



International
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IESS

Improving Effectiveness
in Social Security

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Balancing adequacy and financial sustainability of old-age income

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Structure of presentation

- Introduction
- Defining adequacy of old-age income
 - ✓ Multi-dimensional concept
- Balancing adequacy and financial sustainability
 - ✓ Impact of pension reforms in the EU
- Concluding remarks

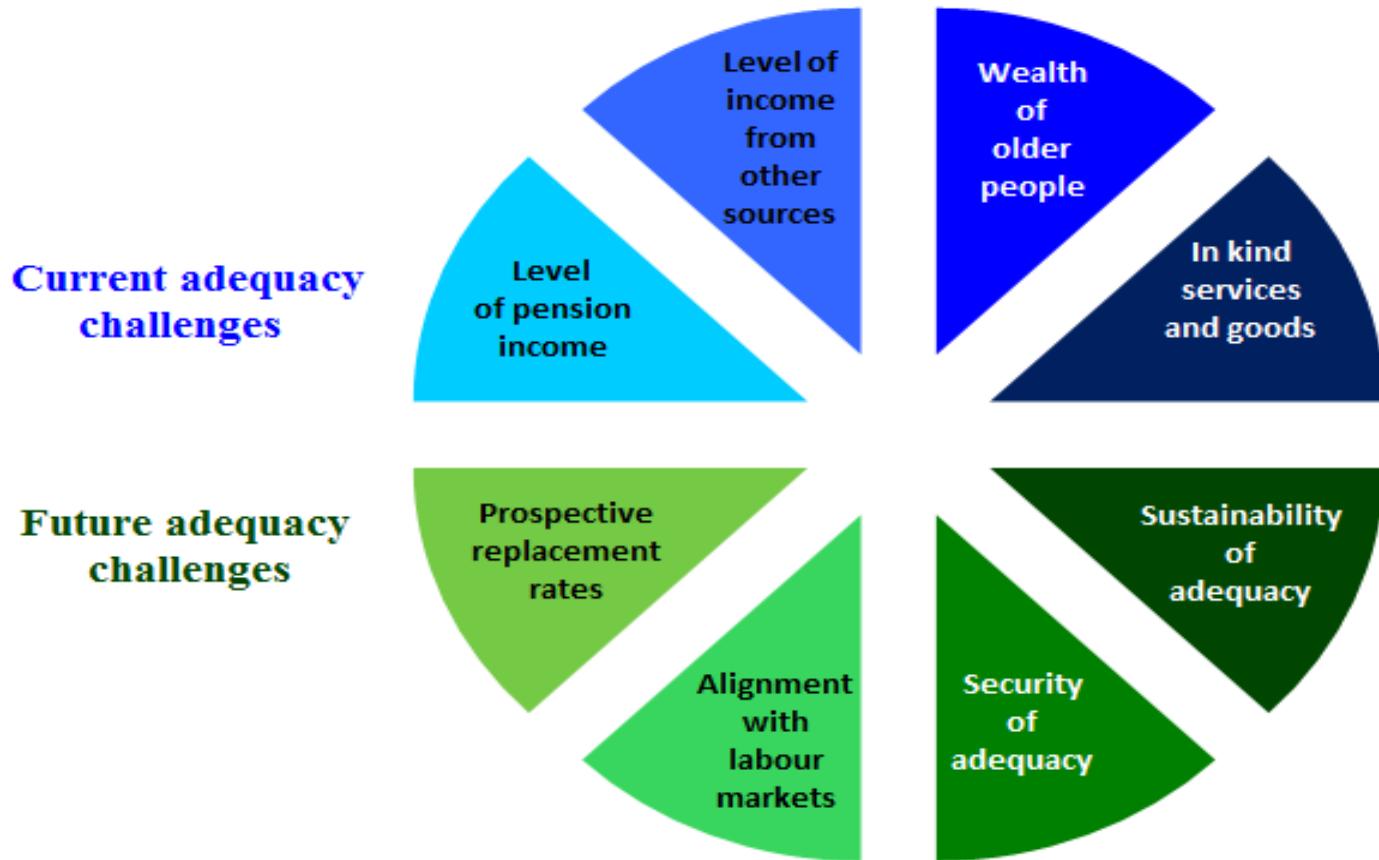


Introduction

- Adequacy and sustainability are joint and interlinked objectives of social policy - two sides of the same coin; or
- Sustainability is one of the dimensions of adequacy (or vice versa)
- Adequacy/ sustainability are always defined nationally as part of the broader implicit or explicit social contract
- However, such social contracts sometimes cross the borders when international benchmarks or standards are established
 - ✓ ILO social security conventions (C.102, C.128) and recommendations (R.131, R.202); European Code of Social Security; and other agreements at EU level



