

# Demographic and financial issues for pensions in Europe

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European Commission

**Pension reforms in Europe: beyond parametric changes**

2<sup>nd</sup> Recwowe Executive Short Course

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# Outline

- **Background**
- Demographic prospects
- Economic effects of ageing populations
- Implications for pensions
- Overall budgetary effects of ageing populations
- Potential medium- and long-term impact of the economic crisis
- Concluding remarks



# Background

- Preparing the European Social Models to be apt for tomorrow is high on the EU's policy agenda
- Population ageing is a key challenge
- At the March 2001 Stockholm European Council EU leaders took initiatives to face the impact of ageing on the economy: a three-pronged strategy was agreed, based on
  - Raising employment rates and enhancing productivity
  - Reducing public debt at a fast pace
  - Reforming social security systems
- Challenge addressed by several initiatives at EU level:
  - the renewed Lisbon agenda
  - the Stability and Growth Pact (SGP) – reformed in 2005
  - the Open Method of Coordination on Social Protection and Social Inclusion
- Commission Communications on the Ageing Report and the Sustainability report in 2009

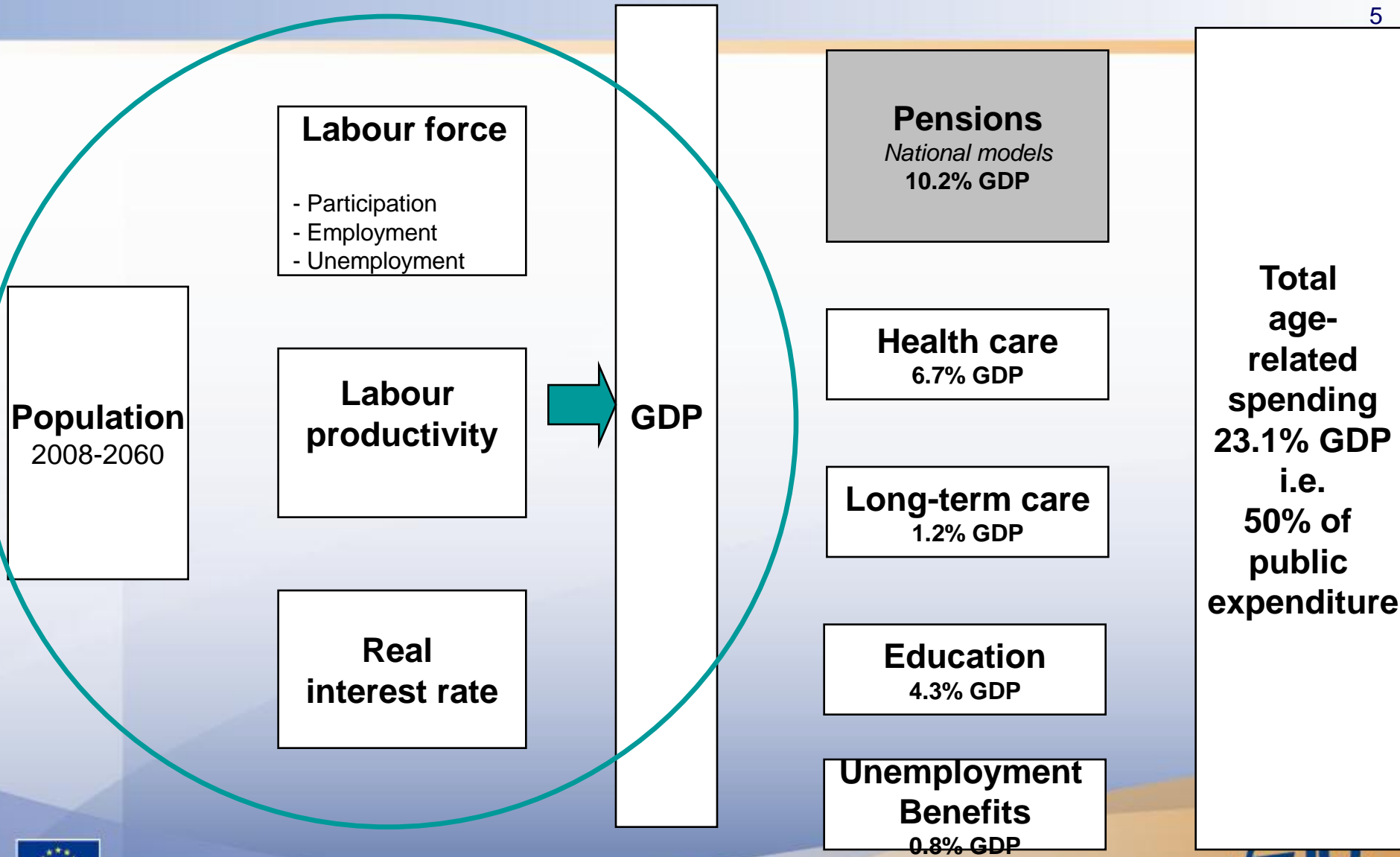


# A unique collaboration

- Projections at EU level for economic consequences of ageing and future public expenditure on pensions, health care, long-term care, education and unemployment transfers
- Joint project of the Member States – the Ageing Working Group (AWG) under the Economic Policy Committee (EPC) and the European Commission (DG ECFIN) to ensure comparability while reflecting the diversity of welfare systems accross Member States
- A special time of crisis: the Commission will continue to monitor the situation



# Overview of 2009 projection exercise



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# Main demographic indicators (EUROPOP2008)

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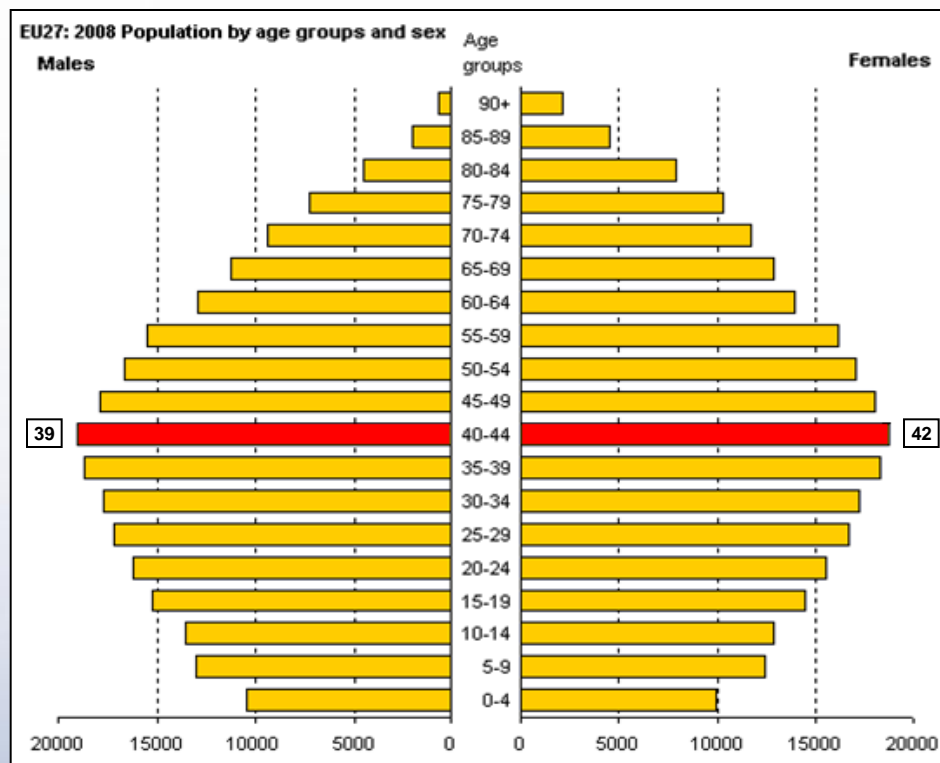
|   | EU15 |      | EU12 |      | EU27 |      |
|---|------|------|------|------|------|------|
|   | 2008 | 2060 | 2008 | 2060 | 2008 | 2060 |
| <b>Fertility rate</b>   | 1,6  | 1,7  | 1,4  | 1,5  | 1,5  | 1,6  |
| <b>Life expectancy at birth - men</b>   | 77,2 | 84,8 | 71,2 | 82,3 | 76,0 | 84,5 |
| <b>Life expectancy at birth - women</b>   | 82,6 | 89,1 | 79,0 | 87,6 | 82,1 | 89,0 |
| <b>Net migration flows (thousands)</b>  | 1647 | 750  | 37   | 54   | 1684 | 804  |
| <b>Net migration flows</b><br><i>(cumulated 2008-2060 as % of population in 2008)</i> | 14   |      | 4    |      | 12   |      |
| <b>Total population (millions)</b>  | 390  | 421  | 103  | 85   | 493  | 506  |
| <b>Old-age dependency ratio (65+/15-64)</b>   | 27   | 51   | 21   | 65   | 25   | 53   |



