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PENSIONS AT A GLA

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BETTER POLICIES FOR BETTER LIVES

Key messages

- Limited impact of COVID-19 on pensioners' income and workers' pension entitlements
- Substantial pension reforms over the last two years in many countries
- In-depth analysis of automatic adjustment mechanism (AAMs):
  - AAMs are crucial to help deal with the impact of population ageing

RECENT DEVELOPMENTS IN PENSIONS

Limited impact of COVID-19 on pensions

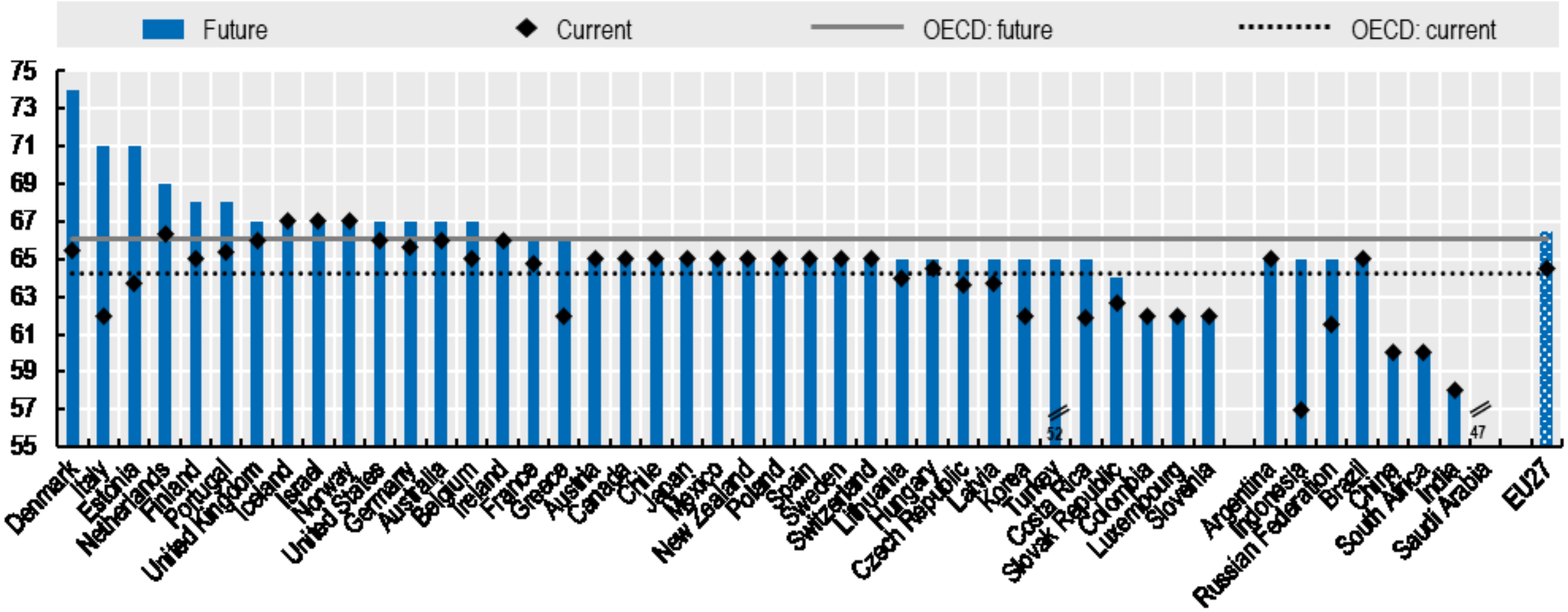
- Safeguarded pension **benefits;** introduced temporary and targeted **income support measures** for current pensioners
- Extraordinary measures protected **pension entitlements** :
  - expanded use of job retention schemes, in which generally pension entitlements accrued;
  - subsidised pension contributions;
  - extension of unemployment protection;
  - specific measures benefiting the self-employed;
  - strong financial markets performance.
- **Exceptional withdrawals of pension assets** in a few countries, with largest effect on future pensions in Chile
- **Pension finances deteriorated due to lost contributions.** Shortfalls have been mainly covered by state budgets
- Due to excess mortality, the number of **people older than 65 has declined by about 0.8%** in the OECD on average, which has slightly lowered pension spending.

