



Pension Systems Facing Demographic Challenges in Europe and Central Asia

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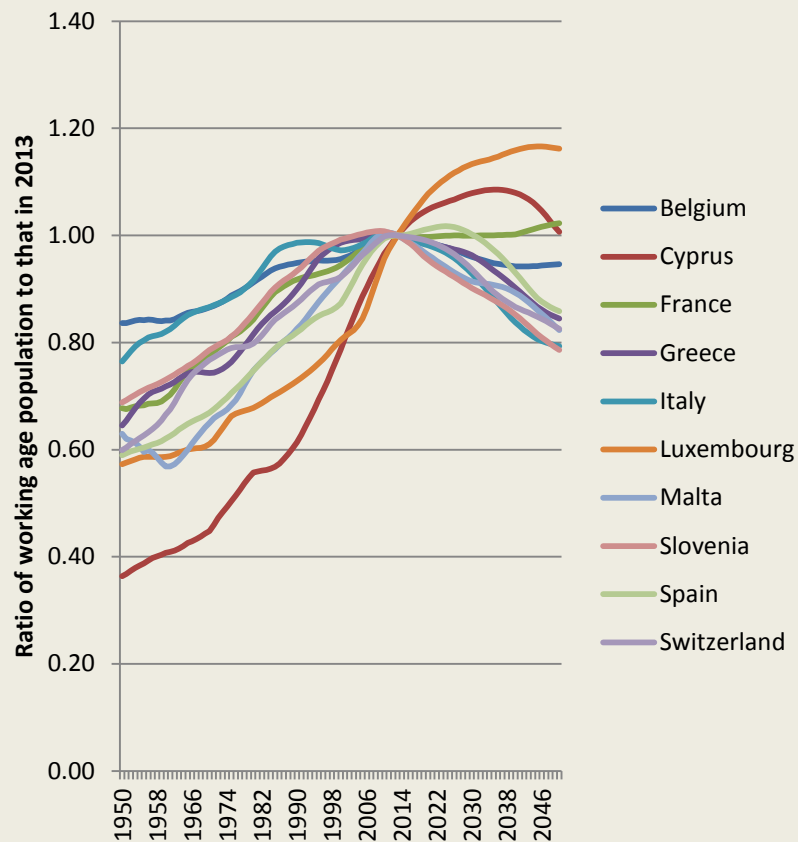
Lead Economist

