

III. The 2021 Ageing Report: pension reform reversal and adequacy risks in the EU

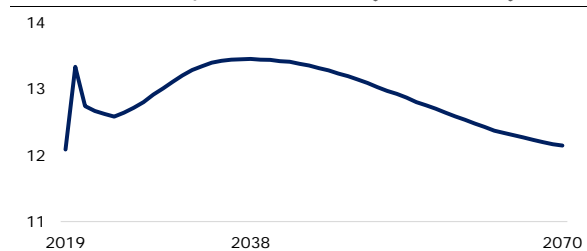
By Eloise Orseau and Ben Deboeck

The baseline projections in the 2021 Ageing Report incorporate current pension legislation across EU Member States. However, there has been a rising incidence of reform reversals in recent years, with governments undoing earlier pension measures, in particular increases in the retirement age. To account for the budgetary impact of such possible reversals, this article first looks at a policy scenario where effective retirement ages are frozen at their current levels. The cost of withdrawing planned increases in the legal retirement age is sizeable in most countries, underscoring the risks posed by future policy reversals for pension expenditure in some Member States. This section also shows that, at current legislation, the baseline projections point to a quasi-universal decline in pension benefits relative to wages. For this reason, a second policy scenario assumes that governments are compelled to raise pension benefits at some point, by changing parameters such as benefit indexation, the valorisation of contributions, or the level of minimum pensions. If such a scenario were to unfold, the estimates point to a considerable budgetary impact in the long term for the Member States concerned.

III.1. Introduction: the 2021 Ageing Report

The 2021 Ageing Report provides long-term projections for pensions and other age-related expenditure items for the EU Member States⁽³⁹⁾. Projections are based on a series of macroeconomic and demographic assumptions and reflect current pension legislation⁽⁴⁰⁾. In the euro area, on average, pension expenditure is expected to follow a bell-shaped time profile – disregarding the temporary hike in the pension expenditure-to-GDP ratio in 2020 because of the pandemic-induced recession (see Graph III.1). Under the baseline assumptions, pension spending would rise from 12.1% of GDP in 2019 to a peak of 13.4% in 2038. It would then decline, falling back to 12.1% of GDP in 2070.

Graph III.1: Public pension expenditure in the euro area, 2019-2070 (% of GDP)



Source: 2021 Ageing Report.

⁽³⁹⁾ European Commission (DG ECFIN) and Economic Policy Committee (AWG) (2021), 'The 2021 Ageing Report: Economic and budgetary projections for the EU Member States (2019-2070)', *European Economy*, No. 148/2021.

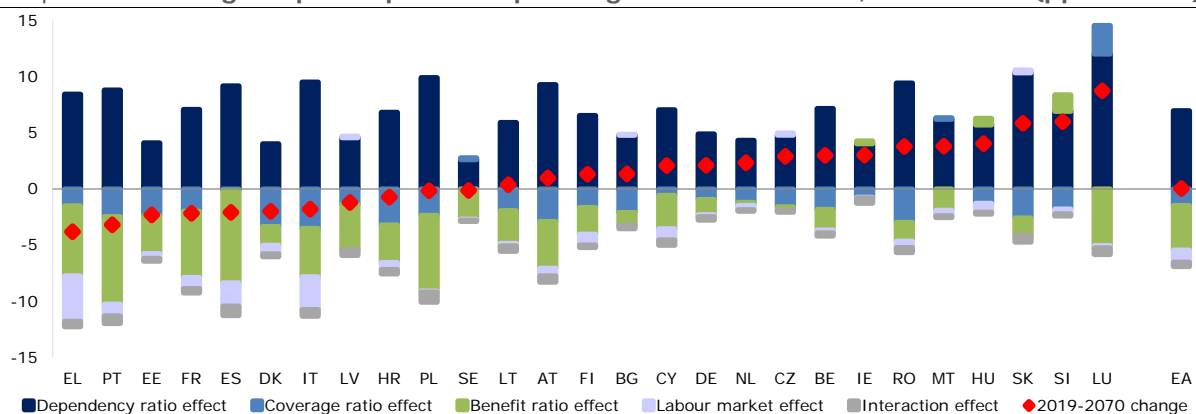
⁽⁴⁰⁾ European Commission (DG ECFIN) and Economic Policy Committee (AWG) (2020), 'The 2021 Ageing Report: Underlying assumptions and projection methodologies', *European Economy*, No. 142/2020.