Main reforms over the past two years

- **Substantial increase of mandatory FDC contributions** in Mexico, boosting future pensions; Greece replaced NDC by FDC for auxiliary pensions; Estonia made private pension contributions voluntary and allowed to withdraw assets.
- **Substantial improvements of low pensions** in Chile, Germany, Latvia, Mexico, the Slovak Republic and Slovenia.
- **Limited action on retirement ages**: Sweden (increase), the Netherlands (postponed) and Ireland (postponed).
- **Extended early retirement**: Denmark, Ireland, Italy and Lithuania.

Retirement age to increase by about 2 years by 2060

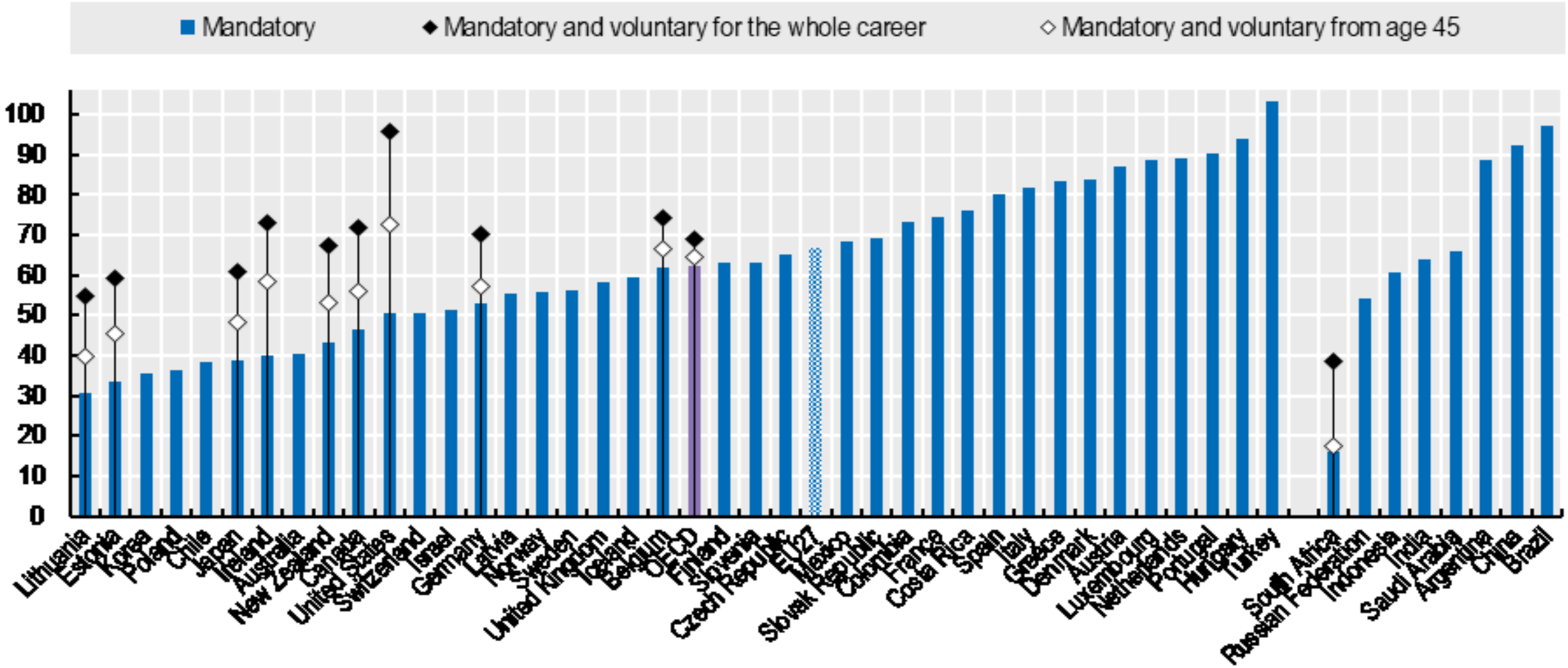
Normal retirement age after a full career from age 22 based on current legislation



