to median earnings of employed persons aged 50-59 excluding social benefits other than pensions.
3. Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first and second pillar pension schemes, retiring at the age of 65 years in 2005.
4. Source: ESSPROS, EUROSTAT. Includes expenditure by certain private social protection schemes.
5. Source: European Labour Force Survey, 2004.
6. Source: European Labour Force Survey, 2004.
7. Source: European Commission, DG ECFIN.
8. Source: EUROSTAT (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15-64.
9. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.
10. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.

* proportion negligible

SLOVENIA

1 MAIN CHARACTERISTICS OF THE PENSIONS SYSTEM

A dominant **mandatory earnings-related scheme** covers the risks of old-age, disability and survivors. All employees and self-employed persons are covered, while specific categories of inactive persons, who are not insured under compulsory insurance, may join the system voluntarily during periods defined by law. The total contribution rate is 24.35%, paid by employees (15.5% of gross wages), employers (8.85% of gross wages), self-employed (the total) and through state compensatory contributions. In 2002 31.6% of all pension expenditures were covered by the state budget (21.1% to cover the growing deficit and 10.5% to finance favourable pensions for various groups of insured persons). Contributions have to be paid on all wages without ceiling or floor. To avoid evasion problems in the contribution collection, wages cannot be paid if social security contributions have not been paid. The maximum pension rating base cannot exceed four times the minimum pension rating base, which implies a high degree of redistribution.

The statutory pension scheme has been considerably modified by the 2000 reform. Each full year in the mandatory insurance scheme now counts for a pension accrual of 1.5% per year for men and women equally, while the accrual for the period greater than six months but less than a full year increases by 0.75% (before 2000 the increases amounted to 2% for a full year and 1% for a period above six months, and for women with pensionable service up to 20 years, 3% for each year and 1.5% for every additional six months). Minimum percentage for calculating old-age pension benefits differs with the sex of the insured person. For 15 years of pensionable service, which is the minimum possible service eligible to an old-age pension entitlement, men aged 65 and over are granted pensions of 35% of their pensionable earning, while women aged 59 years and 8 months in 2004 (61 years after 2008) are granted 38% of their pensionable earnings (40% before 2000).

Age limits are being gradually increased to the full pensionable age of 61 years for women (by four months each year) and 63 years (by six months each year) for men. During an interim period some groups of insured people, e.g. long-term unemployed persons, can still retire according to previous rules. The full retirement age of 63 years for men will be implemented by 2009 for women (61) by 2023.

Pensionable age can be lowered to 58 years for men and 56 years for women on account of parenthood (for one parent only, usually the woman), and to 58 also for those with long careers (40 years for men and 38 for women)

Pensions are indexed on wages. Proposals to index pensions only to the costs of living have not been adopted so far because Of concerns over future adequacy.
A major pension reform was introduced in 2000 enabling two types of supplementary pension insurance to be created: compulsory (for insured persons performing particularly hard work and work harmful to health, and insured persons performing professional activities which cannot be successfully performed after attaining a certain age) and voluntary. Providers must be approved by the Ministry of Labour, Family and Social Affairs and by the appropriate regulator. Old age, invalidity and survivors benefits can be but are not necessarily included. By the end of 2002, one quarter of all insured persons contributed to occupational schemes, while by June 2004 the level of coverage had more

than doubled to around 51.10% of the workforce. The coverage level is expected to continue increasing and exceed 70% of the workforce in the future.

A strong incentive for the participation in this voluntary provision is provided by a favourable tax treatment which is shared between the employer and the employee, provided at least 51% (initially set at 66%) of employees are enrolled in a collective voluntary scheme. In that case, employer contributions are in effect tax free. Employees' contributions are deductible for the purpose of personal income taxation, subject to a ceiling. Portability is granted after three years in the firm. Vesting is immediate.

Individual provision consists of voluntary individual savings for old-age, mostly in the form of life insurance, administered by insurance companies. Premiums paid to this provision are subject to tax relief, but with a fairly low cap (3% of taxable income). Annuities received from this provision are not subject to personal income taxation.

Pensioners who receive low pensions, due to low incomes during their contribution period and/or an incomplete contribution period, can apply for a pension income supplement, provided they fulfil a set of means tested conditions, which are checked every two years. An insured person entitled to old-age pension is guaranteed the minimum pension in the amount of 35% of the minimum pension rating base (414 €) per month. In 1999 the National Pension was introduced, a means tested benefit that unlike the pension income supplement can be granted to a person who is not receiving any pension.

2 SITUATION AND PERSPECTIVES IN THE LIGHT OF THE COMMON OBJECTIVES

2.1 Current situation

Adequacy - The ratio of the average old-age pension to the average net wage gradually decreased since 1995 from 76.2% to 75.3% in 2000 and 70.2% in 2004. Older people experience close to average living standard (the living standard of people aged 65 or more is at 87% of those aged 0-64). The risk of poverty is moderate for people aged 0–64 (9%) but doubles for people aged more than 65 (19%).

The total employment rate was 65.3% in 2004 (70% for men and 60.5% for women). The employment rate of older workers is one of the lowest among EU25 and far below the Lisbon target: less than a third of older workers (aged 55 to 64) are in employment (29%, 40.9% for men and 17.8% for women).

If a person claims pension prior to reaching the full statutory retirement age and without having acquired full pensionable service of 40 (men) or 38 years (women), the old-age pension is permanently reduced. This reduction depends on the pensioner's age and can exceed 18%. For women, such reduction will be applied after 2015 and will gradually reach a maximum of 10.8%. Moreover, the accrual of pension rights is not capped. With longer working lives, persons can to a certain degree compensate for negative impacts of the changed method of calculation. Besides, deferral of retirement after becoming eligible for old-age pension is further stimulated in cases where the eligible person reaches 63 (for men) or 61 years (for women) up to maximum 7.2%.

Financial sustainibility - The expenditure for the statutory scheme was 11.2% of GDP in 2003. Transfers from the state budget to the statutory scheme budget are necessary to cover a deficit and to finance special pensions for different beneficiaries and due to the decrease in contribution rates decided in 1996. According to national data, in 2000, which was the first year of pension reform, the share of total expenditure for pensions remained at 11.4% of GDP, while in the past four years it gradually declined and reached 10.9% in 2004, although the number of pensioners increased by approximately 2.1% per

year in the period 2000-2004. In addition to pensions, other social benefits for retirees were paid (income support, attendance allowance, alimony, and national pensions), amounting to 0.6% of GDP (roughly stable since 1995). The third category of expenditure from the pension fund is wage compensations (due to disability), which in 1995 represented approximately 0.3% of GDP and then slowly but constantly grew so as to reach 0.5% in 2000 and 0.6% in 2004.

Modernisation - Differences in eligibility requirements for widower's pensions for men and women were eliminated with the reform. In particular, the minimum age for the entitlement is 53 years (it was increased by 3 years for women and reduced by 2 years for men). Gender gaps however remain significant; as the poverty risk for people aged more than 65 is twice that for women (23% at the 60 % threshold) than for men (11%). Moreover, while the average living standard of men aged more than 65 is 94% of those aged 0-64, the corresponding level is 83% for women.

2.2 Outlook, reform measures and policy debates

Slovenia is projected to experience rapid ageing in the coming decades. Demographic trends will result in a significant increase in the old-age dependency ratio, from 21% in 2004 to 56% in 2050.

After 40 years of pensionable service for men and 38 years for women (which will be the necessary service period for pensions subject to achieving the earliest pensionable age), the old-age pension will amount to 72.5% of the pensionable earning (in comparison with 85% before the 2000 reform). This may lead to a worsening of the situation of the most vulnerable, in particular women.

In spite of the last reform, incentives in the pension system for extending active life remain low. The pension system still allows for early retirement under quite generous conditions. The effective retirement age in Slovenia is low (56 for women, 59 for men in 2002). Retiring prior to the full pensionable age entails penalties, but this may not convince workers to stay longer in employment.

The number of disabled people increased in the past ten years. Measures in order to increase incentives, job sharing and a quota system will be introduced from 2006.

The budgetary pressures due to age-related expenditures are significantly stronger in Slovenia than in most other Member States. According to the AWG projections of 2005, public pension expenditure is projected to increase to 18.3% of GDP in 2050, a rise of 7.3 p.p. of GDP from 2004. Total age-related expenditure is projected to rise from 25.0% to 34.1% of GDP between 2004 and 2050, a rise of 9.1 p.p. of GDP. Such projections risk resulting in a steep rise in the general government debt, currently still at a low level of 30% of GDP, but without policy changes it would rise to about 200% of GDP by 2050.