Under the baseline scenario, public pension spending would rise in 16 Member States by 2070. The largest increases are expected in Luxembourg (+8.7 pps of GDP), Slovenia (+6 pps) and Slovakia (+5.9 pps) (Graph III.2). Among the 11 Member States in which pension expenditure is expected to decline, the largest falls are in Greece (-3.8 pps of GDP) and Portugal (-3.2 pps). However, in some cases the overall decrease in pension spending by 2070 conceals an initial increase. Spending is thus projected to rise in 20 Member States by 2030, after having already increased steadily in many countries in the past 10-15 years.

To understand better its dynamic, the total projected change in public pension expenditure by 2070 can be broken down into four components (see Graph III.2):

- The *dependency-ratio effect* quantifies the relative change in the old-age (65+) versus the working-age (20-64) population, with an ageing population leading to a higher ratio with pensions computed on the basis of present rules. By 2070, this demographic factor pushes up pension spending in all countries and by 7% of GDP on average in the euro area.
- The *coverage-ratio effect* measures the total number of pensioners against the old-age population (65+). This ratio provides information about access to pension systems. Lower coverage is expected to mitigate the ageing effect in nearly all countries and by 1.5% of GDP on average in the euro area by 2070.
- The *benefit-ratio effect* indicates how the average pension benefit develops relative to the average

Graph III.2: Change in public pension spending and main drivers, 2019-2070 (pps of GDP)



Source: 2021 Ageing Report (see Box II.1.2 for further details).

wage. It measures pension adequacy, reflecting how benefits are calculated and then indexed. Some exceptions aside, benefit ratios are projected to fall, lowering pension expenditure by 3.9% of GDP in the euro area by 2070.

- Finally, the *labour-market effect* captures the impact on pension spending of changes in labour-market behaviour, as captured by the employment rate, the number of hours worked and possible career-prolongation effects. It reduces expenditure in most countries, and by about 1% of GDP in the euro area by 2070.

The overall picture is thus one of stricter eligibility conditions and lower average benefits offsetting higher pension outlays due to ageing populations. The varying impact of the benefit-ratio and coverage-ratio effects mostly reflects the extent to which countries reformed their pension systems.

Given the long-term horizon of the *Ageing Report* projections, there is inherent uncertainty about the demographic and macroeconomic assumptions it makes. This is why the report performs a series of sensitivity tests around the baseline projections by applying uniform shocks to specific parameters, such as fertility and productivity. In addition, the *2021 Ageing Report* includes three policy scenarios that measure the impact of potential policy changes, thus deviating from the no-policy-change assumption of the baseline projections. In keeping with earlier exercises, one policy scenario estimates the impact of linking retirement ages to changes in life expectancy. The two other policy scenarios are new and address policy events that are particularly relevant given recent developments.

- There have been a number of pension reform reversals in the EU in recent years, as discussed in Subsection III.2. By freezing effective retirement ages at current levels, the *unchanged retirement age* scenario acknowledges this implementation risk and assesses the budgetary implications of withdrawing future increases in legal retirement ages that were already legislated. This scenario is discussed in Subsection III.3.
- The baseline projections point to a general decrease in benefit ratios, signalling problems of pension adequacy in some cases. While falling benefit ratios would help contain pension expenditure, excessively low adequacy could compel governments to take corrective measures to raise benefits. The *offset declining pension benefit ratio* scenario, presented in Subsection III.4, assesses the budgetary impact of such measures.