Source: OECD, 2021, Pensions at a Glance; Figure 1.11

Pensions to replace 62% of earnings on average

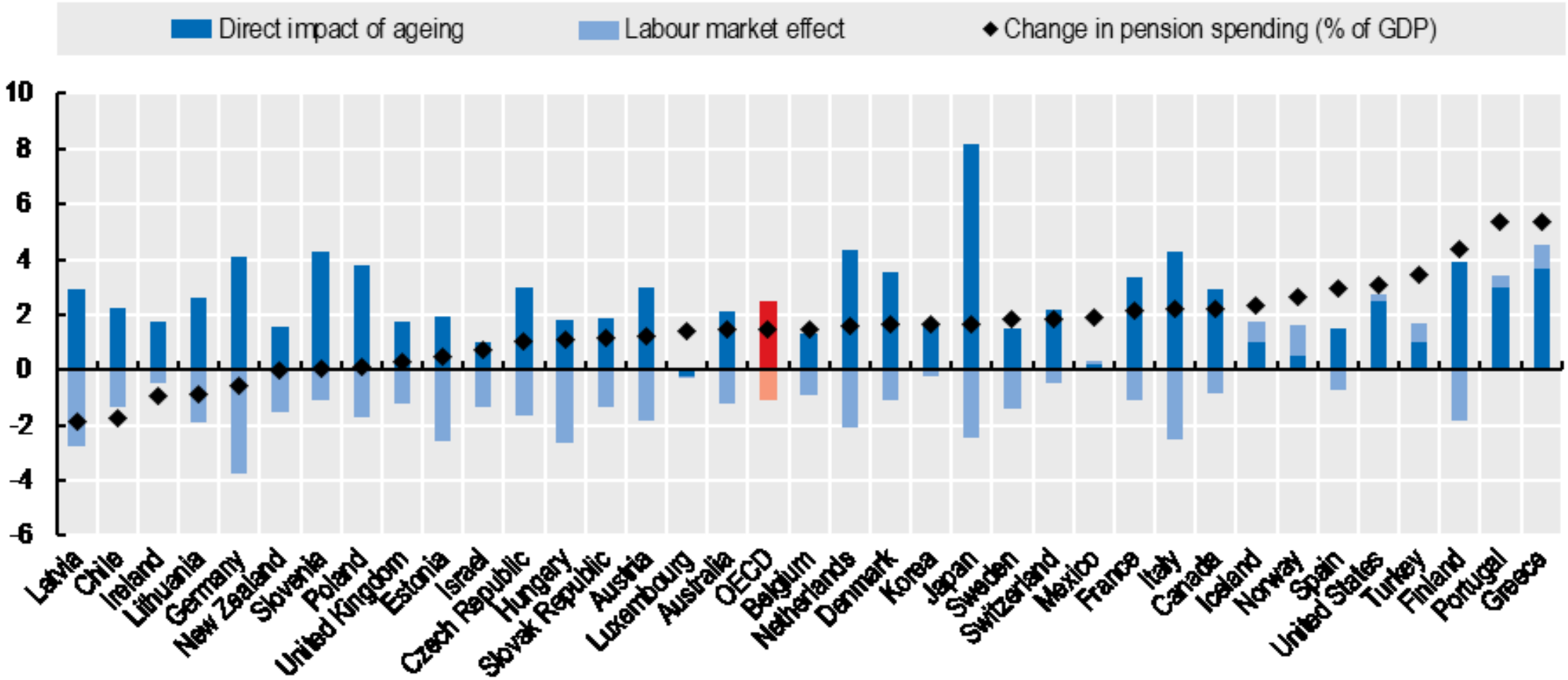
Future net replacement rates for full-career average-wage workers



Source: OECD, 2021, Pensions at a Glance; Figure 1.12

Pension expenditure increased and strong labour markets offset about 40% of the direct impact of ageing

Change in pension expenditure in GDP between 2000 and 2017 and contribution from different factors, in percentage points



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AUTOMATIC ADJUSTMENT MECHANISMS

What are Automatic Adjustment Mechanisms?