3 CONCLUSIONS

The most recent reform constitutes an important step towards ensuring adequate and sustainable pensions. However, budgetary pressures due to age-related expenditures are significantly stronger in Slovenia than in most other Member States, highlighting that further measures will be needed.

Recent reforms improve incentives to work longer which are urgently needed, as the employment rate among older workers is very low. Reducing early exit from the labour market is a major challenge and would contribute to ensuring future adequacy (through

further accrual of pension rights which are otherwise planed to decrease) and sustainability.

Moreover, the 1999 reform stipulated a long term difference in retirement ages of women (61) and men (63). A further reduction of the gap in retirement age would contribute to ensuring future adequacy.

Finally, following the introduction of strong incentives for the participation in voluntary provision, about half of all actively insured persons currently take part in voluntary supplementary pension schemes, highlighting the importance of adequate portability as well as risk sharing rules.

4. BACKGROUND STATISTICS

	SI			EU25		
Adequacy						
Current situation						
	Total	Men	Women	Total	Men	Women
At-risk-of-poverty rate [1]	10	9	11	16	15	17
0-64	9	8	9	16	16	17
65+	19	11	23	18	15	20
75+	25	17	28	Nd	Nd	Nd
Income inequality [1]						
0-64	3,3					
65+	3,1					
Income of people aged 65+ as a ratio of income of people aged 0-64 [1]	0,87	0,94	0,83			
Median pensions relative to median earnings [2]	0,68	0,74	0,61			
Long-term projections						
Theoretical replacement rates[3]	2005	2030	2050			
Total net replacement rate	???	???	???			
Total gross replacement rate	???	???	???			
Gross repl. rate 1st pillar	??	??	??			
Gross repl. rate 2nd/3rd pillar	??	??	??			
Financial sustainability						
Current situation						
ESSPROS Pension expenditure [4], % of GDP	***1995***	2000	***2003***	***1995***	2000	***2003***
		11,4	11,2		12,5	12,6
Employment (2004) [5]	Total	Men	Women	Total	Men	Women
Employment rate ***(25-54)***	83,8	86,4	81,2	76,8	85,2	68,5
Employment rate (55-64)	29,0	40,9	17,8	41,0	50,7	31,7
Effective labour market exit age (2004)[6]	??	??	??	60,7p	60,9	60,4p
Public finances (2003) [7]						
Public debt, % of GDP	29,5			63,3		
Budget balance, % of GDP	-2			-2,8		

	SI				EU25			
Long-term projections (EPC 2006)								
	Level			increase 2004-50	Level			increase 2004-50
	2004	2030	2050		2004	2030	2050	
Old-age dependency ratio [8]	21,4	44,5	55,6	+160%	25	40	52	+108%
Public pensions expenditure, % of GDP [9]	11.0	14.4	18.3	+7.3	10,6	11,9	12,8	+2,2
Factors determining the evolution of public pensions expenditure (2000-2050) [10]	Contribution to change in percentage points of GDP				Contribution to change in percentage points of GDP			
Demographic dependency	13,3				8,6			
Employment	-1,0				-1,1			
Eligibility	-3,6				-2,1			
Level of benefits	-0,9				-2,7			
Total (including residual)	7,3				2,2			

Notes:
1. Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, Income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).
2. Source: Eurostat. Median individual pension income of retirees aged 65-74 in relation to median earnings of employed persons aged 50-59 excluding social benefits other than pensions.
3. Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first and second pillar pension schemes, retiring at the age of 65 years in 2005.
4. Source: ESSPROS, EUROSTAT. Includes expenditure by certain private social protection schemes.
5. Source: European Labour Force Survey, 2004.
6. Source: European Labour Force Survey, 2004.
7. Source: European Commission, DG ECFIN.
8. Source: EUROSTAT (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15-64.
9. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.
10. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.

* proportion negligible

SLOVAK REPUBLIC

1. MAIN CHARACTERISTICS OF THE PENSIONS SYSTEM

The Slovak pension system has undergone a major reform in 2005 which split the statutory old-age pension scheme (survivor's benefits included) into two tiers, one being **defined-benefit pay-as-you-go financed**, the other a **funded defined contribution scheme.** The funded tier is managed by private pension funds. All new labour force entrants will be enrolled in this new two-tiered system and current workers will have until June 2006 to choose whether to join the new system or stay in the old one. Each of these tiers receives a contribution rate of 9% of wages; an additional 6% will be collected for disability benefits.

The reform started a gradual rise of pension ages to 62 for both men (from 60 today, to be reached in 2007) and women (from 53-57 depending on the number of children today, to be reached in 2015). there is no right to early old age pension the pension equates to 1.2 times the amount of the subsistence minimum. In case of early retirement pension benefits will decrease by 0.5% for each month of early retirement.

There is also a **voluntary supplementary pension saving scheme**, consisting of pension insurance from employers or trade union organisations and since 2005 other financial tax deductible products of other financial institutions.

2. SITUATION AND PERSPECTIVES IN THE LIGHT OF THE COMMON OBJECTIVES

2.1 Current situation

Adequacy: The risk of poverty of the 65+ age group is moderate, at 13% in 2002 (12% for men and 13% for women) and is actually much lower than that of the age group 0-64 (22%).[31]

The ratio of average old-age pension provided by the statutory scheme in relation to the average gross wage remained roughly stable over the last decade: it increased slightly in the second half of the 1990s from 44.3 (in 1995) to 47.3 (2000), and then decreased in 2004 (44.5). This ratio shifted due in part to the new pension formula that provides an insured person 50 % of their individual last income after 40 years of insurance. (At the present though, there is a debate about whether to lower the target replacement rate in order to reduce transition costs.) ISG theoretical replacement rate calculations show the total net replacement rate in 2005 at 63% and the gross rate at 49%.

One uncertainty regarding the future adequacy of pensions will be the returns from the mandatory funded scheme. The Government is not guaranteeing minimum returns making future adequacy more uncertain. As the introduction of the new tier entails a significant loss of contribution revenue to the PAYG scheme, the scope for improving current pensions will remain limited.

Financial sustainability: The total unemployment rate declined in 2004 to 18.2%, but long-term unemployment (11%) and unemployment of young people under the age of 25 (34%) remain very high.

[31] According to more recent figures, referring to income year 2003, the poverty rate of people aged 65 and more is at 11%, while the poverty rate of the general population is 21%.

In 2004 the employment rate of persons aged 55-64 increased by 0.6 p.p. compared with the year 2003. Although increasing since 2001, it remains extremely low, at 26.8% in 2004, particularly for older women (12.6%) and far below the Lisbon target. Recently introduced measures, such as the increase of the retirement age to 62 for men and women, cutting of the entitlement by 0.5% for each month of earlier retirement and allowing for pension recipients to work without limiting pension accumulation could contribute to an increase of the average exit age in the future.

Public pension expenditure has showed a slight decreasing trend - from 7.8% of GDP in 1993 down to 7.5% in 2003, clearly below the EU25 average of 12.6%. A continuing deficit in the total balance of the basic old-age insurance fund and the basic invalidity fund is currently covered by the surpluses out of other funds in the Social Insurance System.

Long-term financial sustainability of the pension system was one of the declared goals of the Government, when introducing the last reform. For those who join the funded tier half of the pension contribution will be transferred to private funds. This will cause a reduction in contribution revenues to the public PAYG scheme, transition costs being estimated at approximately 1% of GDP, when a retirement age of 62 is assumed. Over a period of about 30 years, total transition costs are estimated at 50 to 70 billion SKK (from 15 to 20% of current GDP). These costs are expected to be covered by privatization revenues and by newly issued debt or further reforms of the public PAYG scheme. The quantification of the additional funds however, depends primarily on the actual number of persons that join the combined pension system as well as overall economic and employment development. According to estimates of the Ministry of Labour, Social Affairs and Family SKK 70 billion (on 31 December 2004) will be sufficient, if the participation rate in the funded tier amounts to 65% of the economically active population, until mid-2009.

Modernisation of the social security system in the Slovak Republic has been a driving force behind the last pension reform that diversifies the longevity risk between the state and the individual. The strengthening of the insurance principle improves incentives to work. The current retirement age will be raised and equalised. However, there are still persisting pay gaps between men and women due to higher rates of long-term female unemployment and unequal distribution of childcare responsibilities, which impact heavily on actual pension entitlements.