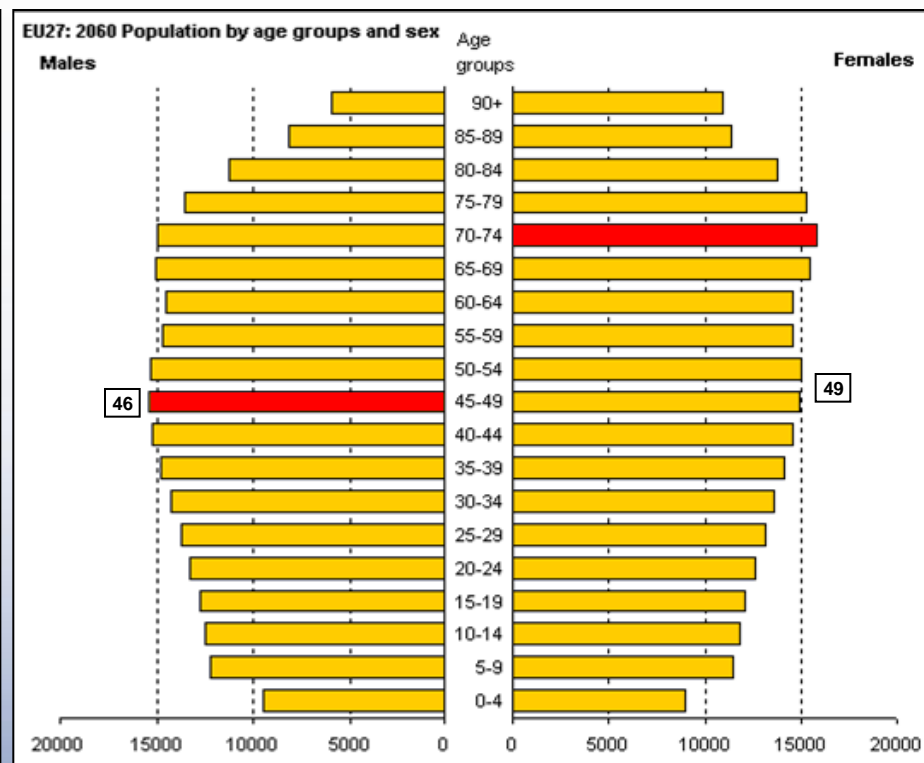
# Population projections: EUROPOP2008

## European Union

2008



2060



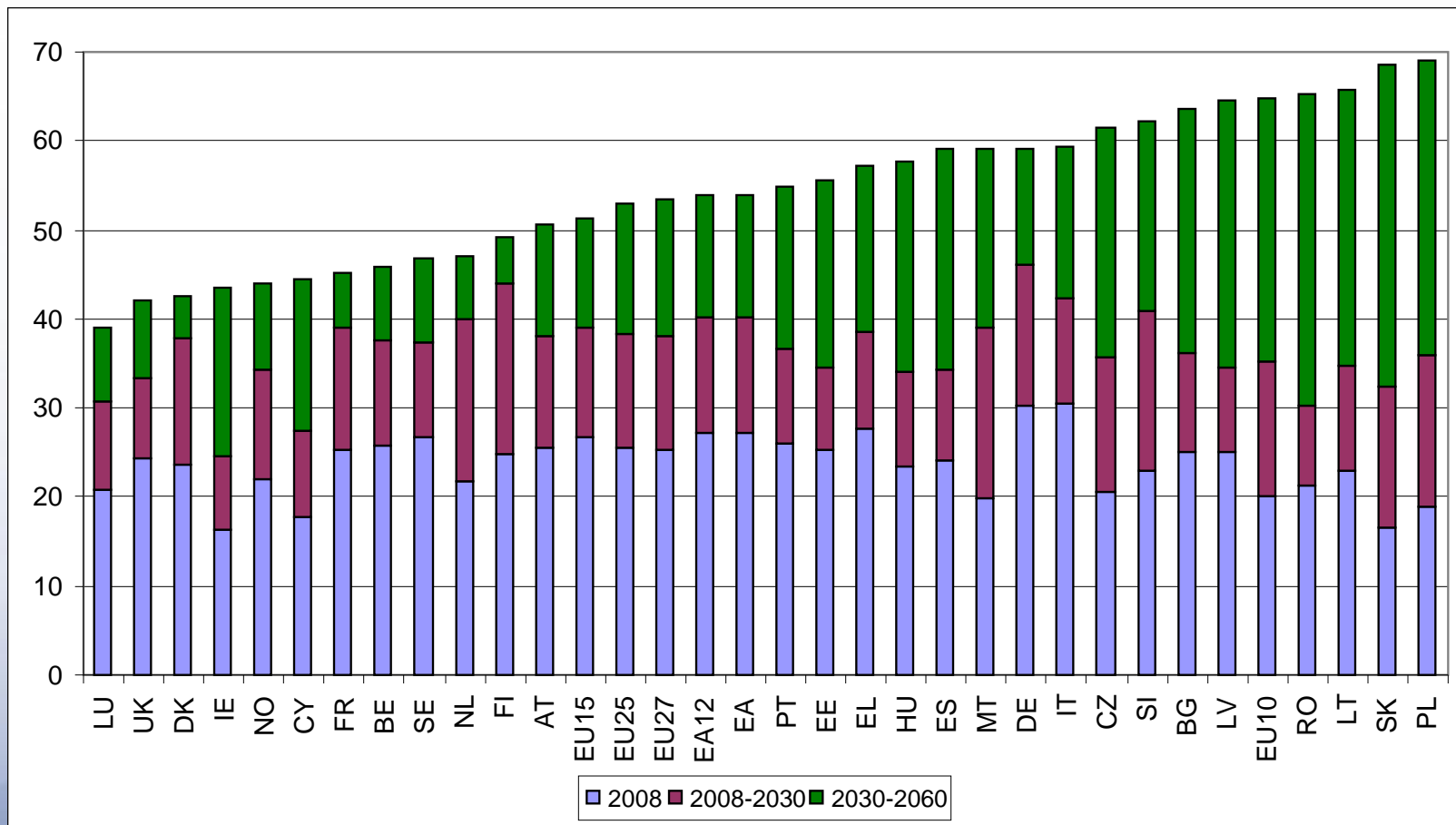
x Median age





# Population projections: EUROPOP2008

## Old-age dependency ratio (65+ / 15-64)



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# Labour force impact: the cohort approach

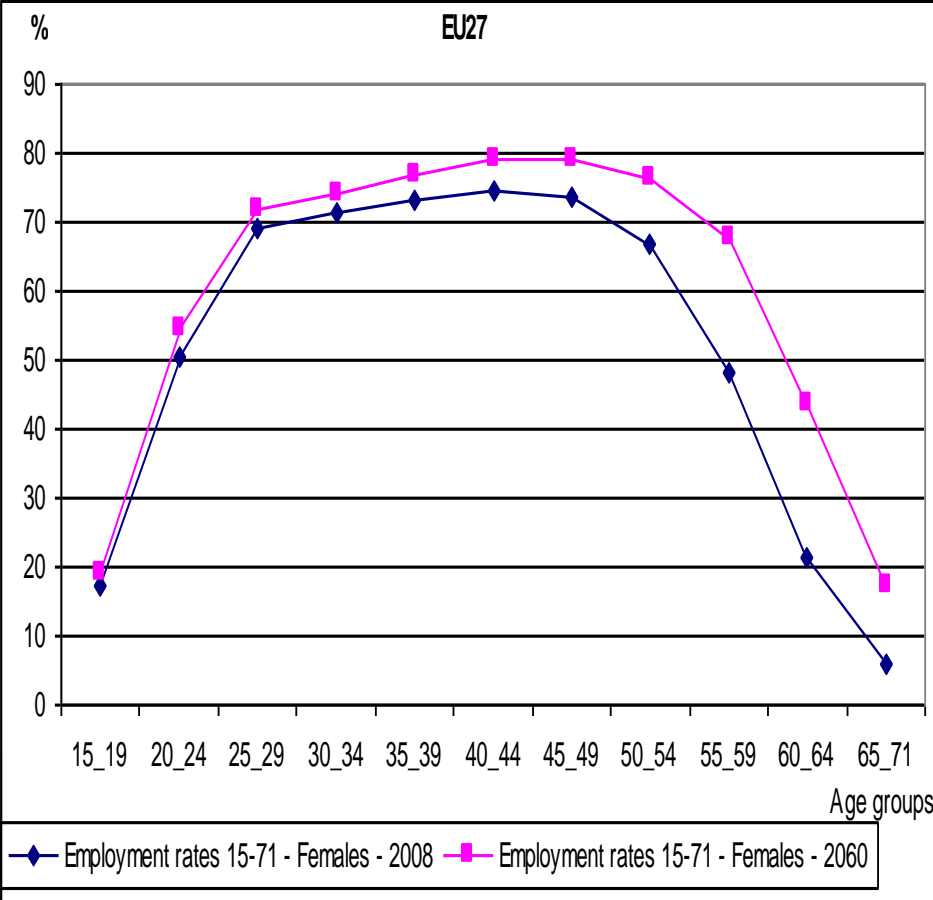
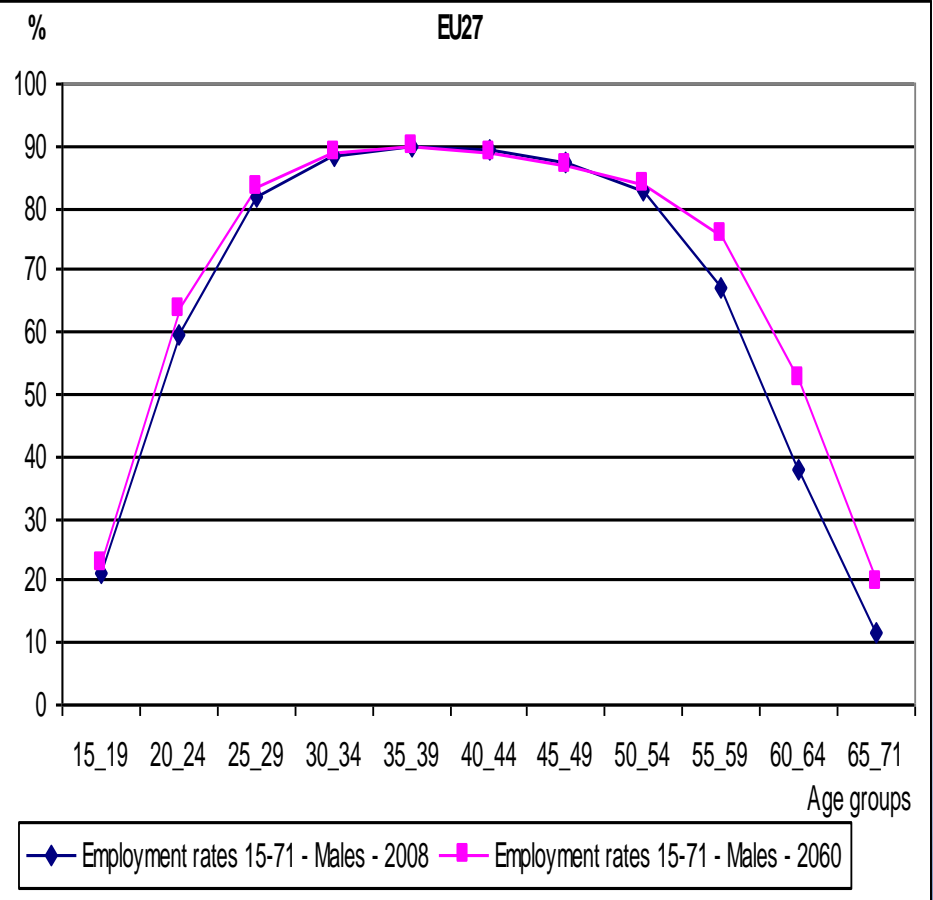
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Three main features of the methodology :