Social Protection and Labor

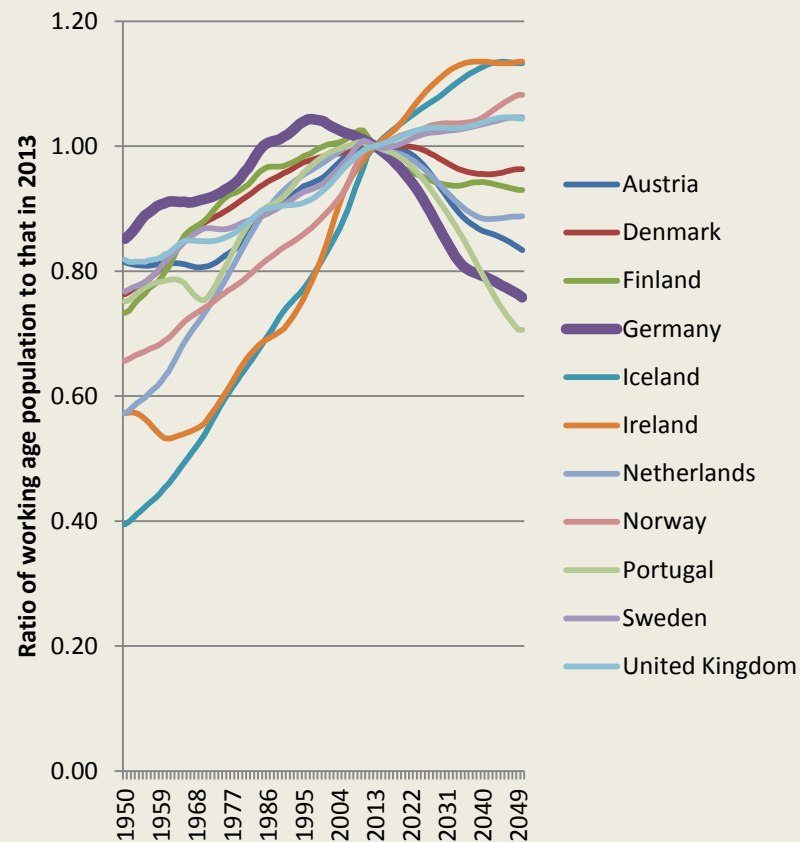


Structural Break in Growth of Working Age Population Around 2013

High Income Generous Spenders



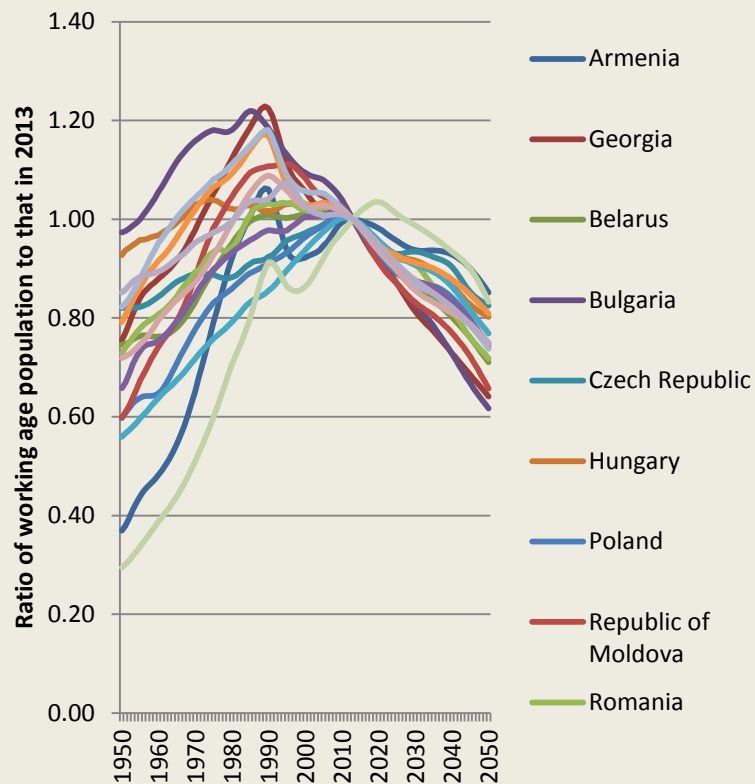
High Income Moderate Spenders



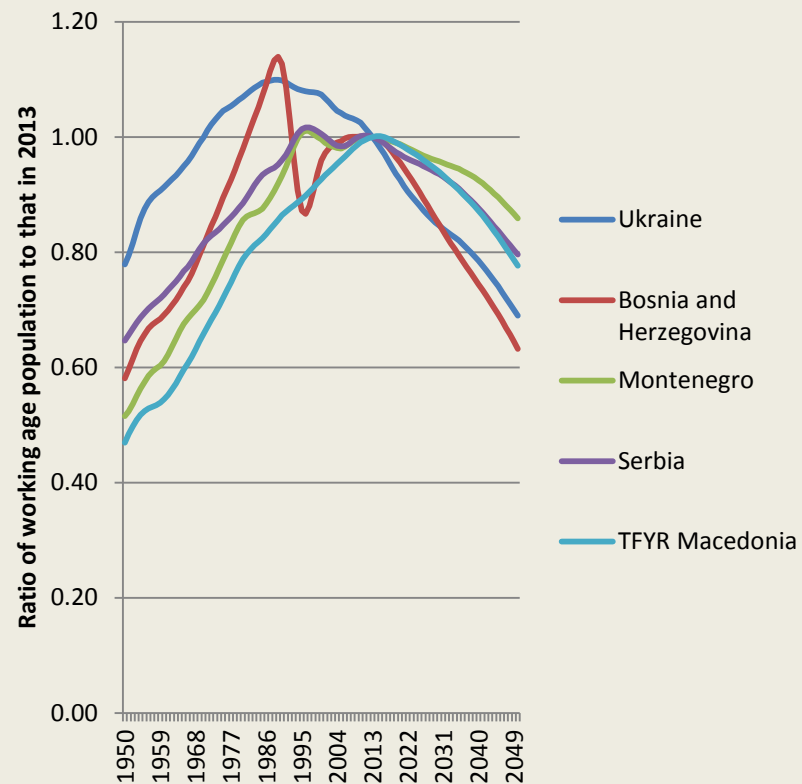