III.2. A rising incidence of reform reversals

In recent decades, most Member States have improved their pension systems' sustainability by limiting pension expenditure increases. Reforms were usually phased-in gradually and will often significantly alter the pension regime over time. Reform measures were wide-ranging. Some tightened eligibility criteria, with higher statutory retirement ages, longer minimum contributory periods and more limited early retirement pathways. Others changed the calculation of pensionable earnings; phased out special pension schemes; introduced penalties for early retirement and bonuses for late retirement; or made pension indexation rules less favourable. Some countries have armed their pension systems against demo-

graphic ageing by adopting automatic adjustment mechanisms, including: (i) automatic balancing rules that lower indexation or raise contributions; (ii) sustainability factors that adjust pension benefits to gains in life expectancy; and (iii) automatic links between the retirement age and life expectancy. In addition, several Member States radically redesigned their public pension system, for example by moving from a defined benefit to a notional defined-contribution scheme (NDC) or by introducing a statutory, funded defined-contribution pillar (FDC) ⁽⁴¹⁾.

The 2008 financial crisis and the subsequent euro area debt crisis accelerated the intensity of reforms. This led to the adoption of prompt, temporary and additional structural measures, as discussed in Carone et al. (2016) ⁽⁴²⁾. Legal retirement ages rose in nearly every Member State following the crisis, so that the average statutory retirement age in the EU in 2030 is set to increase by 1.8 years for men and by 3.3 years for women, compared to 2010. Since 2010, 10 Member States have adopted at least one of the three automatic adjustment mechanisms described above, mostly in the period 2010-2013. Currently, 15 Member States apply such mechanisms.

Around 2015, the focus of pension reforms started shifting away from fiscal sustainability towards fairness and benefit adequacy. As a result, certain crisis-induced reforms were adjusted, for example by phasing in measures more gradually, or by taking additional measures to address adequacy concerns. In other cases, governments fully or partially reversed earlier reforms, in particular reforms that had already been enacted, or pending increases in the legal retirement age. However, too low an effective retirement age may exacerbate issues of old-age income adequacy as people retire before obtaining full pension rights.

Some revisions were made necessary by court rulings. This was the case in Portugal, where the

Constitutional Court considered several pension reforms unconstitutional, such as the alignment of the civil servants' scheme with the general scheme, or suspensions of 13th and 14th monthly pension payments. In Greece, the legality of some benefit cuts was successfully challenged in court.

The first major reversals of structural pension reforms took place in two non-euro area countries: Poland (2016) and Czechia (2017).

- In 2012, the Polish Parliament approved an increase in the retirement age for both sexes, increasing it gradually from 65 to 67 years by 2020 for men and from 60 to 67 years by 2040 for women. The reform was repealed at the end of 2016, returning to a statutory retirement age of 65 for men and 60 for women. The annual budgetary cost of this reversal was estimated at 0.8-1% of GDP in 2020-2040, in addition to lower adequacy given shorter average careers and the impact of the sustainability factor embedded in Poland's NDC system ⁽⁴³⁾.
- In 2011, Czechia linked the statutory retirement age to changes in life expectancy. However, in 2017, a cap at 65 years was reintroduced, which will be reached in 2030 and is estimated will cause an additional increase in pension expenditure of 1.7 pps of GDP by 2070 ⁽⁴⁴⁾. Although the law still requires the government to monitor developments in life expectancy, the government did not propose any changes beyond 2030 at the time of the first possible revision, in 2019.

More recent examples of pension reform reversals include Slovakia (2019), Croatia (2019), the Netherlands (2019) and Ireland (2020).

- Slovakia adopted a link between pension age and life expectancy in 2012 and applied this link as of 2017, using a starting point of 62 years for both men and women. In 2019, however, the link was abolished after a constitutional amendment stipulated that the retirement age cannot

⁽⁴¹⁾ Under defined contribution schemes (either notional or funded), the pension benefit depends on the contributions made as well as other parameters such as remaining life expectancy. NDC schemes are pay-as-you-go with only a 'notional' capital being accumulated since the contributions are never actually invested. In the case of FDC schemes, the contributions are invested to finance the corresponding pension rights in the future.