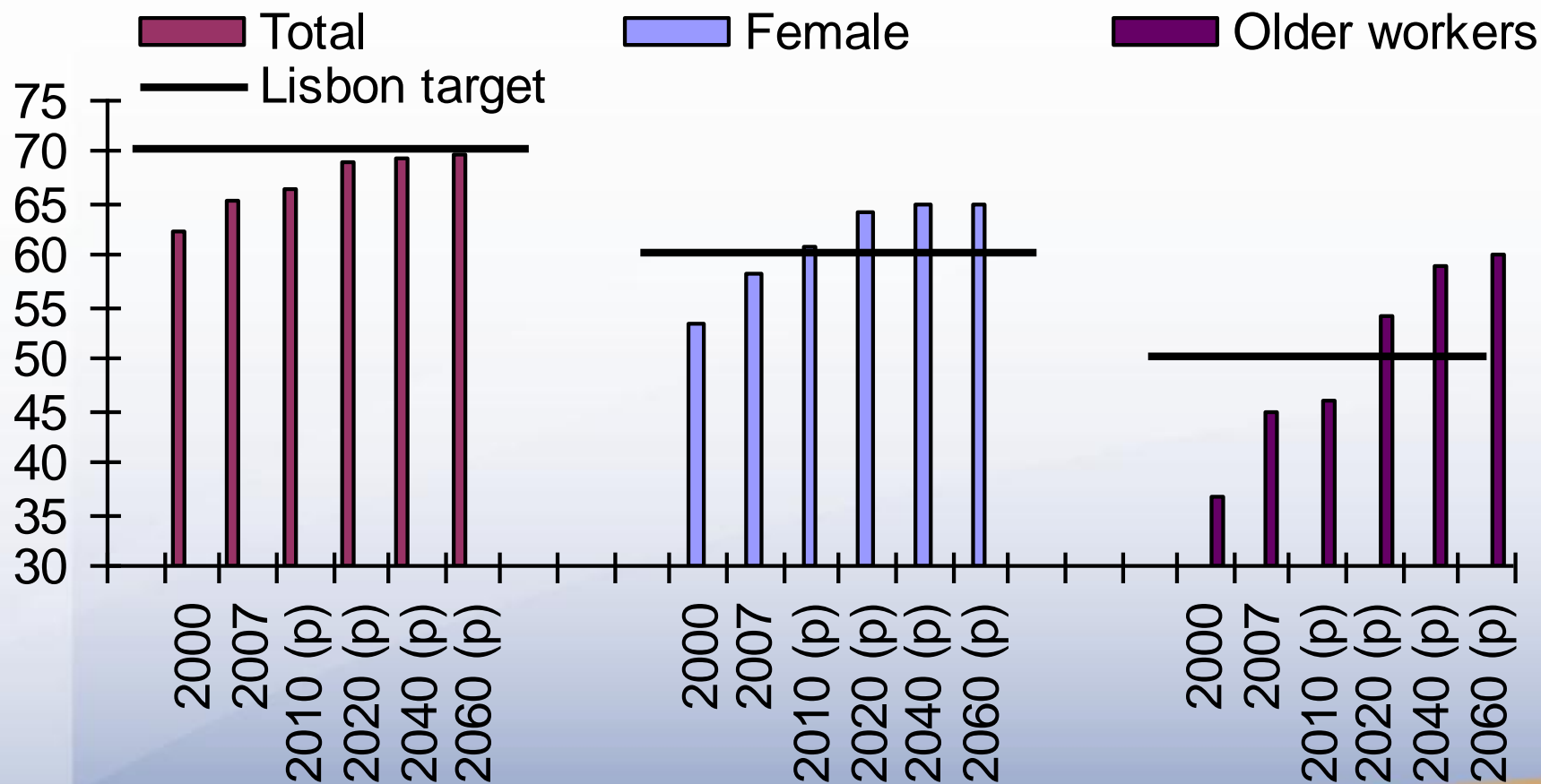
- 1) Use of entry rates and exit rates (based on average of participation rates over last ten years)
- 2) Participation rates are projected for each single year of age and gender
- 3) Incorporate the impact of pension reforms



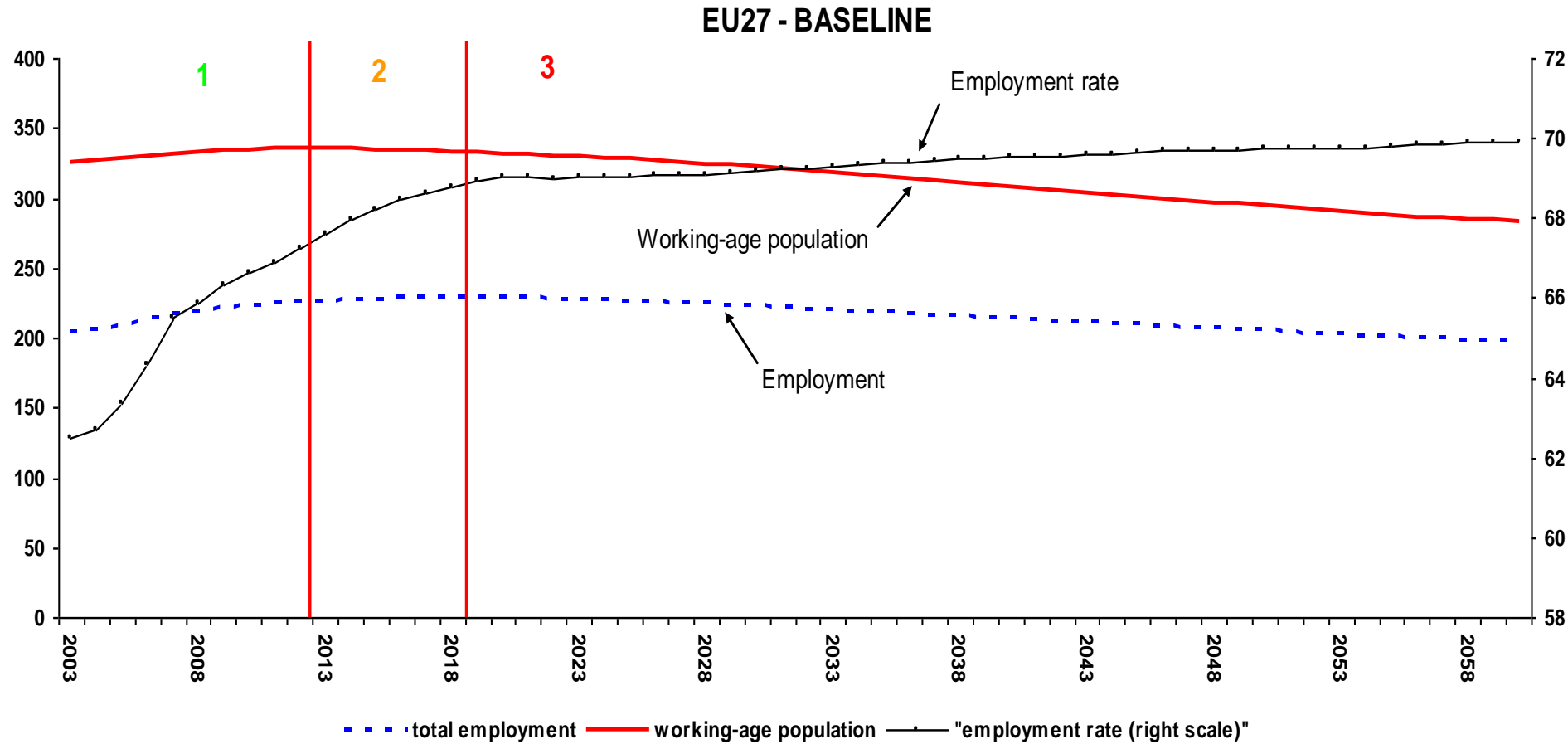
# Employment rates rise due to reforms and cohort effects