Structural Break in Growth of Working Age Population

Lower Spending Transition Countries



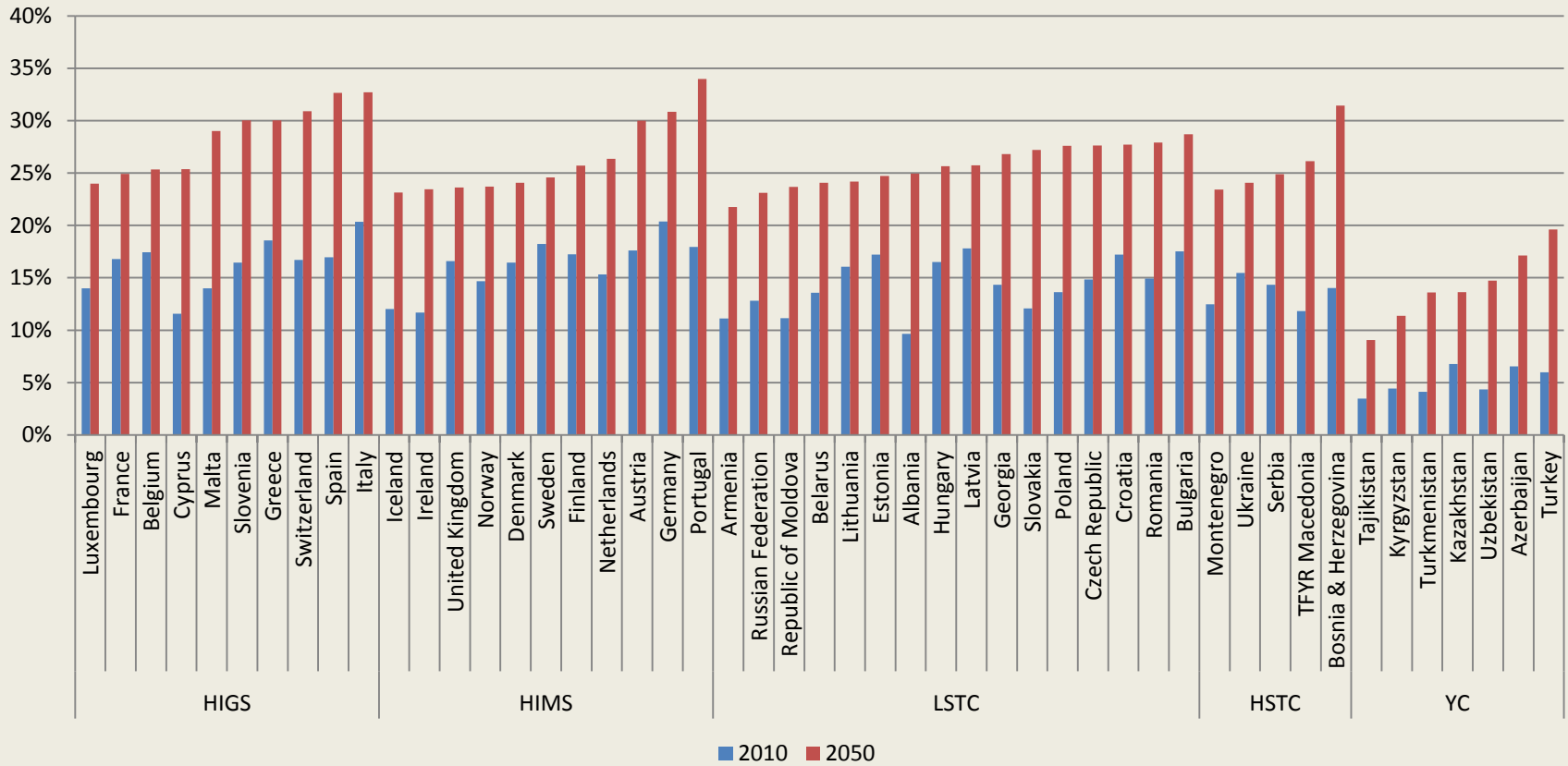
Higher Spending Transition Countries





While contributors are falling, share of elderly in population is rising