Information on the pension system is largely available to the public via internet sites, toll-free information phone lines and several booklets. An extensive education campaign was conducted at the time of launching the new pension system in order to inform the populace about the effect the combined pension system would have on future benefits. An interactive pension calculator was an important part of this campaign. The Social Insurance Agency gives information on acquired pension entitlements on its website.

2.2 Outlook, reform measures and policy debates

The elderly dependency ratio is set to increase quickly from the present 16% to 28% in 2025 and 51% in 2050 (staying just below the EU25 52%). A low fertility rate combined with increased longevity is the main reasons for the change.

According to replacement rate calculations the net replacement rate from the statutory scheme for a worker retiring at 65 after 40 years of average earnings will remain stable over the next decades, slightly increasing from its present level of 63% to 64% by 2050 and the total gross rate from 49 % to 50 % by 2050. However, because of a tighter link between contributions and benefits, where 40 years of contribution are taken into

account, the individual pension level of under-average earners or shorter careers are projected to decline dramatically, whereas over-average earners gain. During a transition period transition measures for low income groups have been established.

The Slovak public PAYG pension system has been in deficit and will face gradually worsening financial imbalances due to a relatively radical switch to a funded scheme, which will significantly reduce contribution revenues to the PAYG scheme. Additional transfers from the state budget will be required.

The AWG projections of 2005 show some pressure on public finances due to the ageing of the population. Pension expenditure is projected to increase from 7.2% of GDP in 2004 to 9.0% in 2050, an increase of 1.8 p.p. of GDP (when taking into account the mandatory funded tier of the statutory scheme, pension expenditures increase from 7.2% of GDP in 2004 to 11.2% of GDP in 2050). All age-related expenditure is projected to increase from 15.5% to 17.9% of GDP between 2004 and 2050. The increase in public pension expenditure is mitigated by the 2005 reform, which involved a partial shift to the funded system. The main concern in the context of sustainability of public finance is the high level of current and projected budgetary deficit, largely driven by social security and health care costs. The State budget deficit was at its peak in 2000 (-12.3% of GDP) but then reduced to 5.7% in 2002 and 3.3% in 2004.

3. CONCLUSIONS

The Slovak pension system has undergone a major reform introducing a funded tier in 2005, which strengthens adequacy and sustainability of the statutory old-age pension scheme and contributes to the sustainability of public finances as a whole in the long term. However, over the transition period, a large deficit in the financing of the public PAYG scheme will occur. The Slovak Republic plans to earmark additional revenues from privatisation. For how far the privatisation revenues will be enough, depends on both the take-up of the funded scheme and overall economic development. Additional measures to reform the public PAYG scheme further, might be needed in order to avoid running into heavy debt.

The new pension formula of the PAYG pillar, as well as the introduction of funded elements, established a strong link between personal contributions to the system and benefits. That could lead to adequacy issues in the future for the lower income earners and people with breaks in their careers, notably women. A key challenge for the Slovak Republic is to raise its employment rates in general and of older workers in particular and to lower unemployment, which would both strengthen the contribution base and allow people to accrue additional pension rights.

An extensive education campaign was conducted at the time of launching the new pension system, providing in particular large access to information on acquired pension entitlements. The provision of adequate information for personal pension planning and thus motivating people to contribute more to increase the adequacy in the system will be of continuing importance. .

4. BACKGROUND STATISTICS

	SK			EU25		
Adequacy						
Current situation						
	Total	Men	Women	Total	Men	Women
At-risk-of-poverty rate [1]	21	21	21	16	15	17
0-64	22	22	22	16	16	17
65+	13	12	13	18	15	20
75+	20	20	20	Nd	Nd	Nd
Income inequality [1]						
0-64	5,8					
65+	3,2					
Income of people aged 65+ as a ratio of income of people aged 0-64 [1]	0,89	0,89	0,89			
Median pensions relative to median earnings [2]	Nd	Nd	Nd			
Long-term projections						
Theoretical replacement rates[3]	2005	2030	2050			
Total net replacement rate	63	62	64			
Total gross replacement rate	49	49	50			
Gross repl. rate 1st pillar	49	49	50			
Gross repl. rate 2nd/3rd pillar	*	*	*			
Financial sustainability						
Current situation						
ESSPROS Pension expenditure [4], % of GDP	***1995***	2000	***2003***	***1995***	2000	***2003***
	7,4	7,5	7,5		12,5	12,6
Employment (2004) [5]	Total	Men	Women	Total	Men	Women
Employment rate ***(25-54)***	74,7	80,0	69,3	76,8	85,2	68,5
Employment rate (55-64)	26,8	43,8	12,6	41,0	50,7	31,7
Effective labour market exit age (2004)[6]	58,5	60,3	57,0	60,7p	60,9	60,4p
Public finances (2003) [7]						
Public debt, % of GDP	42,6			63,3		
Budget balance, % of GDP	-3,7			-2,8		

Long-term projections (EPC 2006)	SK				EU25			
	Level			increase 2004-50	Level			increase 2004-50
	2004	2030	2050		2004	2030	2050	
Old-age dependency ratio [8]	16,3	31,7	50,6	+210%	25	40	52	+108%
Public pensions expenditure, % of GDP [9]	7.2	8.3	11.2	+4.1	10,6	11,9	12,8	+2,2
Factors determining the evolution of public pensions expenditure (2000-2050) [10]	Contribution to change in percentage points of GDP				Contribution to change in percentage points of GDP			
Demographic dependency	9,0				8,6			
Employment	-1,3				-1,1			
Eligibility	-2,5				-2,1			
Level of benefits	-3,1				-2,7			
Total (including residual)	1,5				2,2			

Notes:

1. Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, Income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).
2. Source: Eurostat. Median individual pension income of retirees aged 65-74 in relation to median earnings of employed persons aged 50-59 excluding social benefits other than pensions.
3. Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first and second pillar pension schemes, retiring at the age of 65 years in 2005.
4. Source: ESSPROS, EUROSTAT. Includes expenditure by certain private social protection schemes.
5. Source: European Labour Force Survey, 2004.
6. Source: European Labour Force Survey, 2004.
7. Source: European Commission, DG ECFIN.
8. Source: EUROSTAT (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15-64.
9. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.
10. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.

* proportion negligible

FINLAND

1 MAIN CHARACTERISTICS OF THE PENSIONS SYSTEM

The statutory pension provision comprises a basic national pension scheme that aims to guarantee a minimum income for all pensioners and a complementary earnings-related scheme. The latest major pension reform was introduced in the earnings related scheme from the beginning of 2005, complementing the range of earlier reforms during the two previous decades.

The national pension provides a minimum pension based on the length of residence and can, after 40 years of residence, reach a monthly amount of approximately 495€ for a single (about 21% of average wage-earners' income), depending on the place of residence. The amount decreases as the person's earnings-related pension increases with a phasing-out rate of 50% (only the earnings-related pension affects the means-testing.). Above a defined level of earnings-related pension, the national pension is not paid. For low-income worker's, especially those with short employment records, continuing to work will increase the total pension only partially, as the earnings-related pension reduces the amount of national pension (from 2005, this is not the case for any rights accrued beyond 63 years). The pensionable age for the national basic pension is 65.

The share of pensioners receiving only national basic pension is declining. In 2004, only 8% of pensioners received a complete national pension, while the national pension supplemented the earnings-related pension of a further 52%.

The earnings related scheme provides insurance-based pensions and covers all employees (without income ceiling) and the self-employed. Old-age pensions for private sector employees currently start to accrue from the age of 18. Retirement is flexible between 62 and 68 years, accompanied by higher accrual rates for the last years of work: 1.9% a year between 53 and 62 years and 4.5% between 63 and 68 years instead of the standard accrual rate of 1.5%.[32]

From 2005, the pension has been calculated on the basis of the wages received during the whole professional career, revalorized on the whole, in line with earnings growth.[33] National pensions are indexed with the consumer price index, while earnings-related pensions are indexed with weighted index comprised of wages at 20% and of prices at 80%.

In the statutory earnings-related pension scheme, mandatory partial funding was introduced in the 1960's. Currently, it contributes to about a quarter of the financing. For employees of the private sector, these funds are managed by private pension funds, which compete on the basis of customer service and return on investments and must comply with a detailed regulatory framework. A guarantee scheme ensures the payment of benefits in the event of insolvency of a pension institution. Also, for local government and State pensions, reserve funds have been established with the aim of increasing funding to the same level as for the private sector pension schemes. Altogether, the reserves of all mandatory schemes amounted to 59% of GDP in 2004 and are projected to rise to almost 80% of GDP by 2020.