⁽⁴²⁾ Carone, G., Eckefeldt, P., Giamboni, L., Laine, V. and S. Pamies (2016), 'Pension reforms in the EU since the early 2000s: Achievements and challenges ahead', *European Economy*, No. 42/2016.

⁽⁴³⁾ Country fiche on Polish pension projections, accompanying the 2018 Ageing Report, https://ec.europa.eu/info/sites/default/files/economy-finance/final_country_fiche_pl.pdf.

⁽⁴⁴⁾ Country fiche on Czech pension projections, accompanying the 2018 Ageing Report, https://ec.europa.eu/info/sites/default/files/economy-finance/final_country_fiche_cz.pdf. Higher indexation added 0.3 pps of GDP in pension spending by 2070.

exceed 64. This maximum retirement age of 64 is reduced for mothers by 6 months for each of the first three children. The amendments prevent any further increases beyond circa 2030. It is estimated that this reversal will raise pension expenditure by 2.2 pps of GDP by 2070 ⁽⁴⁵⁾.

- In 2018, Croatia brought forward the planned full convergence of women's retirement ages to those of men – from 2030 to 2027 –, followed by a gradual increase in the statutory retirement age to 67 by 2033, 5 years earlier than planned. Croatia also increased penalties for early retirement. However, these measures prompted strong resistance from the trade unions, who collected enough signatures to call a referendum. The government therefore annulled some of the measures, setting the statutory and early retirement ages back to 65 and 60, compared to 67 and 62 under the short-lived legislation. The annual budgetary impact of this reversal was estimated at 0.4 pps of GDP by 2040 ⁽⁴⁶⁾.
- In the Netherlands, the 2012 reform involved a gradual increase in the statutory retirement age to 67 by 2023 and a full link to gains in life expectancy thereafter. In 2019, the target year was postponed from 2023 to 2024, and the link to life expectancy was limited to two thirds of the gains. This weaker link will push up pension expenditure by 0.8 pps of GDP by 2070, according to the *2021 Ageing Report* ⁽⁴⁷⁾.
- Under the 2011 social welfare bill, the Irish state pension age was to rise from 66 years to 67 in 2021 and 68 in 2028. However, on taking office in mid-2020, the new government announced that it would keep the retirement age at 66. This raised the estimated increase in pension spending by 0.5 pps of GDP by 2050.

In Italy and Spain, rules that were introduced to limit pension spending were temporarily suspended in recent years. However, if temporary suspensions

are repeatedly extended, they risk becoming the norm.

- In Italy, a new temporary scheme was introduced in 2019 to allow early retirement for people who were at least 62 years old in 2019-2021 and had a career of 38 years ('Quota 100'). The possibility for women aged at least 58 to retire after a career of 35 years ('Opzione donna') was supposed to expire in 2015 but has been renewed every year since then. For people exiting work through these schemes, pension benefits are reduced given Italy's NDC system. Nevertheless, as the measures have increased the number of new pensioners, the budgetary impact amounted to 0.4% of GDP in 2020 ⁽⁴⁸⁾.
- As part of its 2013 pension reform, Spain adopted two automatic adjustment mechanisms. The first mechanism was the index for pension revaluation (IPR), which adapts annual benefit indexation to the projected financial situation of the pension system, with a minimum indexation of 0.25% and a maximum increase of consumer prices (CPI) +0.5%. In 2018-2019, however, the IPR was suspended and replaced by CPI indexation. This suspension was extended in 2020 and again in 2021. Moreover, there is broad political support for permanently replacing the IPR by CPI indexation, with legislation to this effect pending at the moment of writing. According to the *2021 Ageing Report*, applying CPI indexation instead of the IPR would increase pension expenditure by 1.4 pps of GDP in 2030, rising to 2.7 pps in 2050 ⁽⁴⁹⁾. The second mechanism introduced in the 2013 reform was a sustainability factor to adjust new pensions for changes in remaining life expectancy at the age of 67, the statutory retirement age as of 2027. Its entry into force, initially planned for 2019, was postponed to 2023 at the latest. If the sustainability factor were never to be applied, this would cause pension spending to be 0.8 pps of GDP higher in 2050 and 1.4 pps higher in 2070 ⁽⁵⁰⁾.