Percentage of Population Above Age of 65 in 2010 and 2050





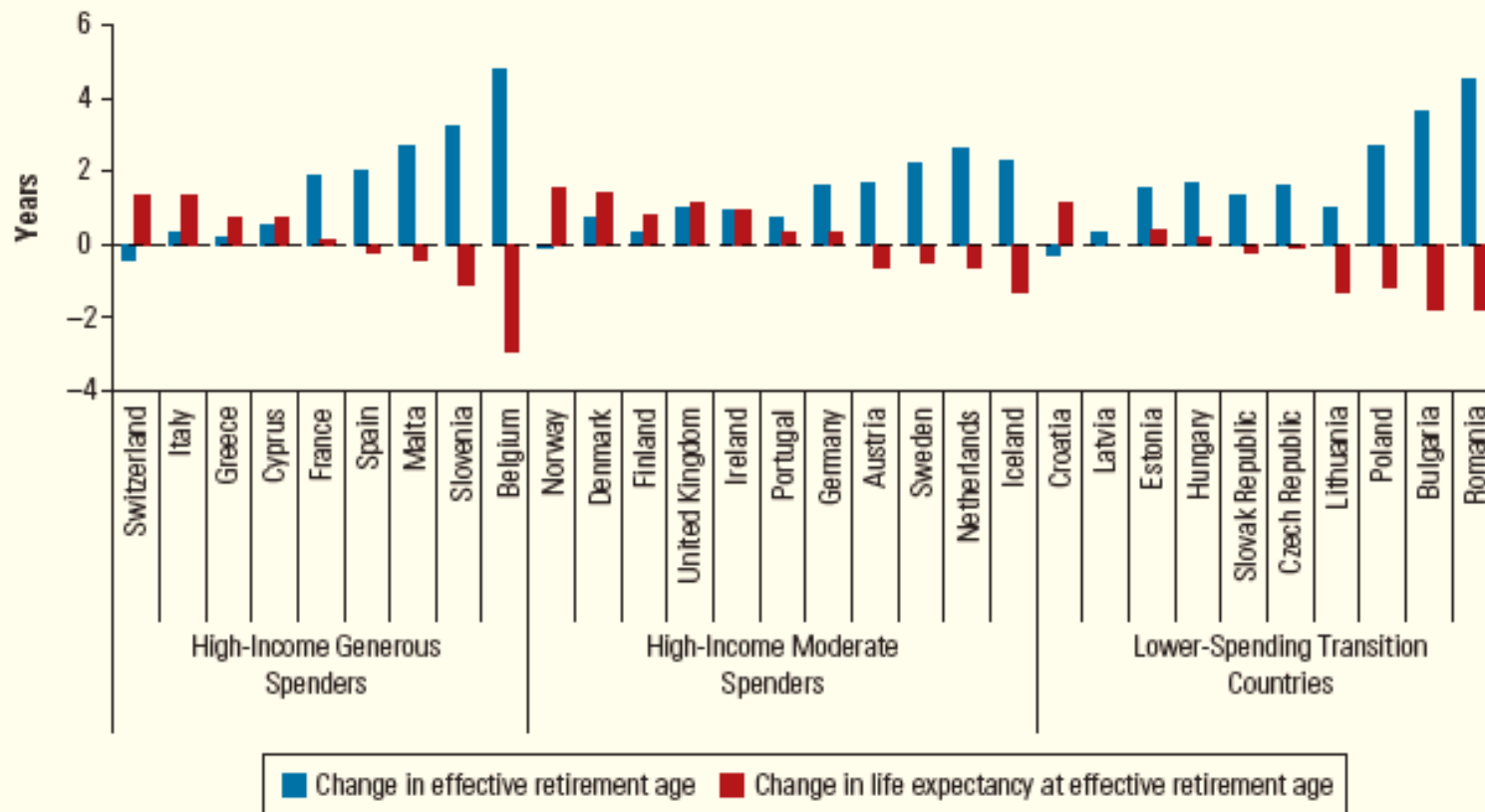
Options Under Pay As You Go System

- Raise contribution rates
 - Region already has contribution rates close to twice those in US and higher in many cases