[33] When calculating the pension at the time of retirement Past earnings are adjusted to present levels: this wage coefficient puts a weighting of 80 % on changes in wages and 20 % on changes in prices.

Access to early retirement schemes and unemployment pensions has been significantly reformed. At present, it is possible to retire at 60 by receiving an unemployment pension[34], or by receiving a partial pension from the age of 58 (in 2001, the share of persons employed part-time among the 55-64 years was 5% of all and around 11% of persons employed in this age bracket).

Due to comprehensive coverage of the statutory schemes, the relatively high replacement rate and the absence of a pension contribution ceiling, the supplementary pension coverage is modest. In 2002, occupational pensions covered approximately 5% of the working age population (15-64 years) and the share of the benefits from occupational pension schemes in the total of the pension payments was 3.3% whilst that of individual pensions was 1.3%. The number of individual plans increased significantly in recent years. At the end of 2003, approximately 12% of the population between 15 and 64 were covered by private pension plans managed by Finnish insurance companies.

Pension benefits are supplemented by pensioners' housing allowance (which benefited 22% of pensioners in 2004), pensioners' care allowance for supporting independent living at home (24% of pensioners in 2004), special tax treatment of pensions allowing a tax-free income up to the level of the national basic pension and public social welfare and health care services. In recent years the proportion of people aged 65 and over receiving social assistance due to special needs has been less than 4 % while the national basic pension provides a higher minimum income than the standard social assistance.

2 SITUATION AND PERSPECTIVES IN THE LIGHT OF THE COMMON OBJECTIVES

2.1 Current situation

Adequacy - The level of pensioners' incomes is around 75% of that of the rest of the population (it is closer if one takes into account imputed rents on owner-occupied dwellings which are more frequent amongst pensioners than the working-age population). According to ISG calculations, the gross replacement rate for a theoretical worker at the average wage retiring at 65 after 40 years currently lies at 57% (63% net). At the end of 2003, the average total pension of people entitled to an old-age pension (and survivor pension) amounted to 1137€ per month, which corresponded to 49% of average employees' wages.

The statutory pension schemes ensures poverty risk of the elderly population is moderate (17% at the 60% threshold) higher than that of the 0-64 years (10%).[35] Moreover, certain risks seem to persist particularly for women aged 65 or more (poverty rate of 20%) and older pensioners (the poverty risk for people aged 75 or more lies at 25%), which can be connected to the non-employment of the oldest women during their active life and, thus an higher proportion of them receiving only national basic pensions.

Financial sustainability – In 2003, pension expenditure accounted for 11.4% of GDP (below EU25 average of 12.6%, according to ESSPROS data). A number of reforms, with the aim of limiting the increase of retirement expenditure, had already taken place in the nineties. In 2001 and 2002 important reforms were agreed which will come into

[34] Disability is the most frequent cause of early retirement.

[35] The outline of pensioners' income is particularly sensitive to the at-risk-of-poverty threshold applied. In recent years, the relative risk of poverty for the elderly has been very close to that for the entire population, with the at-risk-of-poverty threshold set at 50 or 40 % of the median income. If the poverty threshold is set at 60 per cent, however, the risk of poverty for the elderly clearly increases. Thus, a relatively large percentage of the elderly has an income between the 50 and 60 % thresholds. Moreover, according to national statistics for 2001, when imputed housing income is taken into account, the poverty risk of people aged more than 65 states at 10.5 %, while the risk of poverty for people aged below 65 was 10.8 %.

force in 2005. In particular, Finland made great efforts with regards to early retirement, notably through a tightening of the access to the unemployment pension scheme.

After a significant fall at the beginning of the 1990s, employment rates went up during the second half of the decade and are now above the European average, due to a large part with employment policies for older workers and of a progressive adaptation of pension schemes. The employment rate of the 55-64 population has increased by approximately 15 percentage points during the last decade and the last reforms of the retirement system, which were introduced at the beginning of 2005, will further strengthen incentives to extend working lives.

In 2004, the employment rate of 55-64 year olds was 51%, in line with the Lisbon target. The previous National Strategy Report identified the employment rate of 55-64 year old men as a particular challenge. In 2004 this had risen from e 42 % to 51 %, while women's' employment rate is similar at 50% and increased from 2003 to 2004 by around 2 p.p.. In 2004, 83 % of Finns retiring on a pension were under 65 years old - a slight improvement from the previous reporting round, when it was 86%. Two out of three persons aged 60-64 are currently pensioners. The most common reason given is reduced work ability. Improvements in older worker employment rates have mainly occurred in the 55-60 age group in part due to the 2005 reforms..

Modernization- Gender differences in living standards and the risks of low-income amongst older people remain significant. In particular, among people aged 65 and more, poverty rates are 11% for men and 21% for women. This is mainly linked to their lower participation in the labour market in the past and average lower wages. Since 2005, pensions accrue during periods without earnings due to childcare, unemployment, training, sickness and rehabilitation.

2.2 Outlook, reform measures and policy debates

According to the latest Eurostat demographic projections, Finland will face an atypical demographic ageing until 2025: the increase of the dependency ratio will be faster than that for EU25 until 2025 and then become slower. Indeed, it is expected to rise from current levels of 23% (25% for EU25) in 2004 to 45% in 2030 (40% for EU25), and then increase slowly to 47% by 2050 (while EU average would be 52%).

The overall strategy to cope with significant pressures in pension expenditure is built upon the elements of increasing the pre-funding of the earnings-related pension scheme more than the legal requirements and reducing public debt, as well as conducting sound macroeconomic policies conducive to higher labour productivity, economic growth and employment rates (notably among older workers, thereby increasing the effective retirement age). The Government aims at raising the overall employment rate to 75% by 2011. The objective of recent reforms is also to increase the rate of employment of older workers to 55% by 2010 (from 51% in 2004). Recent projections suggest that, further reforms should involve a raising of the age of retirement by about two or three years between now and 2050.

The 2005 reform of the earnings related scheme aims at discouraging early retirement. One element of the reforms introduced flexible retirement between the ages of 62 and 68, accompanied by higher accrual rates for later years of work, and an increase in the age of partial retirement. Moreover, for people born in 1944 or later, early retirement pensions will no longer be available before 62, with stronger incentives to postpone retirement until 63.[36] The reform also introduced a reduction of the lower age threshold for the accrual of pension rights (from 23 to 18 years), a gradual abolition of the

[36] A 0.6 % reduction for early retirement will be made in the pension for each month before the age of 63.

unemployment pension scheme and, finally, the abolition of the individual early (disability) pension scheme.

From the 1st January 2005, benefits are calculated on the basis of incomes received during the whole professional career and the integration of pensions (the previous 60% ceiling) is abolished, making work increase the amount of pension at all times. In addition, one of the innovations of the last reform consists of a mechanism for taking into account the future rises in life expectancy by the introduction of a life expectancy coefficient. It will begin to affect the level of pensions from 2010 (it should be about 95% in 2020 and 90% in 2040), while the effects of strengthened incentives to retire later are expected to emerge more quickly.

According to the ISG 2005 projections, net replacement rate levels are projected to remain roughly stable for a worker retiring at 65 after 40 years at the average wage, at a level of 63% in 2005 (gross 57%) to 62% in 2050 (gross 52%). As a result of reforms adopted, the replacement rate is projected to decline for a career with high wage progression, due to the extension of the calculation on pensions on a whole career (from 61% to 53% for progressively high earners). The level of the replacement rate is also projected to decline for a worker retiring at 65 after 40 years at 2 thirds of the average wage (from 74% in 2005 to 67% in 2050).

The recent reforms of the pension system should significantly reduce the pressure of an increase in pension expenditure in relation to GDP. Finland is expected to face relatively strong pressure in its public finances due to an ageing population and the resulting growing age-related public expenditure. According to projections made by the AWG in 2005, public spending on pensions is expected to increase by a further 3.0 p.p. of GDP by 2050. All increase in pension expenditure will occur between 2004 and 2030, peaking at 14% of GDP in 2033 and thereafter slightly decreasing. Total age-related expenditure is projected to increase from 23.7% to 27.0% over the period of 2004-2050, being dominated by the pension spending.

Contributions to private sector pension schemes are projected to rise by about 6 p.p. by the 2030s from today's 21.6 per cent and then remain stable (this corresponds to about half what was projected before the pension reform which will significantly reduce pressure to raise pension contributions in the private sector). Moreover, the partial funding of all earnings-related pensions will reduce future pressure to increase contributions as half of the projected rise in the pension expenditure is expected to be financed through the return from the funds.