# Projected employment rates and the Lisbon targets



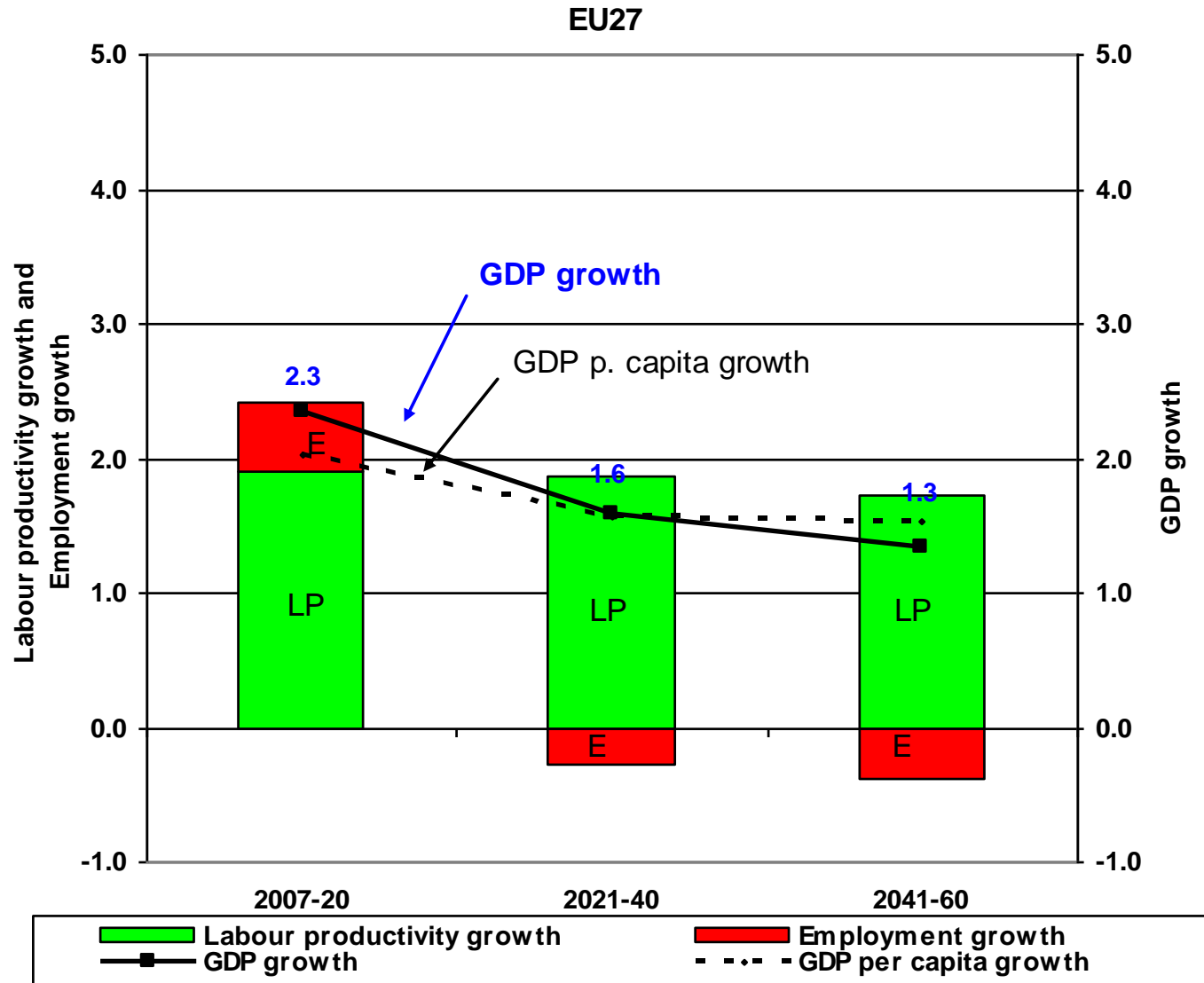
# The consequences of ageing populations on employment



# Potential growth rates decline

due to shrinking working age populations

Productivity becomes the dominant source of growth

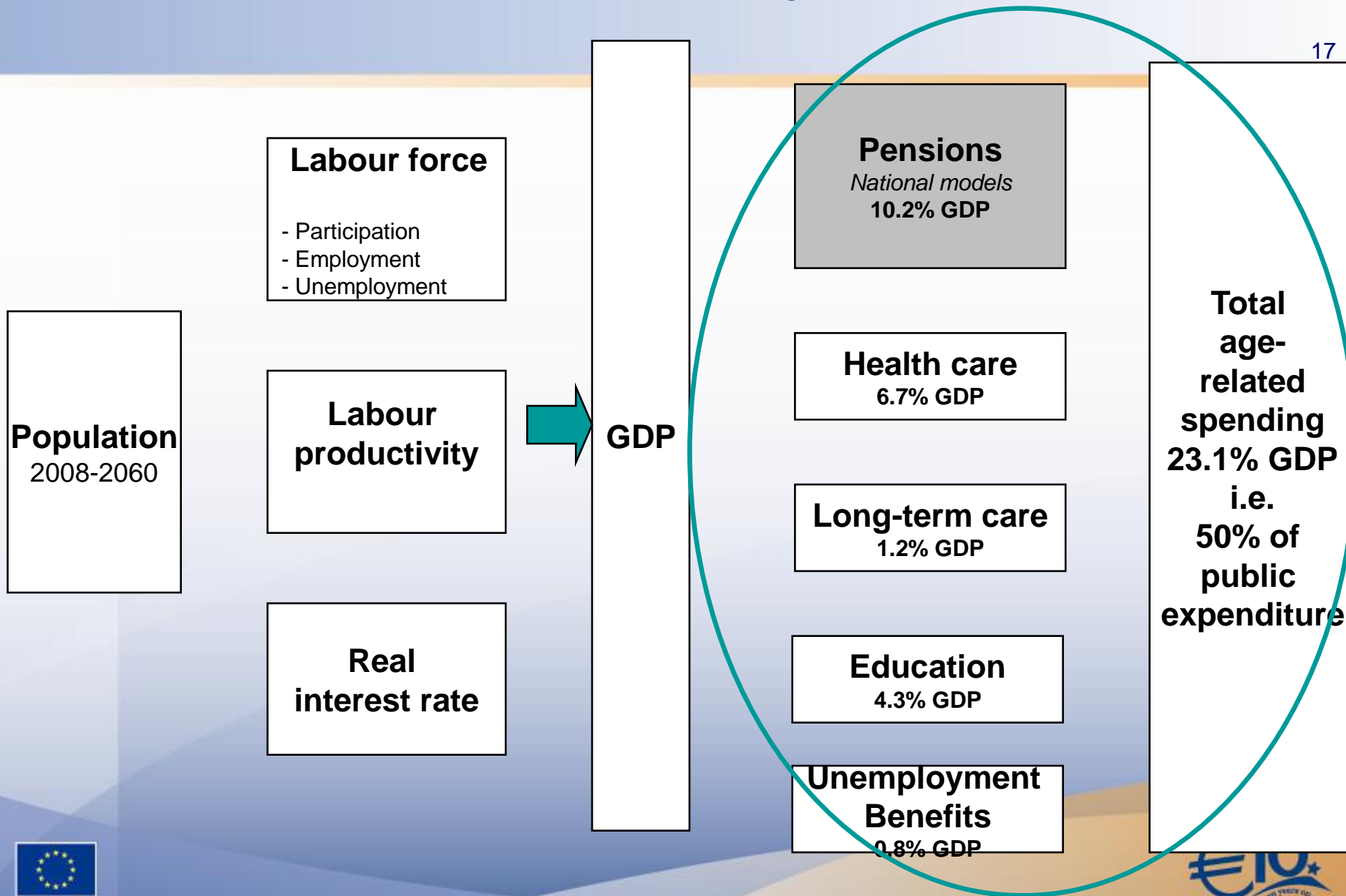


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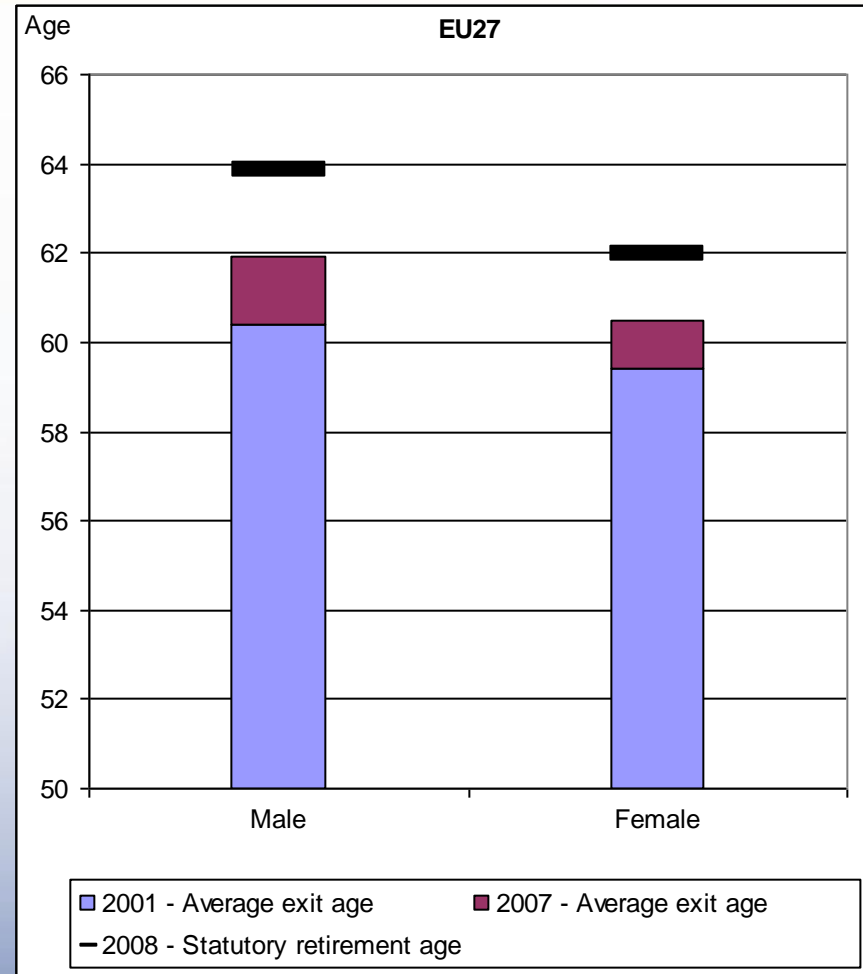


# Overview of 2009 projection exercise



# Retirement age: effective and statutory

- Exit age lower than statutory retirement age
- Prevalence of alternative exit pathways present
  - Early pensions
  - Other government spending schemes (unempl. benefit, disability, 'pre-pension, ...)
  - Private savings?