- Raise retirement age
- Reduce benefits



Retirement ages increased, but duration of retirement generally did not fall

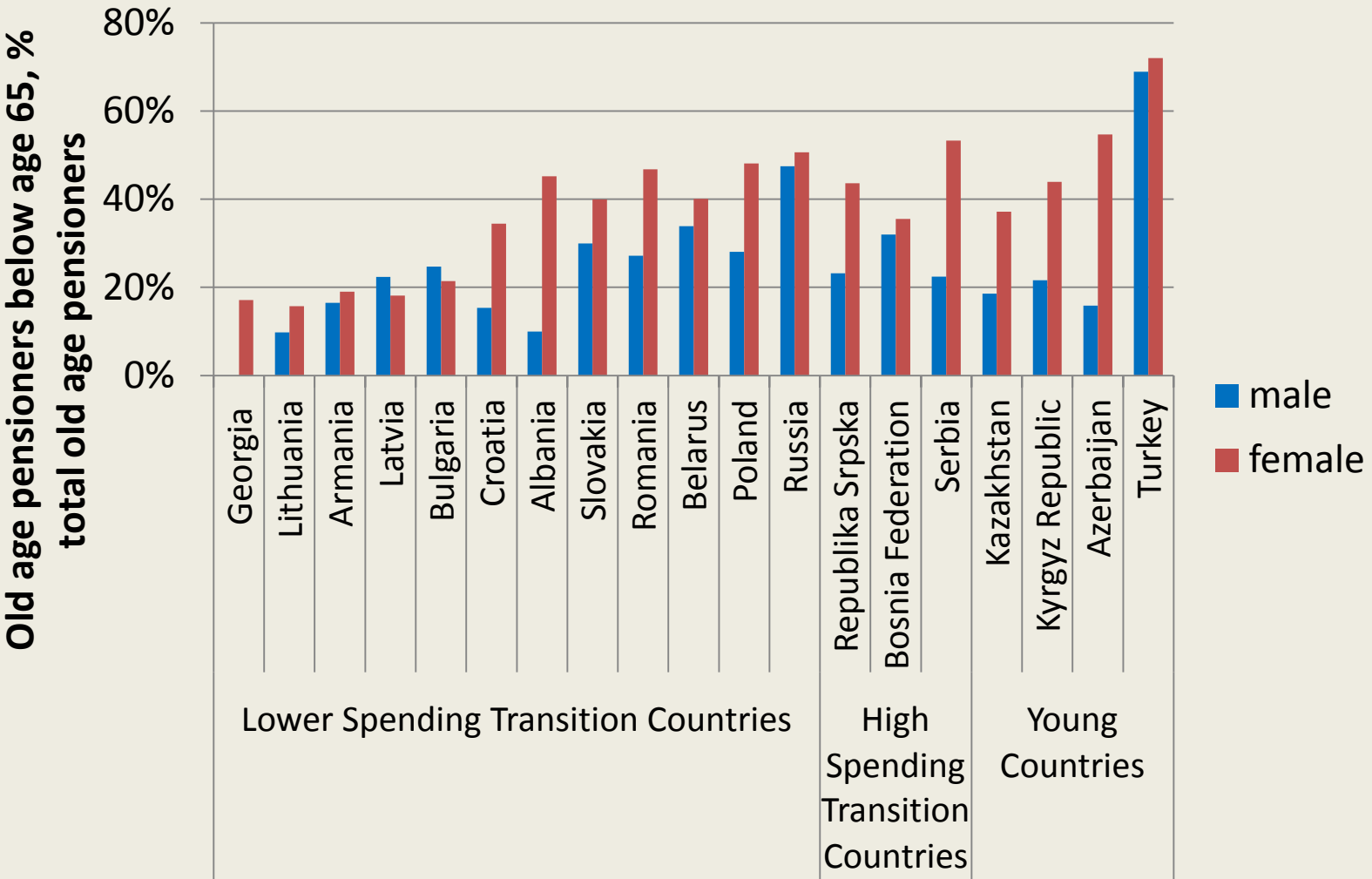
Change in Effective Retirement Age Compared to Change in Life Expectancy, Selected European Economies, 2001–2009



