Executive summary

This edition of *Pensions at a Glance* reviews and analyses the pension measures enacted or legislated in OECD countries between September 2013 and September 2015. It provides an in-depth review of the first layer of protection of the elderly, first-tier pensions, across countries and assesses the impact of short careers on pension entitlements. This edition analyses also the sensitivity of future replacement rates to parametric changes. As in past editions, a comprehensive selection of pension policy indicators is included as well as profiles of the pension systems for all OECD and G20 countries.

The aftermath of the global economic crisis continues to strain pension systems

The economic recovery remains sluggish in most OECD countries and, as a consequence, pension contributions remain low while fiscal pressure adds urgency to reforming public pension systems. Going forward, the likely protracted uncertainty in financial markets, low returns and record-low interest rates cast doubts on the ability of defined-contribution systems and annuity schemes to deliver adequate pensions. These challenges are compounded by population ageing, which is accelerating in many countries.

However, despite remaining slack in many countries, the average employment rate of people aged 55 to 64 years increased by 7 percentage points in the decade to 2014. Yet, the average effective age of labour market exit remains substantially below the normal retirement ages in several countries. Workers stay the longest in the labour market in Korea, Mexico, Iceland and Japan; men exit the soonest in France and Belgium while women leave the earliest in the Slovak Republic, Poland and Slovenia.

Renewed efforts to improve the financial sustainability of pension systems

About half of OECD countries have taken measures to improve the financial sustainability of their pension systems over the past two years. Benefits were mostly reduced by switching to less favourable indexation but not cut in absolute terms. The finances of pension systems were also improved by raising taxes and contribution rates in defined-benefit systems. Despite tight constraints on the financing side, efforts have been made to improve the adequacy of retirement income for targeted groups in about one-third of countries.

The main objective of recent reforms was to delay retirement by raising the statutory retirement age, tightening early retirement provisions, and increasing incentives to work longer. These changes might entail distributive effects, however, as work ability at older ages and remaining life expectancy can vary between different socio-economic groups.

The retirement age will increase from 64.0 on average in the OECD in 2014 to 65.5 by 2060 based on current legislation. Men entering the labour market at age 20 will still be able to retire before 65 in Slovenia, Luxembourg, Greece and France. Only in Chile, Israel and Switzerland will women be able to retire before men.

Future net replacement rates from mandatory schemes for a full-career average-wage worker average 63% among OECD countries, ranging from 27% in Mexico (and much lower in Indonesia and South Africa) to 105% in Turkey. Due to indexation, the gross replacement rate falls by 6 percentage points, on average, between the retirement age and age 80.

First-tier pensions differ substantially across countries in their design and capacity to fight poverty

First-tier pensions exist in all countries, but their structure and value vary considerably. On average, safety-net payments for elderly people not entitled to a contributory pension are 22% of average earnings, ranging from 6% in Korea and Turkey to 40% in New Zealand. Minimum pensions, which are based on individual contribution history, exist in one-third of countries. Most countries pay a partial benefit after 20 years of contributions, with full minimum benefits requiring 26 years, on average.

In the countries with high poverty rates amongst the elderly and low safety-net benefits there is scope to increase the value of their safety-net payments, even after taking into account their level of GDP per capita. This is the case in Chile, Korea, Mexico and Turkey, but also in Switzerland and the United States.

The majority of first-tier pensions are indexed to prices and so their replacement rate decline over time, as prices tend to increase slower than wages, both across cohorts at a given age and across ages for a given cohort. Price indexation is appealing for governments facing severe budgetary constraints, but if applied rigidly it also runs the risk of fuelling poverty among the elderly.

Various mechanisms limit the effect of shorter careers on pensions in some countries

Short careers can substantially reduce pension entitlements, but a number of features cushion their impact: first-tier pensions based on residence or on relatively short contribution periods; reference wages based on best years of earnings; and pension credits. These features imply that, for every year without a job (up to a period of ten years), old-age pensions drop by only 1% on average across the OECD. In their absence, pensions would fall by 2-2.5%.

Delaying entry into the labour market by five years for an average-wage worker implies, beyond its implications for earnings prospects, a pension loss of 6% on average. The largest impact is found in Chile and Mexico, at 15%, and eight other countries have drops greater than 10%. On the other hand, France and Luxembourg record 3% and 6% gains, respectively, as people then have to retire four and five years later to be entitled to a pension without penalty.

A woman on average wage interrupting her career for five years to care for two young children would lose about 4% in pension income on average. The largest declines are recorded in Germany, Iceland, Israel, Italy, Mexico and Portugal, while pensions are not affected in about one-third of countries. Unemployment periods generate similar albeit slightly larger reductions in pension entitlements on average.

Striking the right balance between length of leave from work and benefit entitlements is fundamental to ensure that people return to work but do not lose too much from work interruptions. Policy makers should ensure that pension losses are kept low but also take into account that paying high benefits for long absences may lure workers away from the labour market.


Pensions at a Glance 2015
OECD AND G20 INDICATORS
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