- AAMs are **predefined rules** that
  - automatically change pension parameters or benefits
  - based on the evolution of an indicator

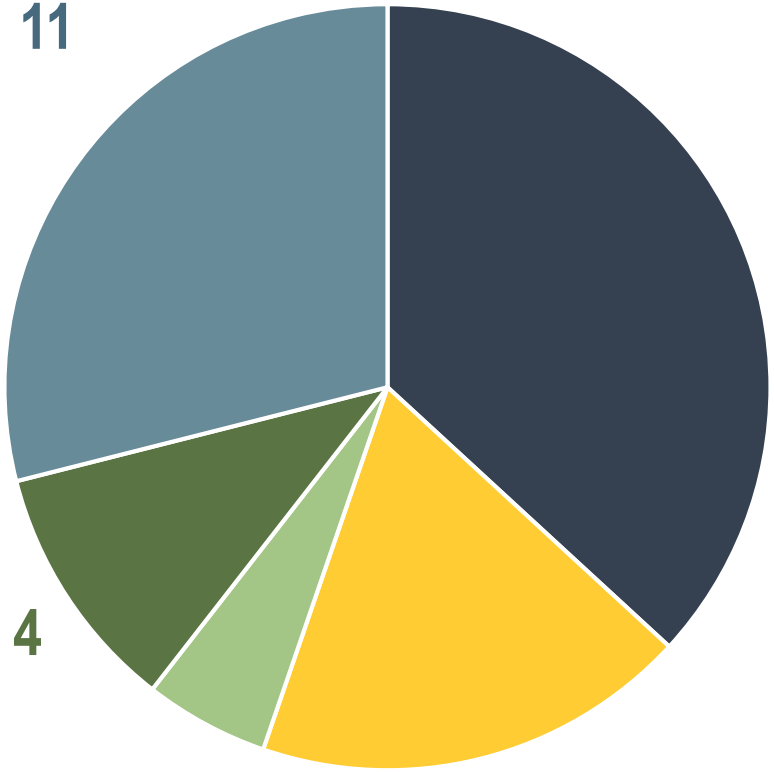
- AAMs **protect** pension systems
  - against demographic, economic and financial uncertainties

- AAMs can help **uphold** financial sustainability

Why use AAMs?

- Compared to discretionary reforms, AAMs are
  - **less erratic** $\Rightarrow$ reduce the risk of under- or overshooting the mark
  - more **transparent**
  - more **equitable** across generations
- AAMs reduce
  - **political cost** of maintaining or improving **financial sustainability**
  - **need for subsequent reforms**
- AAMs can only provide financial sustainability **if they are politically sustainable**
  - need for wide political agreement on their introduction and design that avoids harsh adjustments
- Policy-makers retain **full control** over pension system