Source: Eurostat Statistics Database.

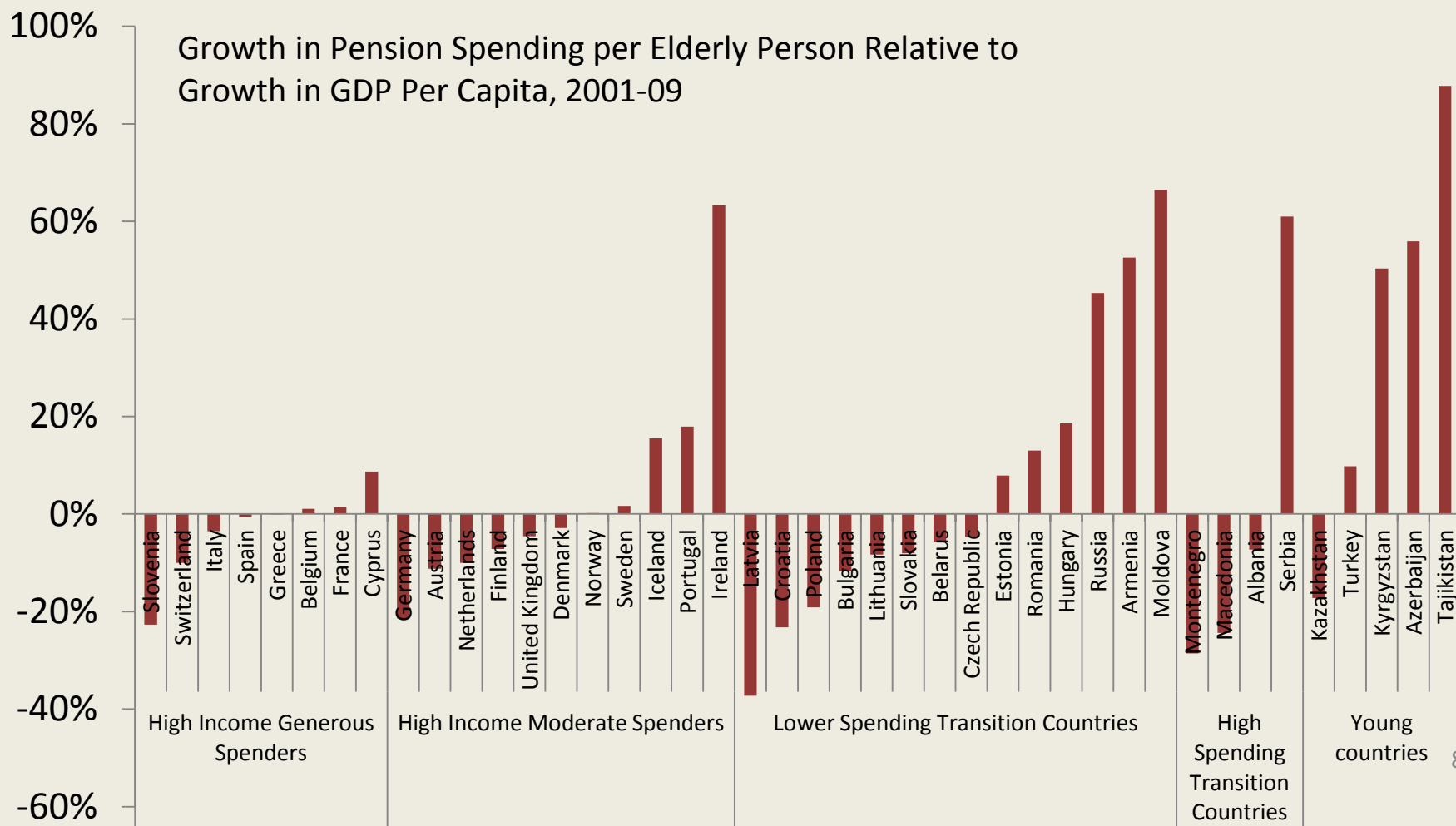


Early retirement is still prevalent





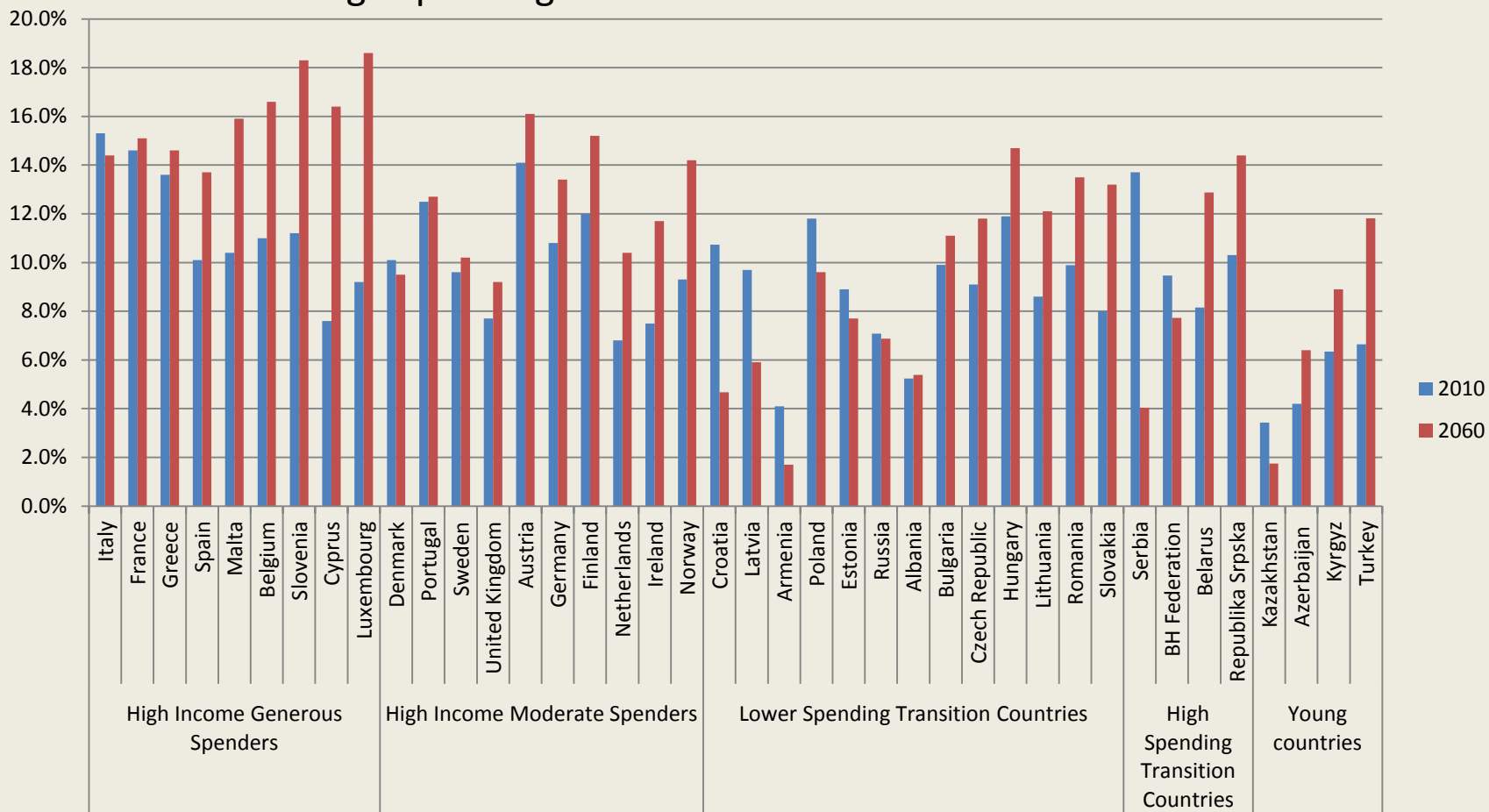
No clear trend-line of reduced spending per pensioner