Finland has so far succeeded in adapting its system to the development of its society. The succession of reforms has, on the one hand, made the legislation more complex, but, on the other it has provided an opportunity to streamline the system and bring various schemes closer to each other. One issue under discussion is the consolidation (planned for 2007) of pension schemes which should contribute to a gradual harmonization of the principles of internal operation of the various arrangements.

3 CONCLUSION

With the 2005 reforms Finland has made significant progress in meeting the challenge of creating financial sustainability in its pension system, whilst ensuring adequate levels of pensions and simultaneously adjusting its system to changing societal circumstances, in particular through an adjustment mechanism of pensions to increases in life expectancy. In the long run the last reforms imply a raising of the retirement age by about two or three years between now and 2050.

Finland has developed a strategy of accumulation of surpluses both in the private and public sector (in total, the assets of social security pension schemes account to 59% of

GDP in 2004). However, it is expected that a further increase in the contribution rate will be needed in the statutory scheme for the private sector. This strategy hinges critically on economic and productivity growth as well as on rising employment rates which will have to contribute to maintaining surpluses in general government finances and to accumulating pension reserves.

4. BACKGROUND STATISTICS

	FI			EU25		
Adequacy						
Current situation						
	Total	Men	Women	Total	Men	Women
At-risk-of-poverty rate [1]	11	11	11	16	15	17
0-64	10	10	10	16	16	17
65+	17	11	20	18	15	20
75+	25	15	30	Nd	Nd	Nd
Income inequality [1]						
0-64	3.6					
65+	2.8					
Income of people aged 65+ as a ratio of income of people aged 0-64 [1]	0.75	0.81	0.72			
Median pensions relative to median earnings [2]	0,64	0,67	0,63			
Long-term projections						
Theoretical replacement rates[3]	2005	2030	2050			
Total net replacement rate	63	66	62			
Total gross replacement rate	57	57	52			
Gross repl. rate 1st pillar	57	57	52			
Gross repl. rate 2nd/3rd pillar	*	*	*			
Financial sustainability						
Current situation						
ESSPROS Pension expenditure [4], % of GDP	***1995***	2000	***2003***	***1995***	2000	***2003***
	12.7	10.7	11.4		12.5	12.6
Employment (2004) [5]	Total	Men	Women	Total	Men	Women
Employment rate ***(25-54)***	81.0	83.8	78.2	76.8	85.2	68.5
Employment rate (55-64)	50.9	51.4	50.4	41.0	50.7	31.7
Effective labour market exit age (2004) [6]	60.5	60.2	60.8	60.7p	60.9	60.4p
Public finances (2003) [7]						
Public debt, % of GDP	45,6			63,3		
Budget balance, % of GDP	2,3			-2,8		

Long-term projections (EPC 2006)	FI				EU25			
	Level			increase 2004-50	Level			increase 2004-50
	2004	2030	2050		2004	2030	2050	
Old-age dependency ratio [8]	23,3	46,9	46,7	+100%	25	40	52	+108%
Public pensions expenditure, % of GDP [9]	10.7	14.0	13.7	+3.1	10,6	11,9	12,8	+2,2
Factors determining the evolution of public pensions expenditure (2000-2050) [10]	Contribution to change in percentage points of GDP				Contribution to change in percentage points of GDP			
Demographic dependency	8,8				8,6			
Employment	-0,9				-1,1			
Eligibility	-3,1				-2,1			
Level of benefits	-0,9				-2,7			
Total (including residual)	3,3				2,2			

Notes:
1. Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, Income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).
2. Source: Eurostat. Median individual pension income of retirees aged 65-74 in relation to median earnings of employed persons aged 50-59 excluding social benefits other than pensions.
3. Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first and second pillar pension schemes, retiring at the age of 65 years in 2005.
4. Source: ESSPROS, EUROSTAT. Includes expenditure by certain private social protection schemes.
5. Source: European Labour Force Survey, 2004.
6. Source: European Labour Force Survey, 2004.
7. Source: European Commission, DG ECFIN.
8. Source: EUROSTAT (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15-64.
9. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.
10. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.

* proportion negligible

SWEDEN

1 MAIN CHARACTERISTICS OF THE PENSIONS SYSTEM

The **statutory pension scheme** is earnings related and draws all its financing from social security contributions (separated from the budget of the State), which are planned to be kept constant at 18.5% of pensionable earnings. The guarantee pension and survivors' pensions are covered by general taxes and disability pensions by the sickness insurance scheme.

Out of the 18.5% contribution rate until a social insurance ceiling, 16 p.p. are financing pensions on a pay-as-you-go basis through the mechanism of notional accounts: contributions are capitalized at a given interest rate into a hypothetical retirement capital (this capitalization path follows income growth, while the indexation of pensions in payment more or less follows income growth, i.e. income growth minus 1.6%). The remaining 2.5 p.p. are invested in one or more funds selected by the member (so called *premium pension*). At the time of retirement, the hypothetical retirement capital is converted into a pension, the amount of which depends primarily on the current level of remaining life expectancy. The capital accumulated under the *premium pension* can be either paid out from the pension fund or transferred into an annuity.

The earliest income-based pensions and premium pensions can be drawn is 61. The size of the annual pension will increase the later a person chooses to retire due to further earned pension rights during the additional working years and decreasing remaining life expectancy. Pension rights may be earned for an unlimited time, and no definite retirement age exists. Under the Employment Protection Act, an employee is entitled to stay on in employment until their 67th birthday. 25, 50, 75 or 100 per cent of the pension may be drawn. If the individual continues to work after beginning to draw the pension, additional pension rights are accrued irrespective of age.

Occupational schemes are primarily based on four large collective agreements, concluded by social partners. These agreements cover more than 90% of the employees. Contributions are paid by employers and range between 2% and 5% of wages in the defined contribution schemes, while in the defined benefit schemes they can be higher. There is a strong shift of the occupational schemes towards defined contribution arrangements. Occupational pension schemes usually provide an extra income amounting to approximately 10-15 % of a person's final salary. These contracts may also contain survivor's protection and sickness insurance in case of long-term illness.

Approximately 40% of the employed population are covered by **individual provisions**, which corresponded to approximately 5% of total pension expenditure in 2002. These individual pension insurance schemes are contracted on a voluntary basis and are fiscally deductible. The average amount contributed in 2003 corresponds to around 2.3% of the average annual gross wage. The importance of these private pensions has been rising continuously within the last 10 years. Typical products generally take the form of traditional life insurance or unit-link insurance.

The **old-age guarantee pension** provides a minimum pension for persons from the age of 65 years as a supplement to the statutory pension earnings related scheme (maximum amount after 40 years of residence in Sweden). It is financed by taxes, price-indexed and not reduced by wage income, capital income, occupational or private pension benefits. A new form of means tested support for the elderly people not entitled to the guarantee pension (especially immigrants) - maintenance support for the elderly - was introduced in

2003. Means tested housing allowances also supplement the incomes of numerous pensioners.

2 SITUATION AND PERSPECTIVES IN THE LIGHT OF THE COMMON OBJECTIVES

2.1 Current situation

Concerning **adequacy**, the earnings related scheme is based on the principle of actuarial neutrality: the accumulated assets from contributions paid during the whole professional life are transposed into an annuity at the time of retirement, taking into account life expectancy at retirement. In addition to this, the contribution account is also credited for some breaks in the professional life such as unemployment and parental leave. The employers' part of the pension contribution is financed by the state budget for such benefits. Furthermore, certain groups are credited with supplementary pension rights based on hypothetical incomes called pensionable amounts in order to benefit the insured for periods that can lead to a loss of income but should not do so. Pensionable amounts are given to parents of small children aged 0 to 4, for periods when sickness or activity compensation is received or studying (as well as time completing national military service). The entire contribution of 18.5%, in these cases, is paid out of the State budget.

In 2005 replacement rates were around 70% (68% gross and 71% net) for a 40 years career at the average wage, retiring at 65 (including both statutory pensions and occupational pensions). Occupational pensions are well developed and also expected to contribute to the maintenance of the standard of living after retirement. The Swedish pension system ensures adequate standards of living for men and women (the relative income of 65+ represents about 80% of the relative income of 0-64), even if differences persist according to the gender dimension (83% for men and 73% for women). The risk of poverty of the elderly people is maintained at a moderate level, close to for the overall population. Poverty rates among 65+ are 14% in 2003 at the 60% ceiling (9% for men and 18% for women).