AAMs exist in about two-thirds of OECD countries



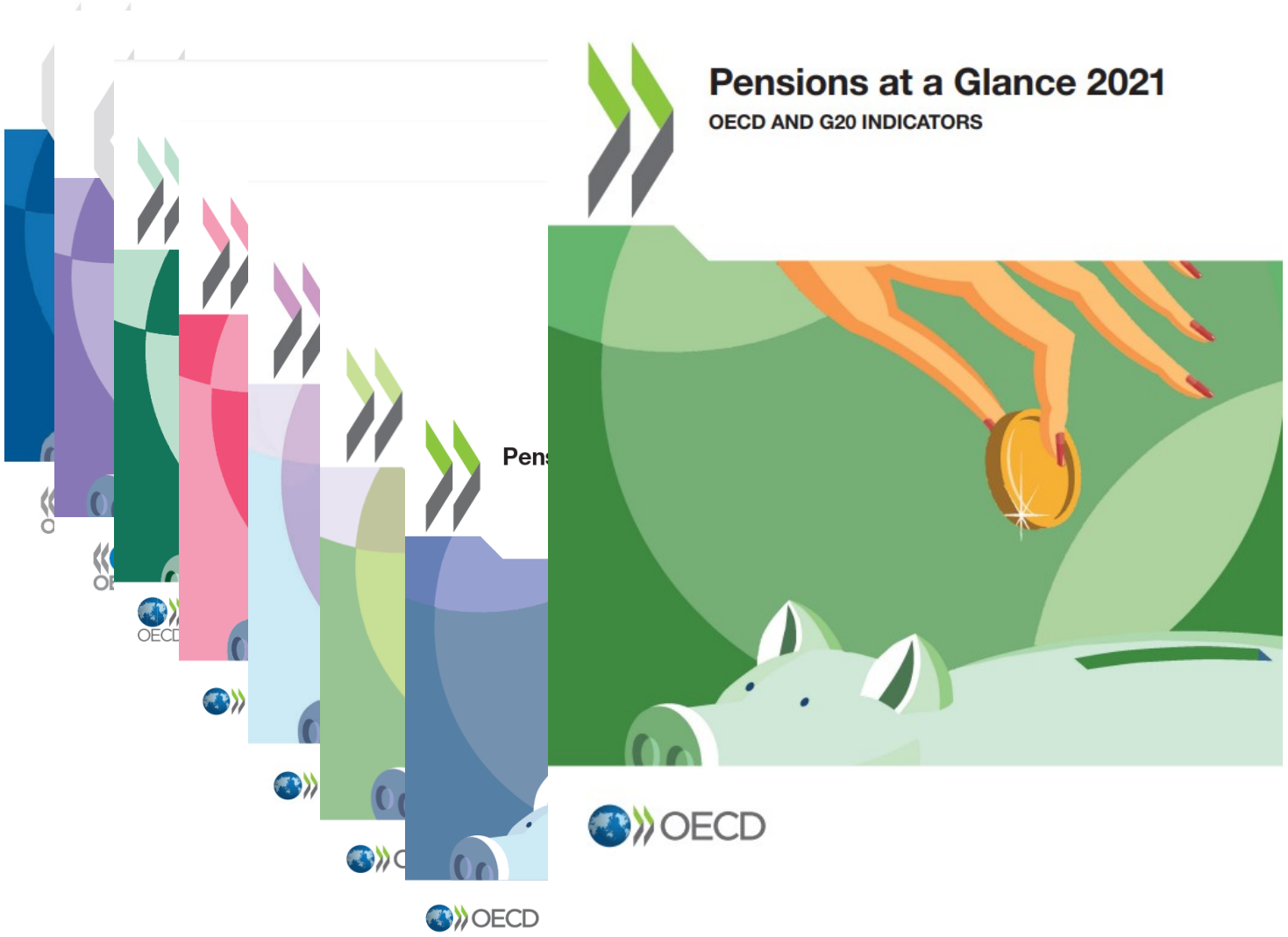
AAMs adjusting benefits and/or retirement ages

	Adjusts to life expectancy	Adjusts to size of the working population
Funded defined contribution • Annuities: benefits adjusted • Lump sums: people manage own longevity risk	●	
Notional defined contribution • Italy, Latvia, Poland • Norway, Sweden	● ●	●
Benefit adjustments • Finland • Estonia, Greece, Japan, Lithuania	●	●
Retirement age adjustments • Full: Denmark, Estonia, Greece, Italy • 2/3rds: Finland, the Netherlands, Portugal	● ●	

Automatic balancing mechanisms

- Adjustments to life expectancy and size of the working population insufficient to ensure financial balance $\Rightarrow$ Need to be **complemented** by a balancing mechanism

- Balancing mechanisms aim to **balance pension budget**
  - Finland, Germany, the Netherlands, Sweden, the United States
  - Canada: backstop
    - Default adjustment if no political agreement on alternative way to restore balance



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