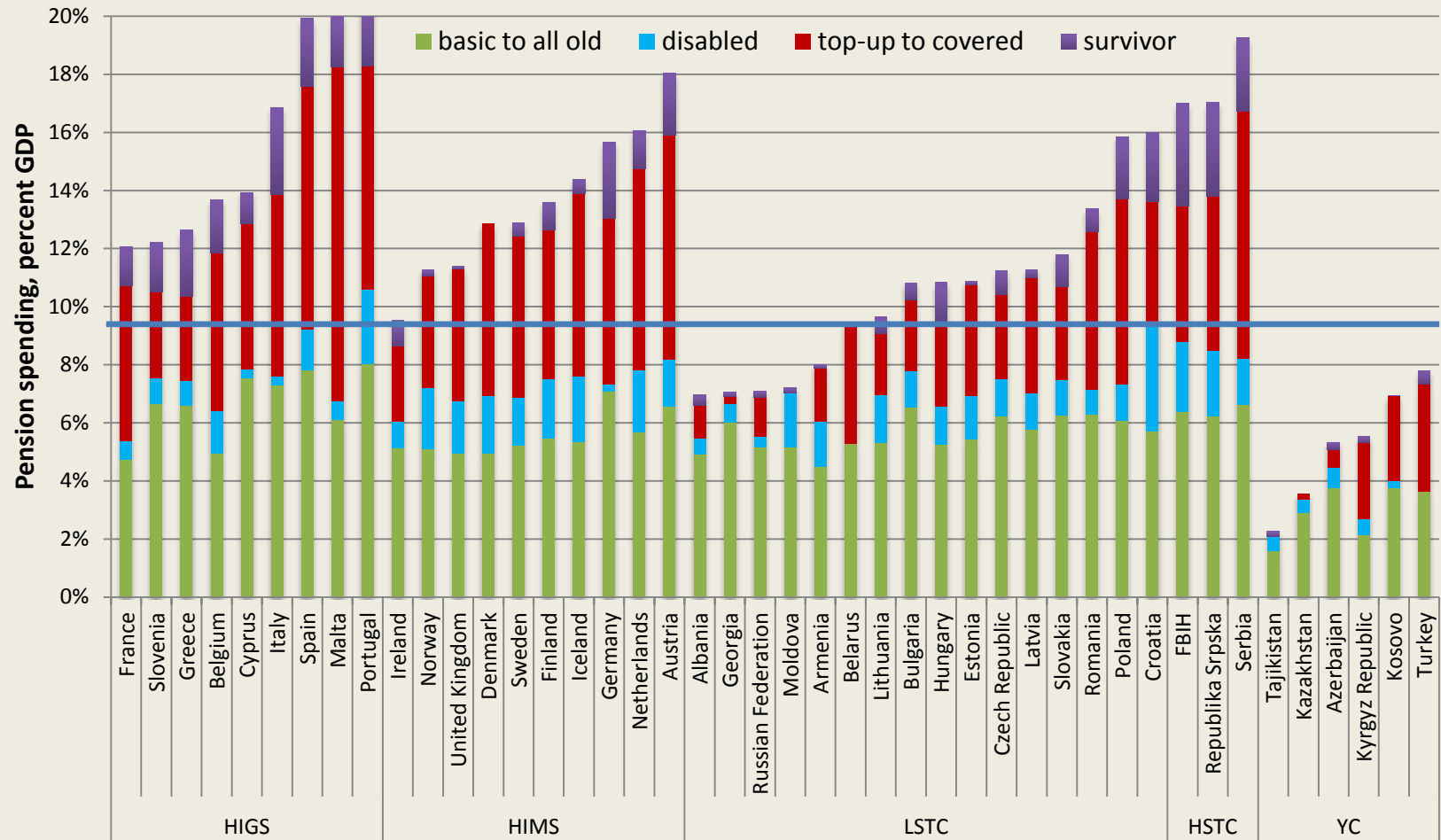
Projected spending in 2060 compared to spending as share of GDP in 2010