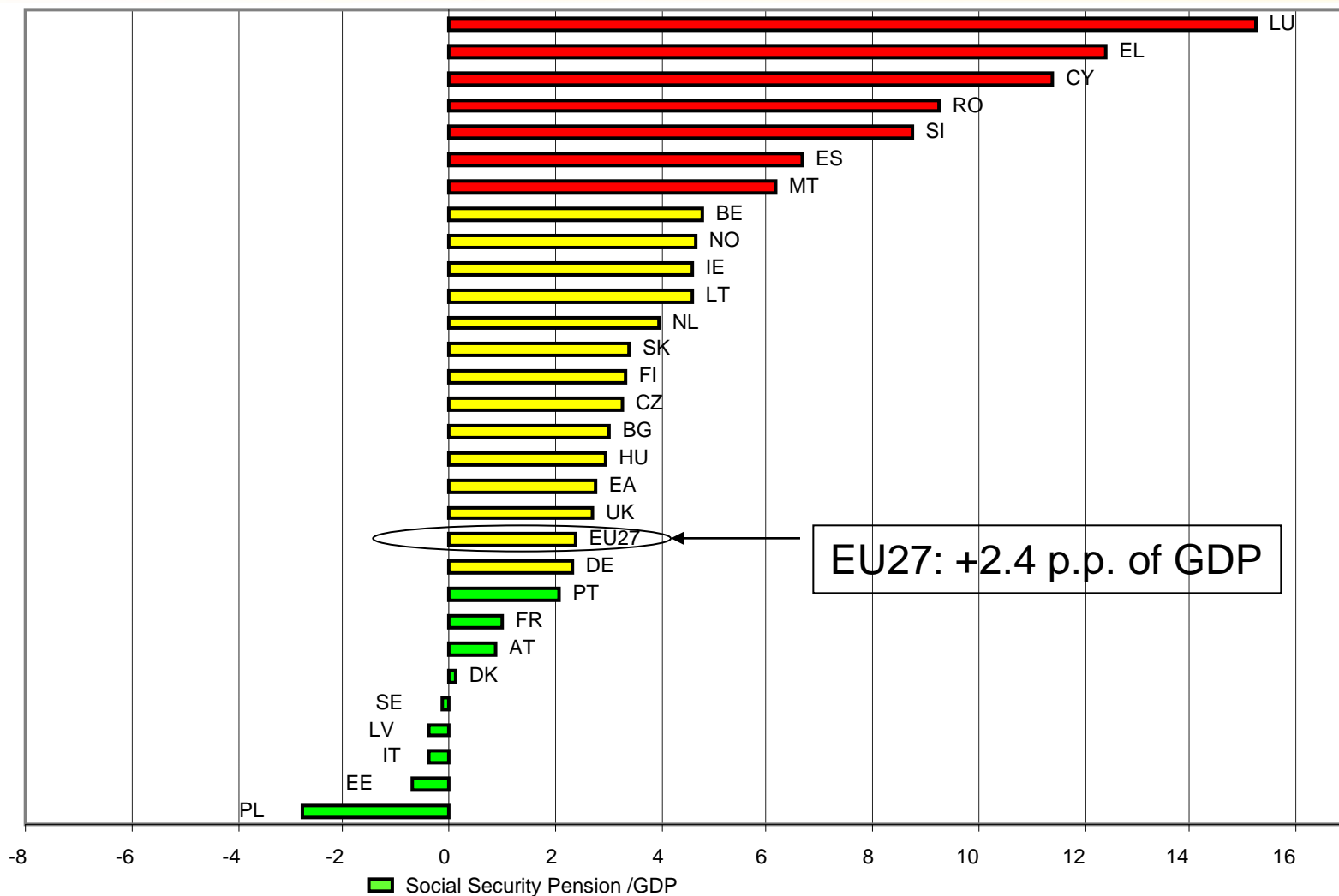
# Pension reform process

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- Large number of pension reforms over the last decade motivated by population ageing, and rising awareness of this challenge, supported at EU level by coordination processes
- Wide range of reforms measures adapted:
  - Eligibility criteria (age, available schemes)
  - Generosity (contributory periods, indexation, sustainability factors)
  - Incentive effects (hard and soft)
  - Additional pillars introduced (often with incentives)



# Projected changes in public pension expenditure (2007-2060 in percentage points)



# Decomposition of the increase in pension expenditure

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$$\frac{\text{PensExp}}{\text{GDP}} = \frac{\text{Dep. effect}}{\text{Pop}(15-64)} \times \frac{\text{Empl. effect}}{\text{EmplNo}}$$

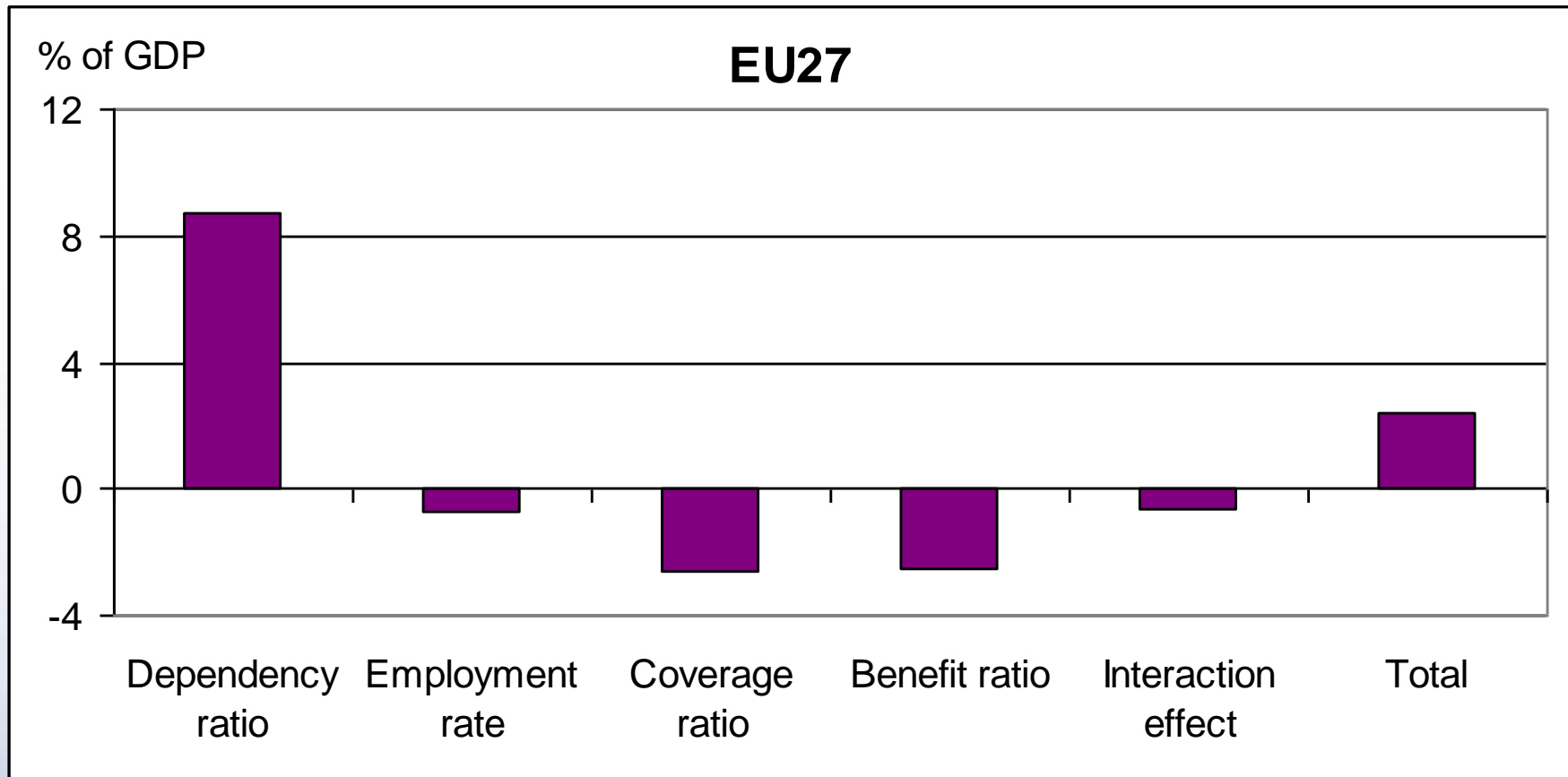
*Dep. effect*      *Empl. effect*

$$\times \frac{\text{Coverage effect}}{\text{Pop}>65} \times \frac{\text{Benefit effect}}{\text{GDP/EmplNo}}$$