Regarding **financial sustainability**, the defined-contribution principle of the new pension scheme limits the future increase in pension expenditure to the increase in the accumulation of pension contributions. Pension expenditure was at 12.7% of GDP in 2003, almost at the EU average. Moreover, the financial viability of the NDC pension system is guaranteed by the mechanism of automatic adjustment in case of imbalances and helped through the intermediate (buffer) fund created at the beginning of the 1960s. This fund is supposed to contribute to the long-term financing of the pension system. Its capital amounted to almost 30% of GDP in 2005. Other pension schemes assets, including occupational and individual schemes, represent around 67% of GDP for 2003.

The pension system allows a high degree of flexibility, both for the choice of the retirement age and also concerning the possibility of combining earned income and a total or partial pension. The rate of employment of older workers in Sweden is the highest in the EU25. While there is no fixed retirement age, early retirement is possible, however, on a pension which is actuarially neutral. While the pension system provides incentives to remain in work, the number of older workers on sick leave and on the receipt of disability benefits experienced a rapid growth; however, trends changed in 2003 and the number of people on sick leave has since decreased, albeit from a high level.

As for **modernisation**, the universal Swedish pension system ensures a great degree of flexibility, for instance, as regards different work patterns and flexible retirement possibilities, while providing effective incentives to work and equality between genders.

The Swedish reform builds on a broad political consensus and is accompanied by a will to improve the information for future recipients, who receive each year a statement of their pension capital and several forecasts of their future pension on the basis of certain assumptions (on the growth rate, the yield, the retirement age, etc). Within this framework, a broad pension Internet portal was set up in 2004, with the objective to make it possible for individuals to make a forecast of their future pensions (not only statutory, but also occupational and in the future also individual).

2.2 Outlook, reform measures and policy debates

The increase in the old-age dependency ratio is projected to be very slow, growing from a moderate 26% in 2003 by just 14 p.p. to 41% in 2050, in particular due to a fertility rate being among the highest in the EU.

Replacement rates at a given age are projected to decrease significantly in the coming decades. According to ISG calculations of theoretical replacement rates, for a worker retiring at 65 after 40 years of work, the net replacement rate would markedly decrease from 71% in 2005 to 57% in 2050 and the gross rate would go down from 68% in 2005 to 56% in 2050 (while the contributions from funded pillars remains the same). This will follow from the increase in life expectancy (i.e. increase in the time being spent in retirement) and the same assumption of 40 years in employment when the defined-contribution principle is pursued. Accordingly, cohorts who retire in 2050 would need to work for 44 years, up to the age of 69, in order to achieve the same replacement rate as those who retire in 2005.

Minimum social security pensions are indexed to prices; earnings-related pensions (both PAYG and funded part) are indexed to average wage growth. However, the indexation is front-loaded so that 1.6 per cent increase is given at the time of retirement, while later index adjustments are equal to the average wage growth minus 1.6 percentage points. That allows having a higher pension level at the beginning of the retirement period, which is considered to correspond better to the consumption pattern of pensioners during their whole retirement period. However, over time, this situation might cause an increase in the relative risk of poverty for older pensioners with a low earnings-related pension.

The contributions are notionally recorded on individual accounts and credited annually by a notional rate of return, which is equal to the increase of total wages. An automatic balancing mechanism has been introduced (slowing the indexation of the pension capital in case of imbalances), while the conversion of the notional retirement capital into a pension takes into account the life expectancy at the time of retirement, which neutralises an important factor of the increase in pension expenditure.

Sweden’s public pension system, independent from the State budget, is expected to face only low pressure due to the ageing populations. According to the budgetary projections made by the AWG in 2005, its current public spending on pensions (10.6% of GDP), is projected to increase to 2050 very slowly - only 0.6 p.p. (compared to 2.2 p.p. in EU15). The overall spending on age-related expenditures is projected to increase from 25.7% to 26.3% of GDP, over the same period.

Nevertheless, the maintenance of the employability and of the capacity of work is a key element of future adequacy and financial sustainability. At the present time, the government is trying to reabsorb the increase in sick leave by the implementation of a broad programme aiming at promoting health at work. The action plan comprises, in particular, measures to improve the work environment and to set out more clearly an employer's responsibilities. It also includes measures for a rapid return to work after recovery, commitments for greater accessibility to health care and medical treatment, as well

as a review of a patients' situation at least once every 3 years. In addition, the system of disability pensions has been re-examined and has been incorporated into the health insurance system. This reform aims at making the system more equitable, by facilitating the access to employment by distinguishing between activity compensation (for workers between 19 and 29 years) and sickness compensation (for those between 30 and 64 years). It provides, in particular, the possibility of access to rehabilitation measures and the possibility of combining employment and partial benefits.

Finally, under the new earnings-related pension scheme, financial risks related to longevity or the contribution base are borne by the pension recipients, while holding the contribution rate constant. A financial risk for the general budget could arise in respect of financing the guaranteed minimum pension, if a large number of people were unable to accrue sufficient earnings related pension rights.

3 Conclusions

Sweden has managed to create a public pension system which is adequate and financially stable in the future, as long as people compensate the significant decrease of replacement rates by a later exit from the labour market. Sweden ensured its financial sustainability by the development of a reserve fund at the beginning of the 1960s (amounting to almost 30% of GDP in 2005) and through a mechanism of automatic adjustment in case of imbalances.

The employment rate of older workers in Sweden is the highest in the EU25. The pension system allows a high degree of flexibility, both for the choice of the retirement age and also concerning the possibility of combining earned income and a total or partial pension. The transparency of the pension system and the pension information given to individuals should enable them to plan their professional life in order to ensure an appropriate pension and thus gives important incentives for a greater participation of older workers in the labour market. Nevertheless, general financial literacy in the field of pensions is not satisfactory, despite the information provision efforts.

Although actuarial neutrality in the system and possibilities for flexible retirement would keep people from retiring early, some channels of early exit from the labour market have tended to develop, in particular through sick leave and disability benefits. The government is addressing these developments and should monitor the outcome of the implemented measures.

4. BACKGROUND STATISTICS

	SE			EU25		
Adequacy						
Current situation						
	Total	Men	Women	Total	Men	Women
At-risk-of-poverty rate [1]	11	10	12	16	15	17
0-64	11	11	11	16	16	17
65+	14	9	18	18	15	20
75+	20	14	24	Nd	Nd	Nd
Income inequality [1]						
0-64	3,3					
65+	2,7					
Income of people aged 65+ as a ratio of income of people aged 0-64 [1]	0,77	0,83	0,73			
Median pensions relative to median earnings [2]	0,68	0,72	0,65			
Long-term projections						
Theoretical replacement rates[3]	2005	2030	2050			
Total net replacement rate	71	60	57			
Total gross replacement rate	68	58	56			
Gross repl. rate 1st pillar	53	43	40			
Gross repl. rate 2nd/3rd pillar	15	16	15			
Financial sustainability						
Current situation						
ESSPROS Pension expenditure [4], % of GDP	***1995***	2000	***2003***	***1995***	2000	***2003***
	12,8	11,7	12,7		12,5	12,6
Employment (2004) [5]	Total	Men	Women	Total	Men	Women
Employment rate ***(25-54)***	82,9	85,0	80,9	76,8	85,2	68,5
Employment rate (55-64)	69,1	71,2	67,0	41,0	50,7	31,7
Effective labour market exit age (2004)[6]	62,8	63,1	62,4	60,7p	60,9	60,4p
Public finances (2003) [7]						
Public debt, % of GDP	52,0			63,3		
Budget balance, % of GDP	0,3			-2,8		

Long-term projections (EPC 2006)

	SE Level 2004	SE Level 2030	SE Level 2050	SE increase 2004-50	EU25 Level 2004	EU25 Level 2030	EU25 Level 2050	EU25 increase 2004-50
Old-age dependency ratio [8]	26,4	38,4	40,9	+55%	25	40	52	+108%
Public pensions expenditure, % of GDP [9]	10.6	11.1	11.2	+0.6	10,6	11,9	12,8	+2,2

Factors determining the evolution of public pensions expenditure (2000-2050) [10]	SE: Contribution to change in percentage points of GDP	EU25: Contribution to change in percentage points of GDP
Demographic dependency	4,8	8,6
Employment	-0,6	-1,1
Eligibility	-0,2	-2,1
Level of benefits	-2,8	-2,7
Total (including residual)	0,9	2,2

Notes:

1. Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, Income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).
2. Source: Eurostat. Median individual pension income of retirees aged 65-74 in relation to median earnings of employed persons aged 50-59 excluding social benefits other than pensions.
3. Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first and second pillar pension schemes, retiring at the age of 65 years in 2005.
4. Source: ESSPROS, EUROSTAT. Includes expenditure by certain private social protection schemes.
5. Source: European Labour Force Survey, 2004.
6. Source: European Labour Force Survey, 2004.
7. Source: European Commission, DG ECFIN.
8. Source: EUROSTAT (2005), demographic projections. Number of people aged 65 and over as a percentage of people aged 15-64.
9. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, also including pension expenditures from the funded tier of statutory schemes), before taxes.
10. Source: Economic Policy Committee 2006. Public pension expenditure (including most public replacement incomes to people aged 55 or over, but not including pension expenditures from the funded tier of statutory schemes), before taxes.