Defining adequacy of old-age income - Multi-dimensional concept of adequacy



Source: Pensions Adequacy Report 2015



Balancing adequacy and sustainability - Impact on financial sustainability (1)

..... Assessing the long-term financial impact of pension reforms

Decomposition of public pension expenditure to GDP into four key drivers:

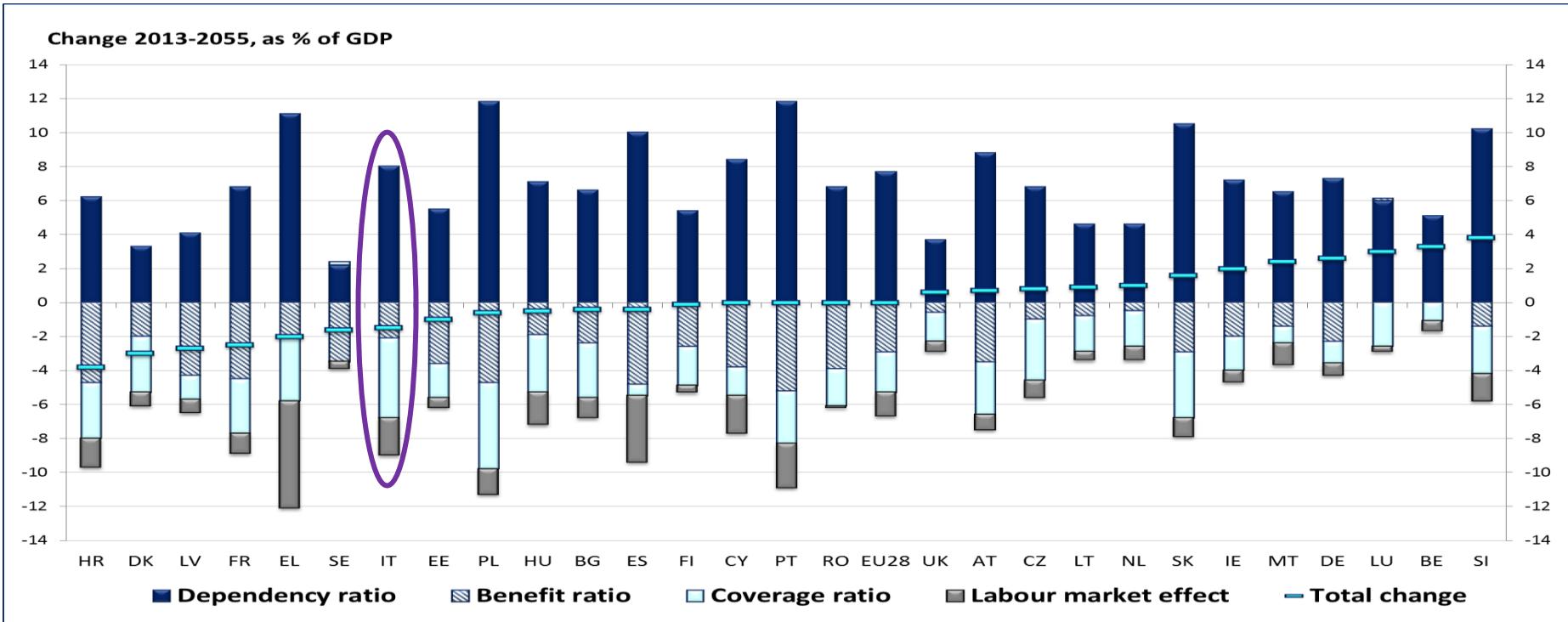
$$\frac{\text{Pension Exp.}}{\text{GDP}} = \underbrace{\frac{\text{Dependency Ratio}}{\text{Population } 65+}}_{\text{Population } 15-64} \times \underbrace{\frac{\text{Coverage Ratio}}{\text{Number of Pensioners}}}_{\text{Population } 65+} \times \underbrace{\frac{1 / \text{Employment Rate}}{\text{Population } 15-64}}_{\text{Working People}} \times \underbrace{\frac{\text{Benefit Ratio}}{\text{Average Pension}}}_{\frac{\text{GDP}}{\text{Working People}}}$$



