Editorial - COVID 19 and ageing: Pension systems at a critical juncture

Almost two years into the pandemic, this new edition of *Pensions at a Glance* offers new insights on how pensioners and pension systems have fared during the crisis. In most OECD countries, retirees have not felt the economic impact of the crisis as pensions in payment were largely upheld. The same cannot be said for pension systems under pressure from lower contributions.

While pension benefits have been protected, retirement income systems had to deal with new financial pressures resulting from lower contributions due to crisis-related exemptions for companies and individuals, even though in many cases transfers from unemployment insurance and governments made up at least partially for the revenue losses. In addition, despite high mortality rates among older populations, savings on pension spending were overall small.

The impact of the crisis on pension systems, however, may be short-lived if the economic recovery observed in most countries over the past months is sustained. Many countries are now showing encouraging signs, and new hiring and a return to normal working hours will help replenish the coffers of public pension systems. If, however, public finance pressures intensify, for example with the increasing cost of debt, and sources of savings are sought, pension spending might also be affected. Currently, it is still early to assess the situation.

For future pensioners, by contrast, the crisis could cast a long shadow on retirement. Young people have been severely affected by the economic and social impacts of the crisis, and might see their future benefits lowered, especially if the pandemic results in longer-term scarring and difficulties in building their careers. Allowing early access to pension savings to compensate for economic hardship, as observed in some countries such as Chile, may also generate long-term problems: unless future higher savings offset these withdrawals, low retirement benefits will be the consequence.

All of these challenges pale in comparison to the long-standing effect of population ageing on pension systems. While it is natural that the COVID-19 pandemic has taken centre-stage in people’s and policy makers’ minds, the biggest long-term challenge for pensions continues to be providing financially and socially sustainable pensions in the future. As stressed regularly in previous editions of *Pensions at a Glance* and *Pensions Outlook*, putting pension systems on a solid footing for the future will require painful policy decisions: either asking to pay more in contributions, work longer, or receive less pensions. But these decisions will also be painful because pension reforms are among the most contentious, least popular, and potentially perilous reforms.

Long-term pension challenges have continued to be on countries’ radar, even during the crisis. Over the past two years, Brazil and Sweden have tightened access to earnings-related pensions through higher pension ages. And a common feature of recent reforms in Chile, Germany, Latvia, Mexico, Slovenia and the Slovak Republic has been to pay particular attention to social sustainability by protecting benefits for low-income retirees. At the same time, political trade-offs can be seen in some of the recent reform packages. Higher pension ages were often accompanied by more lenient options for early retirement. Other countries backtracked, taking back more ambitious reforms and phasing change in more gradually.

According to European Commission projections, the average ratio of benefits to wages will decline by one-quarter by 2070, which would stabilise pension spending as a share of GDP in many countries despite ageing. But it remains to be seen whether these reductions will actually happen. Reviewing the situation over the past two decades, during which there was intense pension reform activity, the actual average ratio of benefits to wages in OECD countries remained broadly stable – implying that many trade-offs were made which partially unraveled the original reform packages.

Trying to avoid getting bogged down in long political debates every time changes to pension systems are made, many countries have introduced automatic adjustment mechanisms in their pension systems. Such mechanisms are a set of rules that automatically change pension system parameters, such as pension ages, benefits or contribution rates, when demographic, economic or financial indicators change.

About two-thirds of OECD countries use some form of automatic adjustment mechanism in their pension schemes. Six have notional defined contribution schemes, seven countries adjust qualifying conditions for retirement to life expectancy, and six adjust pension levels to changes in life expectancy, demographic ratios or the wage bill. Finally, seven countries have a financial balancing mechanism.

However, as this edition of *Pensions at a Glance* shows, these mechanisms can only address part of the challenges of pension systems facing population ageing. While they can reduce the need for governments to make ad hoc interventions and engage in lengthy negotiations of rules, they cannot isolate pension systems from political decision-making and certainly are not able to put pension systems on auto-pilot. In part, this is good news since governments must retain the flexibility to make changes in exceptional situations and adapt their pension policies to changes in labour market, health and social circumstances.

Automatic adjustment mechanisms have the advantage of defining the direction the systems should be heading for; deviating from that path will at least require explanations and discussions and make the trade-offs visible. The OECD analysis of countries' experiences shows that indeed, over the years, the automatic adjustment mechanisms were sometimes suspended or even eliminated in order to avoid pension benefit cuts and retirement-age increases, laid down in automatic adjustment mechanisms. While suspending automatic adjustments may be a necessary step to address concerns that such adjustments could generate harsh corrections at the lower end of the income distribution, governments should be sure to have a concrete alternative plan on how to finance pension expenditures in the longer term.

Overall, as countries gradually move away from COVID-19 crisis management response, governments should address the most pressing structural challenges to pension systems as part of their recovery plans. The use of automatic adjustment mechanism is an essential tool for sound pension systems. This edition of *Pensions at a Glance* sets out a number of principles on the design of automatic adjustment mechanisms to improve the financial and social sustainability of pension systems. It also provides countries with guidelines for their development and implementation.

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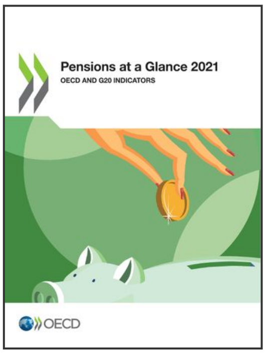

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