* proportion negligible

THE UNITED KINGDOM

1. MAIN CHARACTERISTICS OF THE PENSION SYSTEM

In the UK, the **statutory State Pension** system consists of a flat-rate basic pension and an earnings-related additional pension, the State Second Pension that reformed the previous State Earnings-Related Pension Scheme (SERPS) (survivor's and disability pensions are also statutory). These two tiers of the first pillar are financed through earnings-related National Insurance contributions. In addition, earnings-related pensions of government sector employees are covered in part by State budgets. State Pension age is 65 for men and 60 for women but legislation is in place to equalise State Pension age at 65 by April 2020. A full flat-rate basic State Pension normally requires 44 qualifying years of National Insurance Contributions (which may include some National Insurance credits) for men and 39 qualifying years for women. State Pensions cannot be taken up before State Pension age, but may be deferred in return for a higher State Pension (10.4% increase per year of deferral) or a one-off lump sum with interest instead (annually at least 2% above the Bank of England base rate).

A unique feature of the UK pension system is the possibility to contract out of the additional State Pension. This requires coverage by an occupational or personal pension scheme providing equivalent or better benefits than the earnings-related component of the statutory scheme. 60% of the employed are in such contracted-out schemes and are entitled to a National Insurance contribution rebate.

The introduction of the **State Second Pension** (in 2002) enables people on lower earnings to build up their pension entitlements. People earning between the lower earnings limit (about £4,264 for 2005/6) and £12,100 (for 2005/6) will accrue pension rights as if they had earned £12,100. In addition, individuals are credited second pension rights for periods when they cannot work due to caring responsibilities or disability.

Pension Credit introduced in 2003 is an income-related benefit for people aged 60 or over. It is targeted at the least well off pensioners and the income test is more generous than for previous income-related benefits. Pension Credit provides, or contributes to, a minimum level of income of £109.45 for a single person or £167.05 for a couple. These amounts may be more for people who have caring responsibilities, are severely disabled or have certain housing costs.

Occupational pension schemes tend to be established by a single employer and were generally of the defined-benefit type, providing pensions based on years of service and final pay. However, the coverage of defined-benefit schemes is declining and most new schemes have taken the form of DC schemes.-[37]

Personal pensions were introduced in 1988 to offer a private second pension to people without access to an occupational scheme or who change jobs frequently (although Retirement Annuity Contracts, similar to personal provisions, were available prior to 1988). About 14% of the working age population have personal pensions (44% for self employed). To make private second pensions more attractive, **Stakeholder Pensions** were introduced in April 2001. This form of personal pension account was designed to provide an option for people with moderate incomes who do not have access to a company pension scheme. Stakeholder pensions must meet a number of minimum

[37] 'Occupational Pension Schemes 2004: The twelfth survey by the Government Actuary', published June 2005.

standards and in particular have low charges (maximum 1.5% of fund value per annum, reducing to 1% after 10 year's membership), and have the flexibility for participants to vary contributions or move between schemes without any financial penalty. About 1.37 million people contributed to stakeholder pensions in 2003/4.[38]

Around 40% of the working age population is contributing to an occupational or personal pension – about 60% of employees of working age - and over 2 thirds of pensioner households had income from a private pension scheme (72% had investment income from non-pension sources).

2. Situation and perspectives in light of common objectives

2.1 Current situation

Concerning **adequacy**, the median income of people aged 65 or more stands at about 74% of the income of those aged 0-64. The gross replacement rates for a worker at the average wage retiring at 65 after 40 years of contributions currently lies at 66% (82% net), 17% from the statutory scheme and 50% from the occupational scheme. This is based on the assumption that the person remains in the scheme for three quarters of their career and is contracted out of the State Second Pension for that time. For people with no private pension at all (only with a public State Second Pension) the gross replacement rate is 35% (47% net).

The poverty rate among elderly people in UK has declined in recent years, but remains above EU average. According to latest national figures, in 2003 the relative poverty rate (at the 60% of median income threshold) for people aged 65 and more was lying at 24% (30% for oldest people, aged 75 or more), at an higher level than the poverty risk for the 0-64 population of 17%. According to national figures, the poverty risk among persons aged 65 and more declined by about 5 percentage points from 1996/97 to 2002/2003. [39] However, these figures do not show the full effect of Pension Credit, introduced in October 2003, and which is expected to lead to a further fall in pension poverty in 2004-2005 at a time when earnings of the working age population have increased rapidly.

Concerning **sustainability**, the employment rate of people aged 55-64 was 56% in 2004, which is significantly above the Lisbon targets, while the average age of effective labour market withdrawal is 62.9 for men and 61.4 for women in 2004. Among persons 50 to 69 year olds who retire before State Pension age, 49% give ill-health as a reason, 18% were offered financial terms to retire early or take voluntary redundancy and a further 18% were made redundant, dismissed or had no choice.[40] Moreover, those in receipt of private pension income were more likely to retire early.

Some measures were introduced to encourage the participation of older workers both before and after State Pension age, (in particular by providing back-to-work help through the New Deal 50 Plus) and tackling age discrimination. Incentives for continued or more flexible working have been strengthened and people may delay claiming their pension or even "de-retire" when they have claimed, and earn an increase pension later, or a generous lump

[38] HMRC data 2003/4.

[39] This decline is higher if one refers to the absolute poverty ceiling of 1996/97: the decline from 1996/97 to 2002/2003 amounts then to about 15 percentage points, corresponding to a reduction of the poverty risk of two thirds. According to other national sources, with incomes measured 'After Housing Costs', the relative poverty risk among elderly people above State Pension age declined by about 8% from 1996/97 to 2003/2004.

[40] *Factors affecting the labour market participation of older workers*, Department of Work and Pensions Research Report 200.

sum payment. In parallel, the simplification of tax incentives for pensions will introduce a single universal regime for tax-privileged pension savings. [41]

In view of the importance of private provision, the current diversity and complexity of private pension schemes poses particular challenges. Individuals are faced with a range of choices when they start or change employment. The large number of schemes raises issues of the feasibility of close supervision. A further notable development over the last decade has been the closure of employer sponsored defined benefit (DB) provision (The pensions Commission estimates 60% of DB schemes are closed to new members) which have been replaced with defined-contribution (DC) schemes. While the trend in total scheme membership is uncertain, average contributions to occupational DC schemes are lower than for DB schemes (according to the National Strategy Report, total contributions to DB schemes are broadly in the 17-20% range, whereas DC schemes are usually in the 7-9% range. The difference in contribution levels would suggest less generous occupational pensions for workers in the future.

The challenges posed for private pension provision by longer life expectancy, economic uncertainties and risk of inadequate management are currently being put on the political agenda. The establishment of a Pension Protection Fund (PPF) will provide increased security for the members of occupational pension schemes. The PPF started operating in April 2005 and will pay compensation (up to certain limits) to members of defined benefit schemes and the defined benefit part of hybrid schemes, where the employer becomes insolvent and the scheme is underfunded. For those scheme members who lost part of their defined benefit occupational pension prior to April 2005, who are within three years or above of their scheme pension age, the Government has introduced the Financial Assistance Scheme (FAS) with funding of £400 million, which will top up to a level broadly equivalent to 80% of the core pension benefits (to a maximum of £12,000 per year). Additionally, the new Pensions Regulator, established in April 2005 will take a pro-active approach to pension scheme management focussing on fraud, poor administration and underfunding. It can impose civil penalties and, where appropriate, prosecute those responsible through the criminal courts and contributes to providing information and assistance to some operators.

Concerning **modernisation**, the legislation is in place to equalise State Pension age at 65 by 2020. Relative living standards are on average slightly higher for men (76% for 65+ relative to 0-64) than for women (73%), and poverty risk remains higher for women (28% at the 60% threshold for 65+) than for men (23%).

The portability of pension rights will also be improved from April 2006 onwards by giving early leavers a right to a cash transfer to a new scheme after three months.