Balancing adequacy and sustainability - Impact on financial sustainability (2)

..... mitigating the expenditure-increasing impact of ageing by reducing the coverage and benefit ratios

Change in public pension expenditure projections between 2013 and 2055, total and decomposed into main drivers



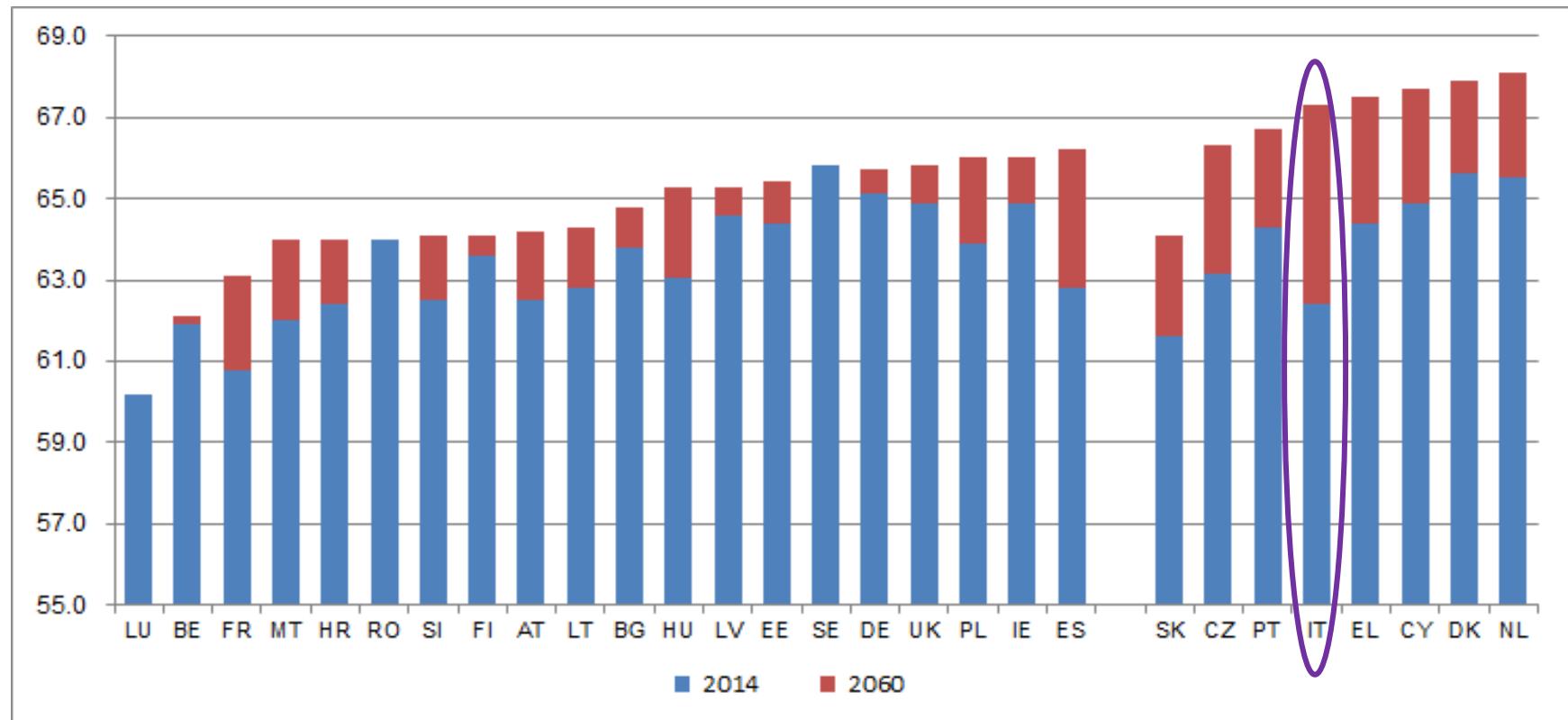
Source: 2015 Ageing Report



Balancing adequacy and sustainability - Impact on financial sustainability (3)