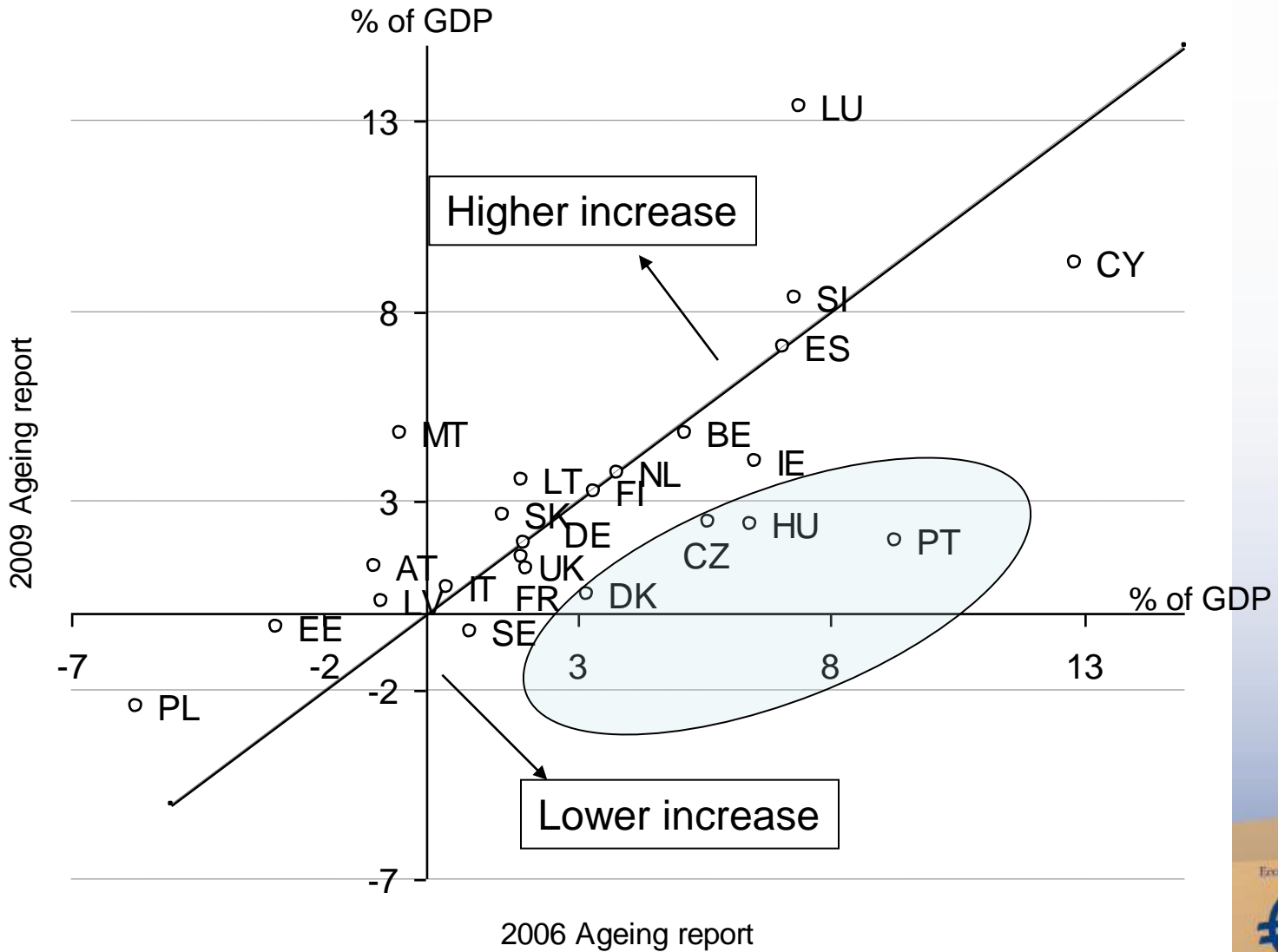
*Coverage effect*      *Benefit effect*



# Factors contributing to public pension expenditure changes (% of GDP)

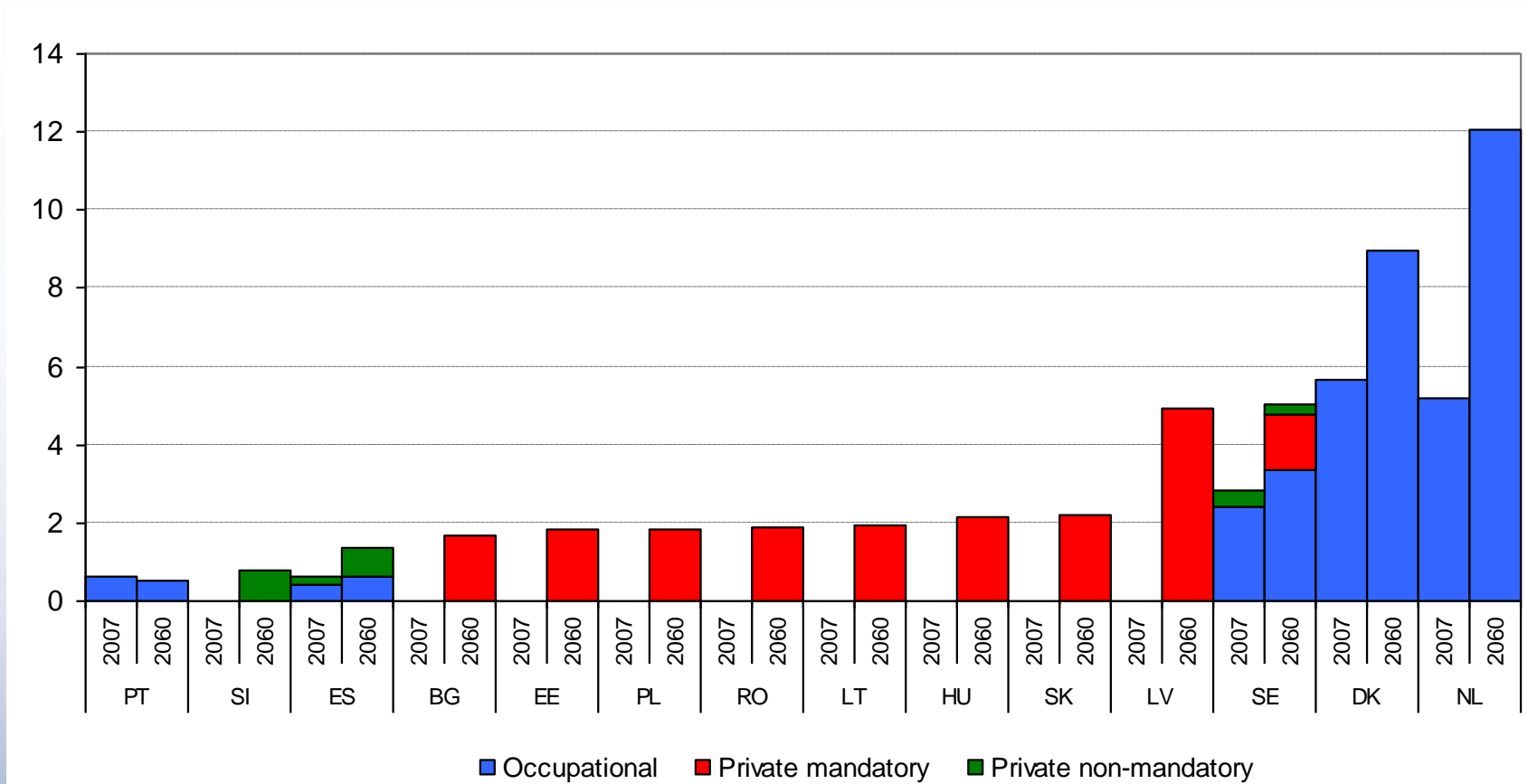


# Measuring overall reform progress: long-term projections compared



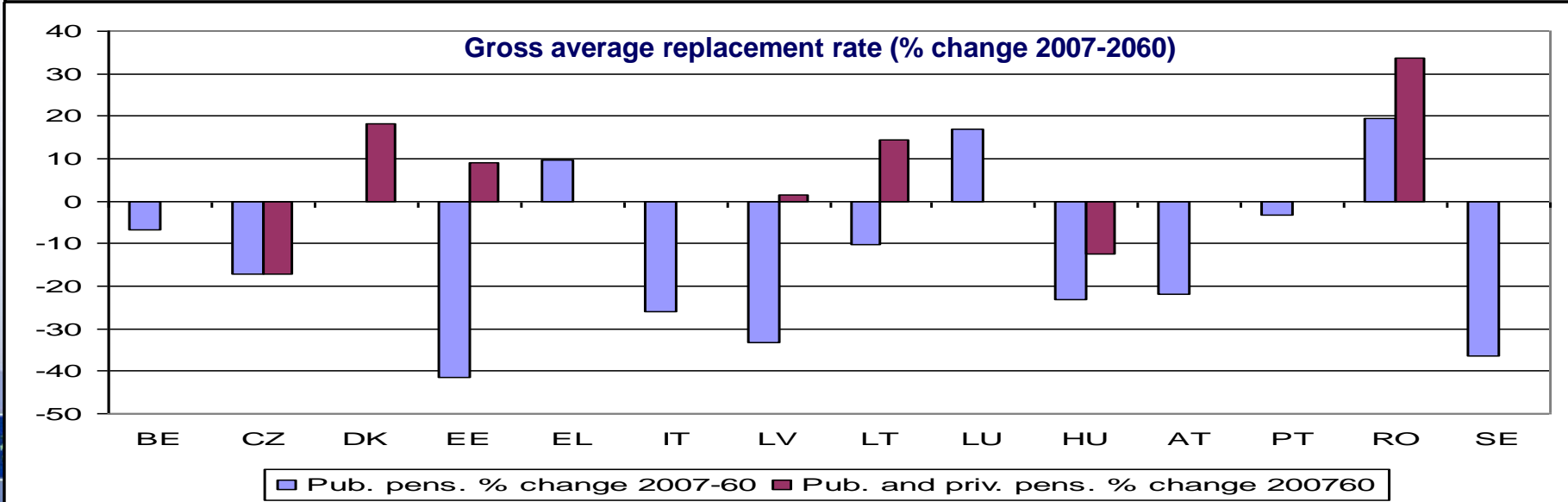
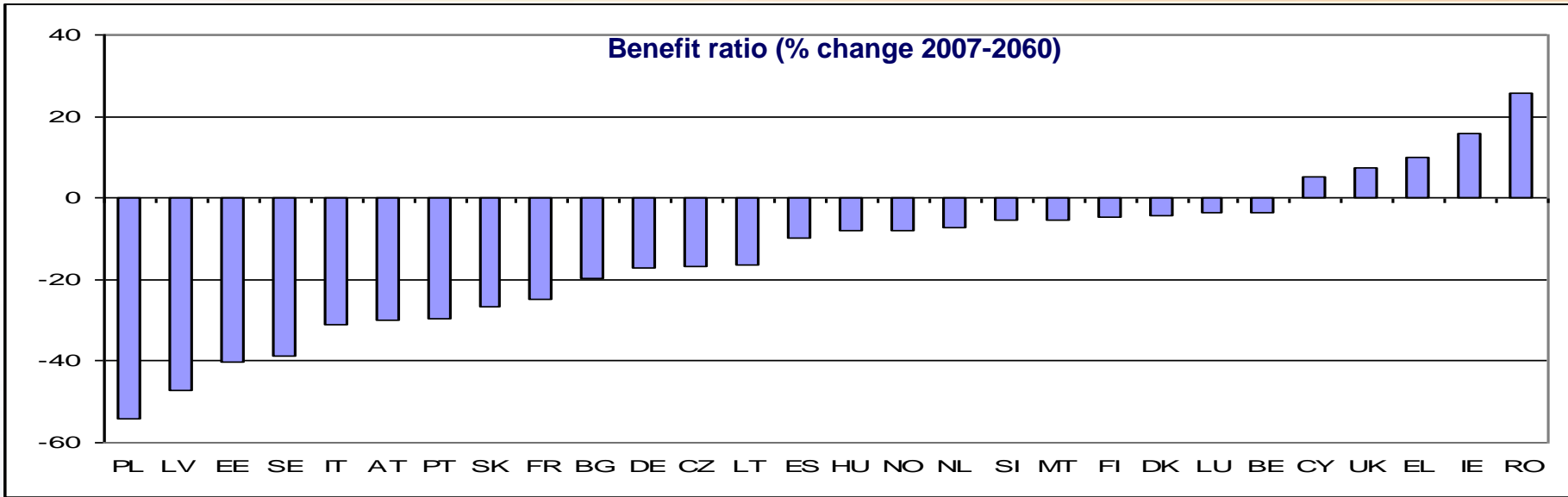
# Private pillars expected to contribute to retirement income in future