Adults (up to State Pension age) are being provided with individual State Pension forecasts, and employers are being encouraged to provide information to their workers on pension options and entitlements. The UK Government is developing a web-based retirement planner and an interactive website, covering work, savings and retirement planning, and is working with financial services to improve the range of information and guidance materials available, to the entire population, including those of school age.

[41] There will be two key thresholds in the new regime - the lifetime allowance, set initially at £1.5 million, rising to £1.8 million by 2009/10; and the annual allowance, set initially at £215,000, rising to £255,000 by 2009/10.

2.2 Outlook, reform measures and policy debates

The United Kingdom is expected to face similar demographic trends to most EU Member States, but the currently favourable situation protects it from the most urgent risks. The old-age dependency ratio, even if growing from 24% in 2003 to 45% in 2050, is still projected to be among the lowest in the EU.

Recent reforms should translate into improvements of **adequacy** of pensions, and in particular of the situation of the poorest pensioners. Continued increases in the take up rate of the Pension Credit should translate into further decreases of poverty rates among people aged 60 or more. Replacement rates at a given age are expected to remain constant for the coming decades for people contracting out, under the assumption of a contribution rate of 23.7% (18.7% employer and 5% employee), which is significantly higher than the current average contribution rates to occupational schemes. Currently, around 60% of employees contract out into occupational/private schemes For people who don't contract out of the State Second Pension the gross replacement rate is projected to decline from the current levels of 35% (47% net) to 25% in 2050 (41% net). A major challenge will then be to ensure that more people have access to, and make use of, opportunities to provide for a higher living standard after retirement.

Although the UK already meets the Lisbon and Stockholm employment targets (the employment rate of people aged 55-64 was 56% in 2004), there is still room for improvement. The UK Government has announced that it will make compulsory retirement ages in companies below age 65 unlawful, except where an employer can justify a lower age. Employers will also give due consideration to individuals who request the right to stay in employment beyond any state retirement age. The need for a 65 default retirement age in legislation will be reviewed in 2011.

The Incapacity Benefit (IB) Green Paper *Pathways to Work* (2002) set out a long-term strategy for encouraging and assisting people with health problems and disabilities to return to work. This strategy is critical to support older people, as 1.3 million of the 2.7 million people claiming IB in the UK are over 50. The UK Government recently announced proposals for reforming Incapacity Benefits. Pathways to Work pilots have been introduced, bringing together employment and health support for the first time and by October 2006 a third of all claimants will be able to receive the help available through Pathways.

Whereas adequacy of the basic State Pension had developed into a major challenge over the 1980s and 90s, future financial sustainability of the public pension system appears less challenging. The strategy for ensuring the financial **sustainability** of the whole pension system is to focus public pension expenditure on lower income groups and to encourage more pension provision to be funded by private savings.

UK State Pension spending is around 5% of GDP – and according to national sources is projected to remain broadly stable over the next 50 years.[42] Expenditure on State Pensions is expected to increase from £47 billion in 2001/2 to £54 billion in 2007/08 (real terms, 05/06 prices). According to the AWG projections of 2005, spending on public pensions, including public employees' pensions, will increase by 2 p.p. of GDP from 6.6 % of GDP in 2004 to reach 8.6% in 2050. On the basis of the current budgetary situation, the budgetary projections imply gross debt to increase from current 41% to 90% of GDP in 2050. Finally, financial sustainability of public pensions appears to be well under control, but depends to a larger extent than in other countries on the performance of private pension providers. If private pensions decline from their current and anticipated levels, future governments may face increased claims of income-tested

[42] Source: Annex A, HM Treasury's Budget Report published alongside the Pre-Budget Report 2005.

benefits.

In October 2004, a government-commissioned report on the future adequacy of pensions was released. The 'Independent Pensions Commission' chaired by Adair Turner indicated that "unless new government initiatives can make a major difference to behaviour, it is unlikely that the present voluntary private system combined with the present state system will solve the problem of inadequate pension saving." (Pension's Commission Press release on 12/10/2004). According to this report total spending amounts to 9.9% of GDP, out of which 6.1% is public and 0.8% of GDP corresponds to public sector pensions. Spending for the later group seems to be dynamic and a reform process has been put in place, including a rise of the normal retirement age to 65. The UK government is seeking to address the issue of under-saving through its Informed Choice programme, which aims to maximise the take-up of work-based pensions and support people through education and information in making decisions about saving for their future.

3 CONCLUSION

Recent reforms of the State Second Pension and 'Pension Credit', the UK has improved state pension adequacy. Poverty rates have been declining in recent years and are expected to decline further once the full effect of Pension Credit appears.

While financial sustainability of state pensions appears to be under control and employment rate among older workers is already high, employment opportunities – full-time, part-time and flexible working hours– to help older people to stay in work as long as they wish can contribute to increase old age income.

A unique feature of the UK pension system is the possibility to contract out of the State Second Pension. Subsequently, the adequacy, as well as sustainability of pensions depends to a larger extent than in other countries on the coverage and performance of private pensions. In this respect, the UK should continue to address the major challenge of ensuring that people have access to, and make use of the provisions for a higher living standard after retirement. Extending the coverage and depth of pensions saving will be important to ensure adequate income replacement in the future.

The precise form of reform will be based on Pensions Commission's recommendations out of its second report at the end of 2005, advising in particular on whether there is a need of "moving beyond a voluntary approach". In this respect at lease three issues arise concerning future adequacy. The first is the impact of the shift to DC pension plans on the level of contributions to occupational schemes, secondly, how to ensure that people accommodate the rate of the basic State Pension through increases in other sources of retirement income, and thirdly how to continue to improve incentives to work later and save adequately.

4. BACKGROUND STATISTICS

	UK			EU25		
Adequacy						
Current situation						
	Total	Men	Women	Total	Men	Women
At-risk-of-poverty rate [1]	18	17	19	16	15	17
0-64	17	16	17	16	16	17
65+	24	21	27	18	15	20
75+	30	28	32	Nd	Nd	Nd
Income inequality [1]						
0-64	5,9					
65+	4,0					
Income of people aged 65+ as a ratio of income of people aged 0-64 [1]	0,74	0,76	0,73			
Median pensions relative to median earnings [2]	Nd	Nd	Nd			
Long-term projections						
Theoretical replacement rates[3]	2005	2030	2050			
Total net replacement rate	82	84	85			
Total gross replacement rate	66	68	69			
Gross repl. rate 1st pillar	17	18	19			
Gross repl. rate 2nd/3rd pillar	50	50	50			
Financial sustainability						
Current situation						
ESSPROS Pension expenditure [4], % of GDP	***1995***	2000	***2003***	***1995***	2000	***2003***
	11,9	12,2	11,0		12,5	12,6
Employment (2004) [5]	Total	Men	Women	Total	Men	Women
Employment rate ***(25-54)***	80,8	87,7	74,2	76,8	85,2	68,5
Employment rate (55-64)	56,2	65,7	47,0	41,0	50,7	31,7
Effective labour market exit age (2004)[6]	62,1	62,9	61,4	60,7p	60,9	60,4p
Public finances (2003) [7]						
Public debt, % of GDP	39,8			63,3		
Budget balance, % of GDP	-3,3			-2,8		

Long-term projections (EPC 2006)

	UK Level			UK increase	EU25 Level			EU25 increase
	2004	2030	2050	2004-50	2004	2030	2050	2004-50
Old-age dependency ratio [8]	24,3	41,3	45	+85%	25	40	52	+108%
Public pensions expenditure, % of GDP [9]	6.6	7.9	8.6	+2.0	10,6	11,9	12,8	+2,2

Factors determining the evolution of public pensions expenditure (2000-2050) [10]	UK: Contribution to change in percentage points of GDP	EU25: Contribution to change in percentage points of GDP
Demographic dependency	4,7	8,6
Employment	-0,1	-1,1
Eligibility	Nd	-2,1
Level of benefits	Nd	-2,7
Total (including residual)	1,9	2,2

Notes:
1. Source: Eurostat data collection 2005. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20. During the transition towards EU-SILC European harmonised income and living conditions data, it has been agreed to use indicators derived from national sources according to a common agreed methodology. While such indicators cannot be considered completely comparable due to the use of different surveys or reference year for income, every effort has been made to ensure the maximum comparability. It can be noted that 12 Member States already use EU-SILC surveys (BE, DK, EL, ES, FR, IE, IT, LU, AT, PT, FI, SE; SILC 2004, Income data 2003), while other Member States rely on national sources (income data 2003), apart MT (2000), CZ, DE and SK (2002).
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* proportion negligible