..... Projected results for IT are highly sensitive to the assumptions of increased labour force participation rates, through the significant shift of effective retirement age

Change in the effective retirement age (average exit age) between 2014 and 2060



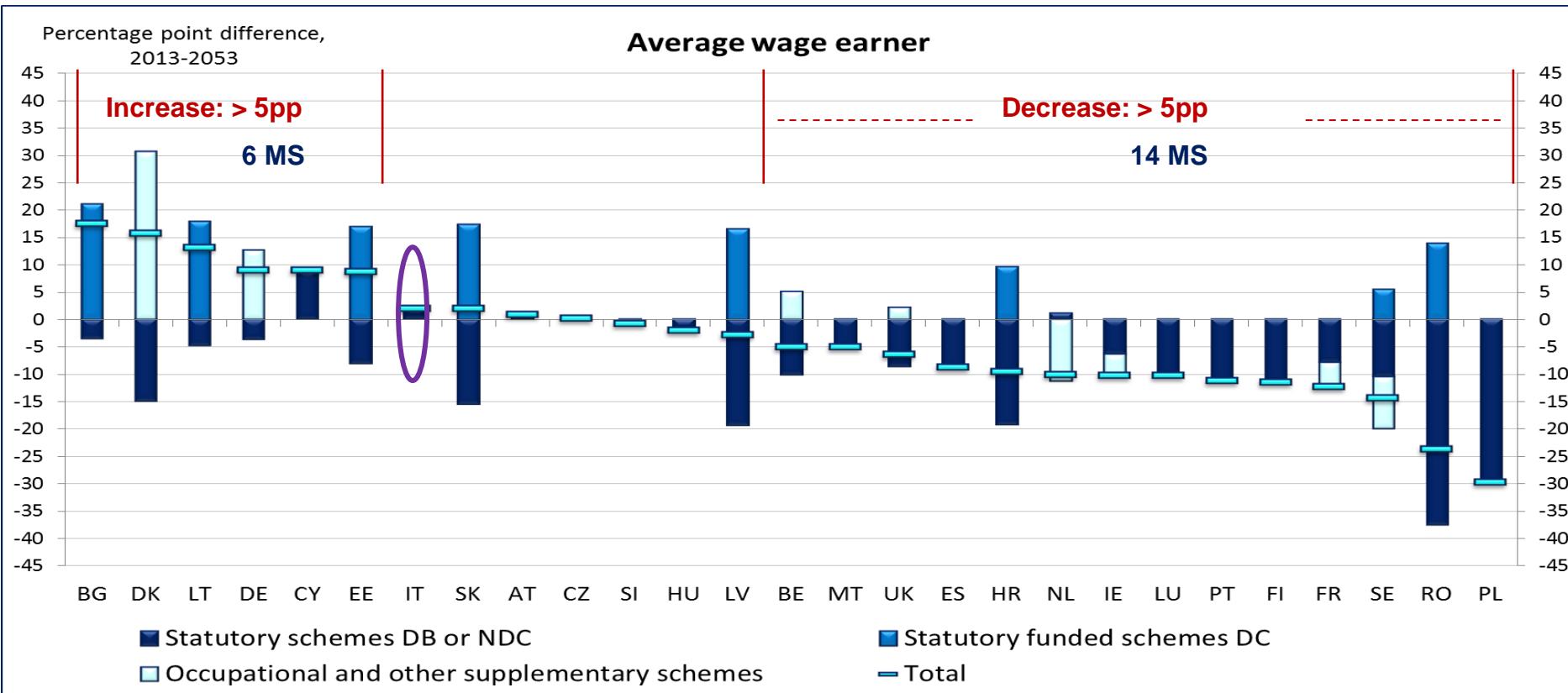


Balancing adequacy and sustainability - Impact on adequacy (1)