% of GDP





# Substantial reductions in the benefit ratio and the gross average replacement rates in several Member States



# Ageing or retirement problem?

| EU27   |      |      |       |      |
|--|------|------|-------|------|
|  | Men  |      | Women |      |
|  | 2008 | 2060 | 2008  | 2060 |
| <b>Employment rate of older workers</b>  | 54.5 | 64.2 | 36.6  | 55.7 |
| <b>Average exit age</b>  | 62.2 | 63.8 | 61.3  | 63.3 |
| <b>Life expectancy at the time of withdrawal</b>   | 13.9 | 20.7 | 20.8  | 25.7 |
| <b>% of adult life spent in retirement</b>   | 23%  | 30%  | 31%   | 35%  |
| <b>Requested exit postponement, in years (to keep % life spent in retirement constant)</b> |      | 4.9  |       | 2.8  |



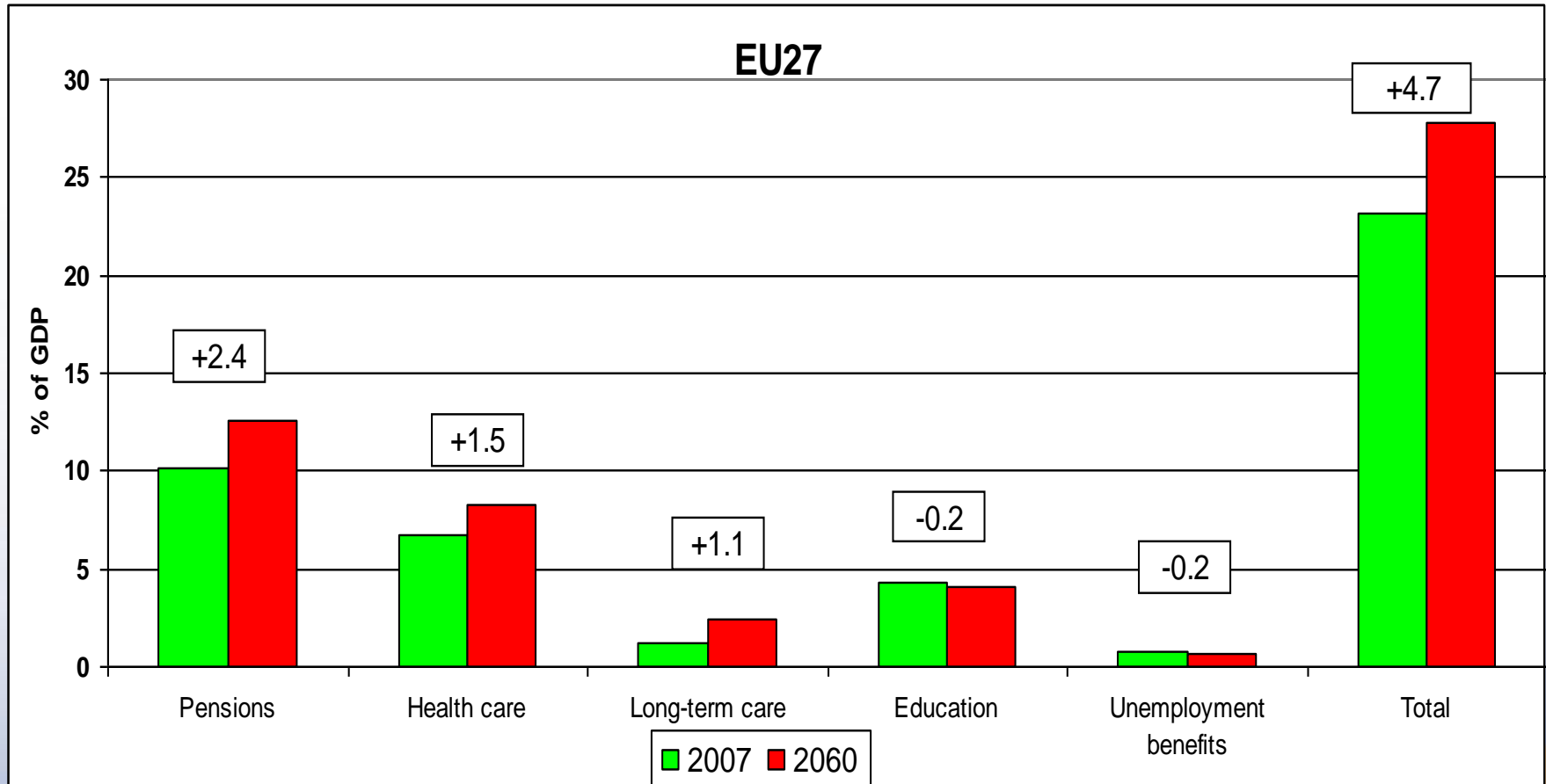
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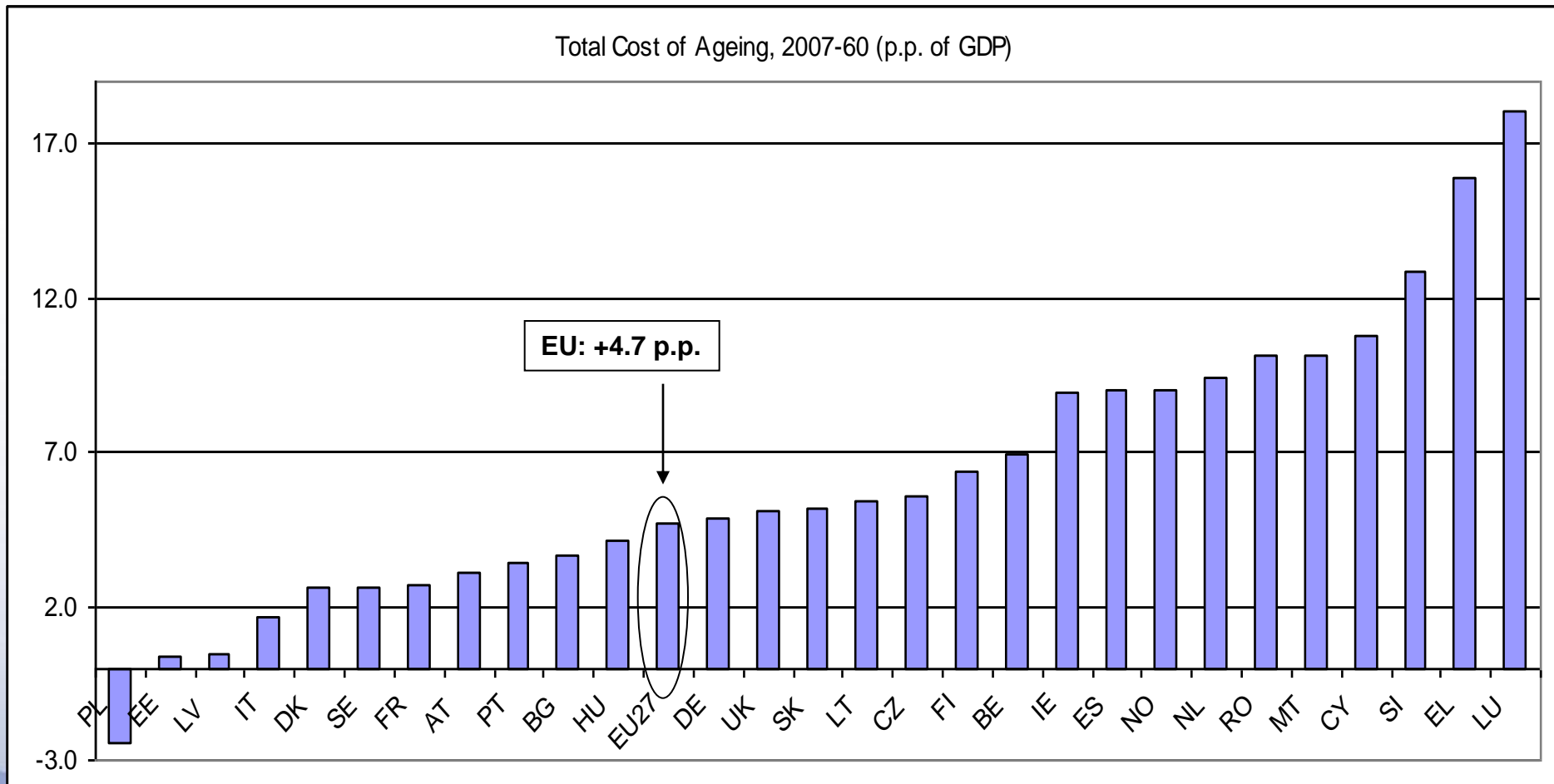
# The Cost of Ageing, EU27, components

(change in percentage points)

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# The Cost of Ageing, EU Member States, variety in the EU (change in percentage points)