Average Spending in 2010 – 9.5% of GDP



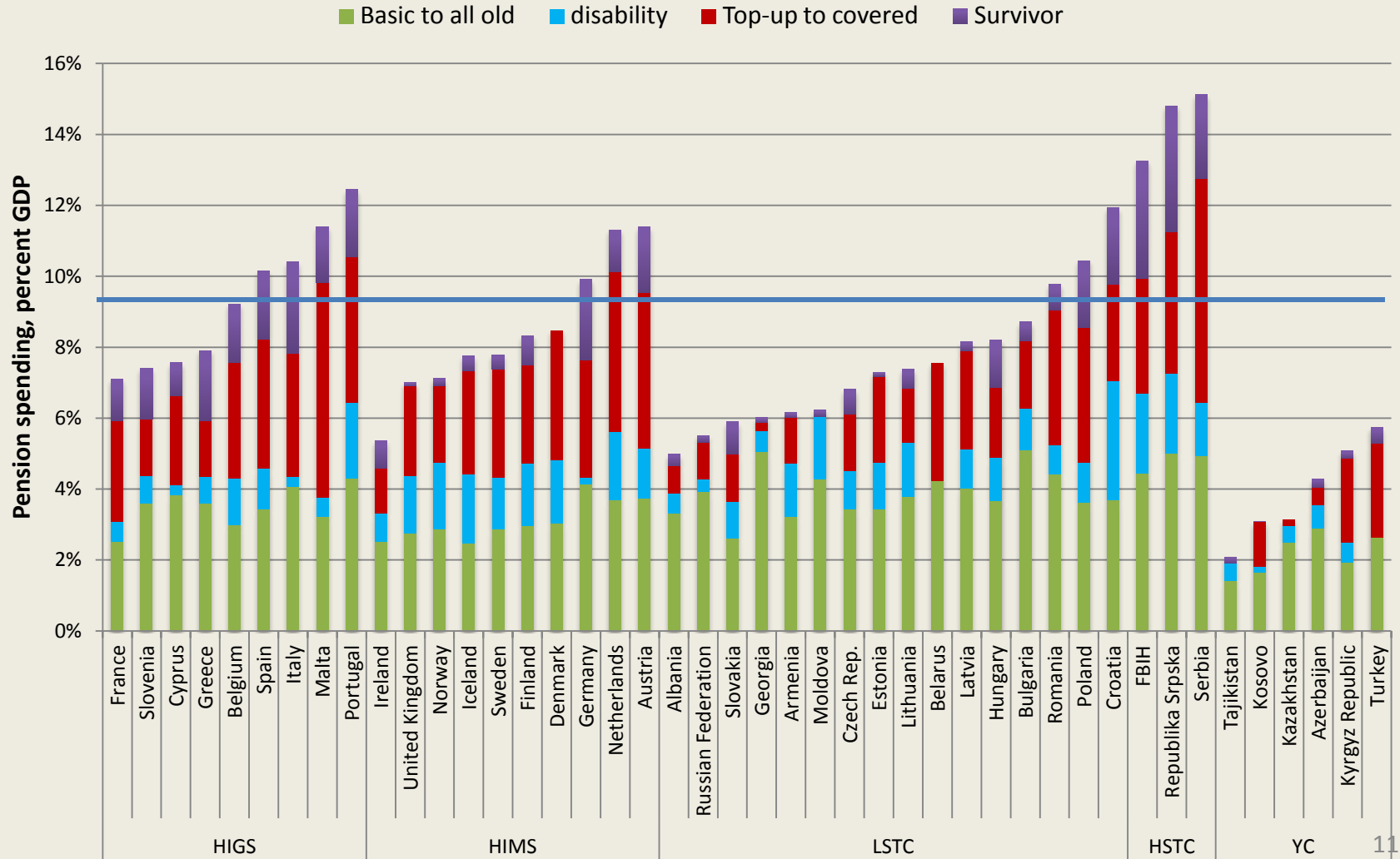


An Example Of Prioritizing Pension Spending and Costing It Out If Effective Retirement Age Is 65 with Prime Age Labor Force Participation Until Age 64 - 2050





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





Bottom Line: It Is Possible To Provide Old Age Security Even With Challenging Demographics!

- Will need some changes in expectations
- Future may be more like past in one of two ways:
 - Pensions given when people are too old to work
 - Pensions only guarantee poverty prevention
- In both cases, savings will play a central role, in the first to enhance benefits and in the second to provide earnings-related benefit
- Labor markets will also need to adapt to older workers
 - Allow more flexibility (part-time work, combine work and retirement, moving away from wages based strictly on seniority)
 - Workplace adaptations to accommodate older workers
 - Lifelong learning with training programs designed for older brains



Many countries added savings pillars

- 15 out of 30 transition countries adopted second pillar (fully funded defined contribution)
 - Linked benefits to contributions and reduced public pension in long run
 - Mandatory contributions were divided so that one part went to public system and the other to private system
 - Led to larger shortfalls in pension systems in the short and medium run



Some of the second pillar reforms were partially or fully undone due to fiscal constraints

- 7 of the 15 countries adopting second pillars reduced or eliminated contributions to the second pillar during the financial crisis, with 3 having now fully restored second pillar
- Financial crisis reduced contribution revenues due to falling wages and rising unemployment, while pension payments remained the same or even rose
 - Pension deficits rose
 - Governments chose to divert contributions from second pillars back to public systems to reduce the deficits in the public systems
- However, this means that the expected reduction in long-run public pension spending will now not take place



Governments aware of need for savings are focusing on voluntary savings options

- Introducing automatic enrollment schemes
 - No substantial differences in coverage between auto-enrollment (opt out) and mandatory systems
- In some cases, requiring additional contributions from the employee to participate in savings schemes
 - Lithuania recently gave people 3 choices:
 - Contribute an additional 1% of wage, combined with 2% of wage coming from existing payroll tax and an additional 1% from general budget (**chosen by 37%**)
 - Allow 2% of wage coming from existing payroll tax to accrue in savings accounts (**chosen by 61%**)
 - Discontinue contributions to savings accounts (**chosen by 2%**)