..... lowering pension benefits

..... increasing reliance on funded schemes and thus on financial markets

Percentage point difference in gross TRRs, by type of pension, base case II (40-year career)



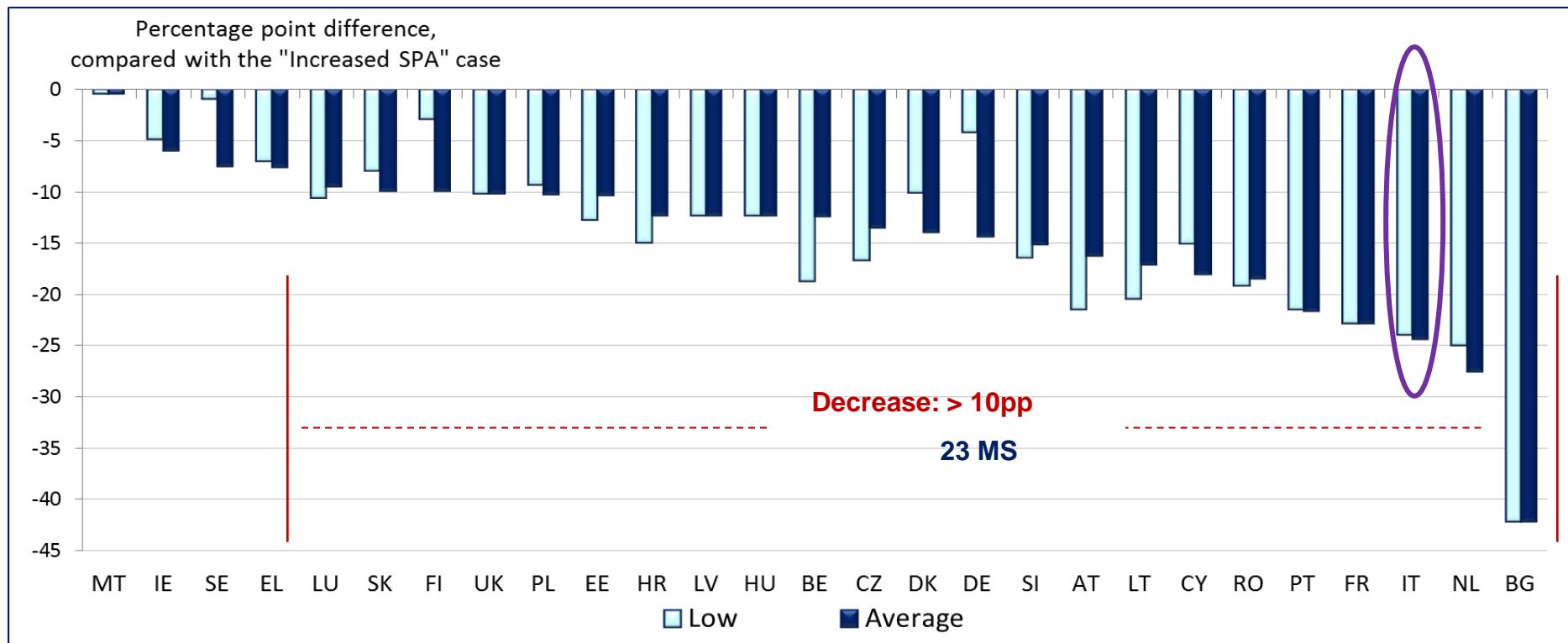
Source: 2015 Pension Adequacy Report



Balancing adequacy and sustainability - Impact on adequacy (2)

..... Past reforms established stronger link between contributions and benefits and stricter eligibility conditions - increased reliance on labour markets and minimum income provisions

Percentage point difference in net TRRs, between short career (30 years) and full career (from 25 to SPA)