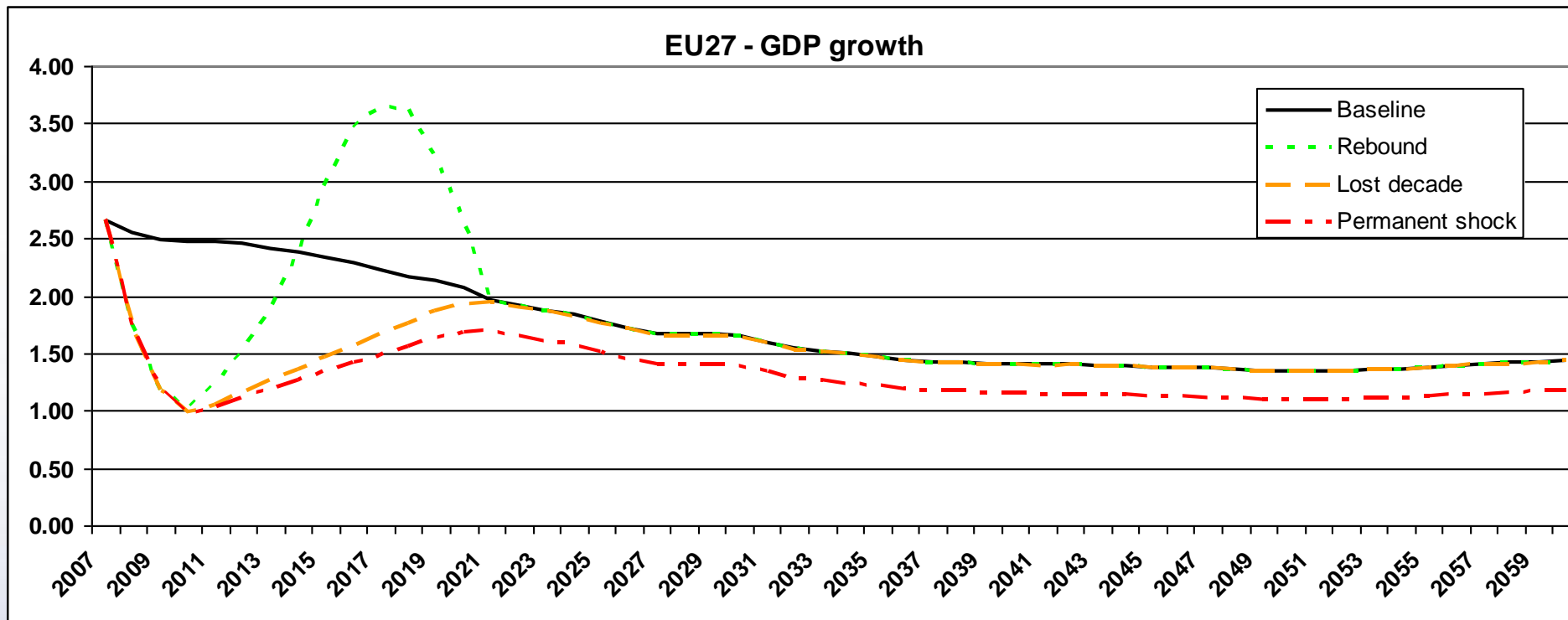
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# Crisis scenarios (1)

## potential GDP growth under different shocks

(European Commission Spring 2009 forecast)



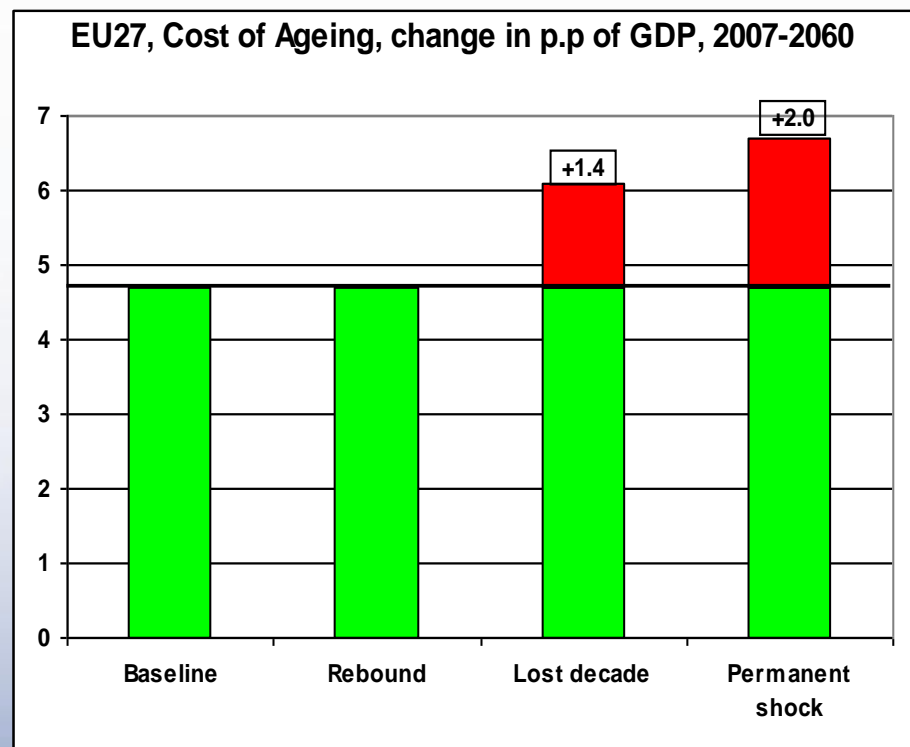
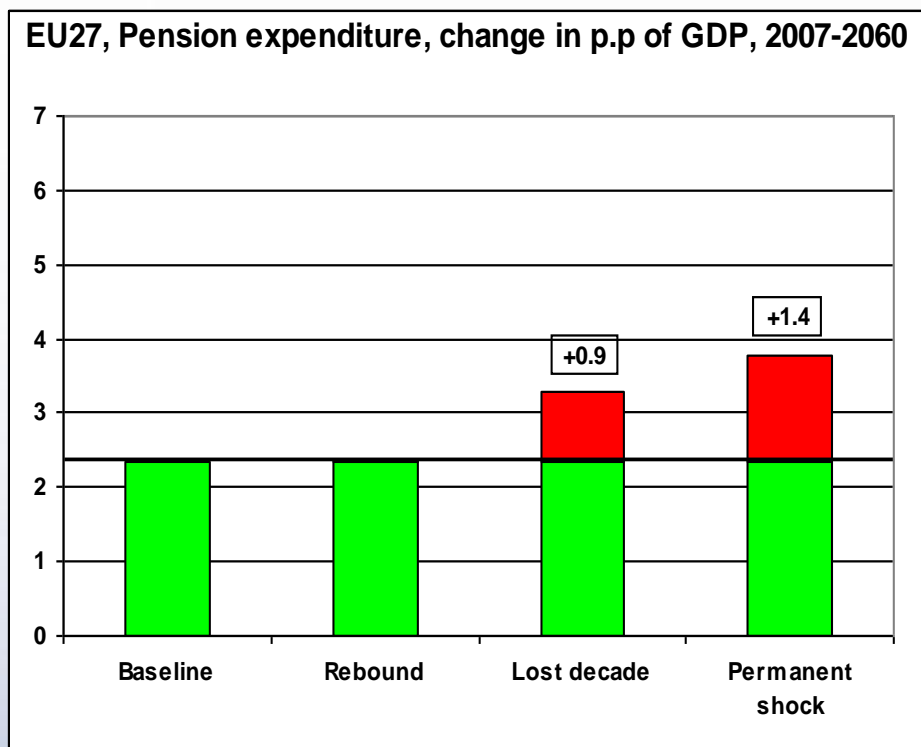
| EU27, GDP per capita, diff. from baseline (in %) |      |      |      |      |      |
|--|------|------|------|------|------|
|  | 2010 | 2015 | 2020 | 2040 | 2060 |
| Rebound  | -4   | -6   | 0    | 0    | 0    |
| Lost decade                                      | -4   | -9   | -11  | -11  | -11  |
| Permanent shock                                  | -4   | -9   | -12  | -16  | -20  |



# Crisis scenarios (2)

## pension & total expenditure under different shocks

(European Commission Spring 2009 forecast)





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# What do the latest projections tell us?

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- Demographic change in the coming decades – the transition to an older population - will exercise strong pressures for higher public spending in the EU
- Considerable policy action in reforming public pension programmes helps to offset this
- There are many cases of successful reforms, most recently PT, HU, CZ, DK
- But vigilance is called for as new challenges emerge... (issues of future pension levels, support from private pillars, ...)
- ...and not least concerning the organisation of health care and long-term care in the future



# Concluding remarks

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- **Europeans living longer than ever before**, and hopefully in good health, **is an enormous achievement** for societies and should not be seen as a threat
- **The EU is facing a retirement challenge and not an ageing challenge**, stemming from European social models of yesterday not being apt for tomorrow, affecting expectations and behaviour of the population
- **On pension policy**, reforms carried out suggest that **fiscal sustainability is within reach for many MS**, although **many still have a long way to go**
- The focus increasingly turns to **aligning public perception of retirement incomes and its composition in the future with what the reformed systems will deliver**, so as to **ensure lasting success of implemented reforms** and to **provide opportunities for people** to adjust and **shape their lives as pensioners**
- **A key challenge will be to extend working lives**, giving a double dividend: (i) higher living standards; and, (ii) progress towards sustainable public finances
- Moreover, the **transformation of the European social models** – not restricted to pension policy - **need to be intensified to support jobs and growth**
- **For the EU to swiftly get out of the crisis, a credible and coordinated exit strategy – building on structural reforms supporting durable growth – is necessary so as to restore confidence in the public finances**



The full report can be found at DG  
ECFINs website:

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[http://ec.europa.eu/economy\\_finance/  
publications/publication\\_summary149  
11\\_en.htm](http://ec.europa.eu/economy_finance/publications/publication_summary14911_en.htm)

***Thank you for your attention***

