

Pensions

ADDRESSING CURRENT AND FUTURE CHALLENGES OF THE PENSION SYSTEM

- ▶ A higher retirement age and linking changes in retirement age to increases in life expectancy could help improve pension levels and the sustainability of the pension system.
- ▶ Trends towards increasing non-standard employment may pose challenges for the Czech pension system, as some of these workers are at risk of low pension entitlements and the financial sustainability of public pensions is undermined.
- ▶ Average earners in the Czech Republic often face marked income reductions relative to low-income earners upon retirement, making a smooth transition from work to retirement difficult.
- ▶ Fostering private pensions as a complement to public pensions can help to achieve higher old-age income.

What's the issue?

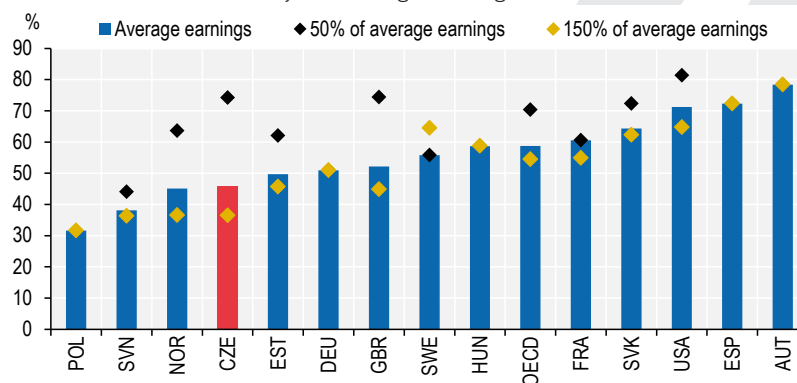
To improve the financing of pensions, the Czech Republic has opted to raise the retirement age, but to a lesser extent than other OECD countries. The retirement age in the Czech Republic is set to gradually increase to 65 years, up from currently 63.3 for men and lower levels for women (depending on the number of children). By comparison, the OECD retirement age will increase to 65.8 for men who entered the labour market in 2016. Currently, the effective retirement age in the Czech Republic is comparatively low, at 62.5 years among men and 60.8 years among women, against 65.1 and 63.6 in the OECD. With projected rapid increases in life expectancy, there is scope for longer working lives in the future. According to UN projections, the average

life expectancy for men and women at the age 65 will increase by almost 5 years in the Czech Republic between 2015 and 2060, exceeding the increase in the OECD by several months. In turn, the number of people aged 65 and over relative to the size of working age population (the so-called old-age dependency ratio) will roughly double both in the Czech Republic and in the OECD on average over the same period.

Workers in non-standard forms of employment, such as self-employment and fixed-term employment, are at risk of low pension entitlements. These workers are covered by the Czech pension system, but they often do not acquire the same level of old-age protection as dependent

Average income earners face low pension replacement rates in the Czech Republic

Future gross replacement rates from mandatory and voluntary pension schemes relative to average wage by career-length earnings level



Note: The future replacement rate is the ratio of the first pension relative to last wage by earnings for full career workers. Replacement rates are calculated for a person who enters labour market in 2016 and retires at the country-specific normal retirement age. Source: Based on data from OECD (2017b), p. 103.

employees. The self-employed, for instance, can freely set the level of income that is used as the basis for their social security contributions as long as it is higher than both 25% of the average wage and 50% of their own average monthly earnings. With a high degree of discretionary freedom, many self-employed may be tempted to make low contributions, and despite reducing their future pension entitlements, creating risks for the financial sustainability of public pensions.

The average income of people over 65 is relatively low, amounting to 78% of the average total population income, against 88% in the OECD. Many workers in the Czech Republic face significant income drops relative to low-income earners when they retire. Full-career workers with low earnings (half of the average wage) are comparatively well protected and benefit from a gross replacement rate of 74%, against 70% in the OECD. Taxation of pensions is low and the net replacement rates of low earners reach 88%, compared to 73% in the OECD. However, both gross and net replacement rates for average (but also high-income) earners are below the OECD average, making a smooth transition from work to retirement difficult (see Figure).

Why is this important for the Czech Republic?

The Czech Republic is one of few OECD countries in which the share of self-employment among total employment has increased over the last 20 years. More generally, it is possible that non-standard forms of work will become even more important in the future, partly driven by the observed expansion of the gig economy. If non-standard employment results in more career interruptions, pension adequacy may become an issue. In the Czech pension system, the negative impact of career breaks on pension entitlements is more pronounced than on average in the OECD (OECD 2017a). In addition, a minimum of 35 years of contributions is necessary to qualify for an old-age pension. Workers with shorter careers do not have access to an earnings-related old-age pension unless they extend their careers 5 years beyond the statutory retirement age.

The role of private pensions as a complement to public pensions is currently limited. Contribution levels in voluntarily funded pension schemes are not sufficient to build a significant supplementary pension. The statutory funded pension scheme that - without a broad political consensus - started in 2013 failed to attract a sufficient number of participants as enrolment was not the default option and incentives to do so were limited. When abolished at the end of 2015, there were fewer than 85 000 participants in the scheme. Private pension funds' assets in the Czech Republic represented 8.4% of GDP at the end of 2016, much lower than the OECD average of 49.5%. Today, individuals can contribute voluntarily to supplementary-funded private pension schemes. Although participation in these schemes is significant, at 52.6% of the population under 65 at the end of 2016, contribution levels are too low to build significant supplementary pension entitlements. In 2016, the average monthly contribution of active participants, including both employee and employer contributions but excluding state contributions, was only CZK 819 or EUR 32. Employers pay

What should policy makers do?

- ▶ Consider increasing the retirement age for future retirees and linking it with changes in life expectancy to strengthen incentives for longer careers and help to offset the effects of population ageing.
- ▶ Ensure a sufficient level of contributions and old-age protection for people in non-standard forms of employment. A thorough assessment should be carried out to evaluate in detail the share of self-employed and other non-standard workers who are at risk of low pensions. The assessment should identify ways of preparing the pension system for upcoming changes in the labour market.
- ▶ Better involve employers in diversifying the sources of retirement income by establishing an automatic enrolment in supplementary-funded pension schemes.

less than 20% of that amount. Employers could automatically enroll eligible employees into a funded pension plan, with employees free to opt out within a certain timeframe. Employees and employers could contribute a minimum amount. Among others, New Zealand, the United Kingdom and the United States have achieved positive outcomes in this area.



Further reading

OECD (2018a), *Reviews of Pension Systems: Latvia*, <https://doi.org/10.1787/9789264289390-en>

OECD (2018b), *The Future of Social Protection: What works for non-standard workers?*, <http://www.oecd.org/social/Future-of-social-protection.pdf>

OECD (2017a), *Preventing Ageing Unequally*, in particular Figure 1.21. page 42, <https://doi.org/10.1787/9789264279087-en>

OECD (2017b), *Pensions at a Glance*, in particular indicators 3.3 (p. 89) and 4.5 (p. 103), https://doi.org/10.1787/pension_glance-2017-en

OECD (2015), *Pensions at a Glance*, in particular chapters 2 (The role of first-tier pensions) and Chapter 3 (How incomplete careers affect pension entitlements), https://doi.org/10.1787/pension_glance-2015-en

OECD (2014), *Pensions Outlook*, in particular chapter 4 assesses automatic enrolment schemes, <http://www.oecd.org/daf/oecd-pensions-outlook-23137649.htm>