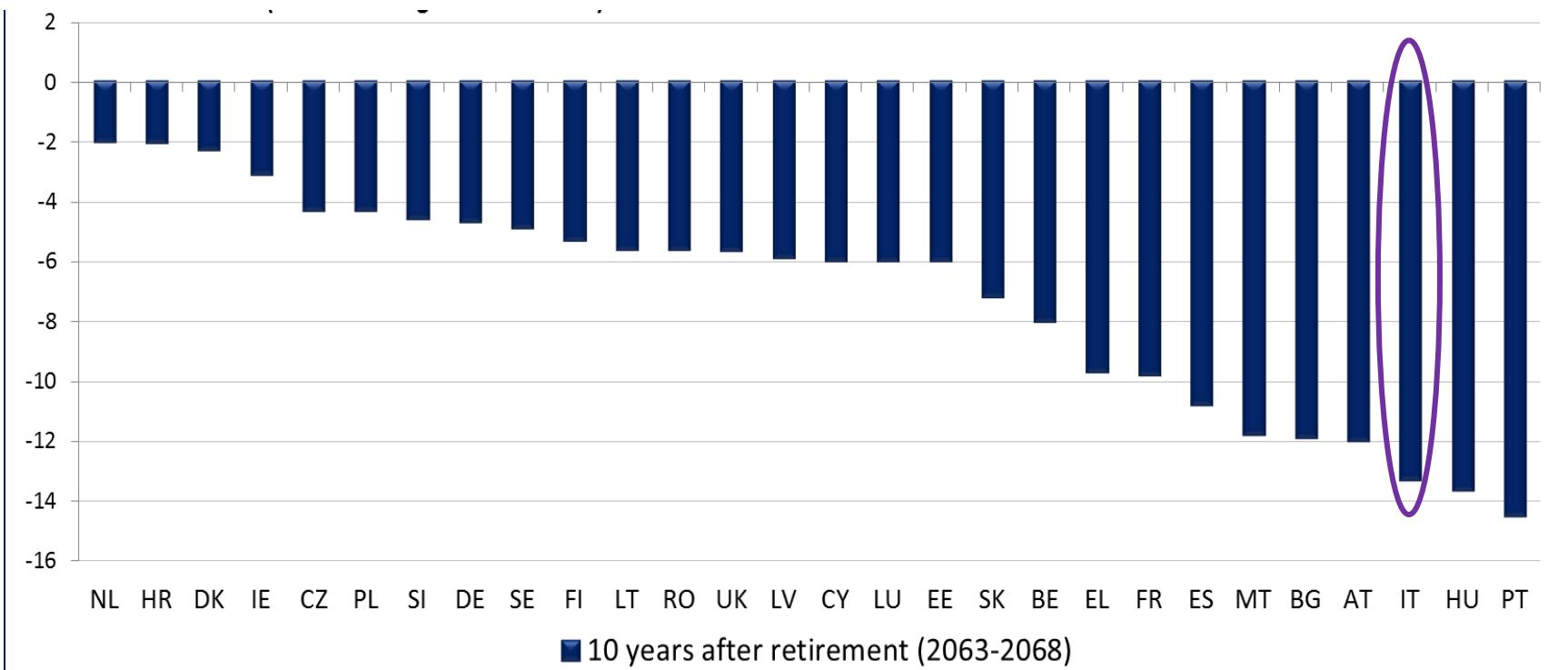




Balancing adequacy and sustainability - Impact on adequacy (3)

..... **Pension indexing:** the relative value of pension benefits could be significantly diminished by wage developments if high economic growth rates

Percentage point change in future TRRs, 10 years after retirement compared with the year of retirement (case "Increased SPA"), average earner





Concluding remarks

- Many reforms introduce various automatic mechanisms to ensure long-run financial sustainability of pensions
- There are no similar built-in mechanisms to guarantee income security and prevent risk of poverty in old-age
- Need for revisiting a number of recent pension reforms to ensure that pension systems deliver adequate level of protection
 - ✓ Especially for those with shorter, broken careers and low earnings
 - ✓ Otherwise increased risk of reversal of reforms
- Need for enhancing the non-contributory guarantees and redistributive effects of pension systems
 - ✓ Look at possible future evolutions of coverage, probabilities of different status at the labour market and resulting distributions of contribution duration/ density and distribution of earnings over the working careers