⁽⁴⁵⁾ Updated country fiche on Slovak pension projections, accompanying the *2018 Ageing Report*, https://ec.europa.eu/info/sites/default/files/economy-finance/update_of_the_country_fiche_on_public_pensions_for_the_ageing_report_2018_-_slovakia.pdf.

⁽⁴⁶⁾ Country fiche on Croatian pension projections, accompanying the *2021 Ageing Report*, https://ec.europa.eu/info/sites/default/files/economy-finance/hr_-_ar_2021_final_pension_fiche.pdf.

⁽⁴⁷⁾ Country fiche on Dutch pension projections, accompanying the *2021 Ageing Report*, https://ec.europa.eu/info/sites/default/files/economy-finance/nl_-_ar_2021_final_pension_fiche.pdf.

⁽⁴⁸⁾ Updated country fiche on Italian pension projections, accompanying the *2018 Ageing Report*, https://ec.europa.eu/info/sites/default/files/economy-finance/country_fiche_it-2019_peer_review.pdf.

⁽⁴⁹⁾ Country fiche on Spanish pension projections, accompanying the *2021 Ageing Report*, https://ec.europa.eu/info/sites/default/files/economy-finance/es_-_ar_2021_final_pension_fiche.pdf.

⁽⁵⁰⁾ *Ibid.*

Box I.2.2 of Volume 1 of the *2021 Ageing Report* provides an overview of pension reforms legislated by Member States in recent years. As most of the observed reversals relate to increases in the retirement age, the *2021 Ageing Report* includes a new scenario that freezes legal and effective retirement ages at their current levels. This scenario is presented in the next subsection.

III.3. What if effective retirement ages do not rise as planned?

Retirement ages in the baseline projections

The baseline projections of the *2021 Ageing Report* incorporate legislated changes in legal retirement ages. In line with the no-policy-change assumption, the baseline scenario considers that all adopted measures will effectively be implemented. The measures increase both early and statutory retirement ages, in some cases by linking them to gains in life expectancy, with an overall impact of around 2 years on average (Table III.1).

Table III.1: Legal retirement ages in the baseline scenario

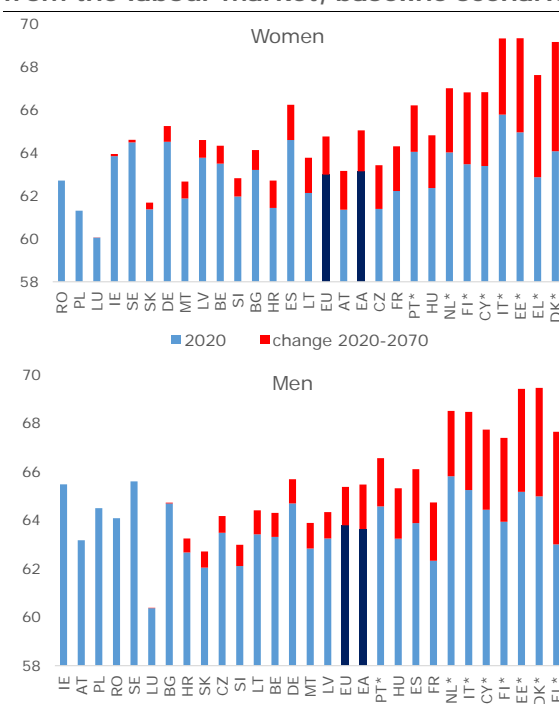
	Statutory retirement age				Early retirement age			
	Male		Female		Male		Female	
	2019	2070	2019	2070	2019	2070	2019	2070
BE	65	67	65	67	63	63	63	63
BG	64.2	65	61.3	65	63.2	64	60.3	64
CZ	63.5	65	61.2	65	60	60	58.2	60
DK*	65.5	74	65.5	74	63	71	63	71
DE	65.7	67	65.7	67	63	63	63	63
EE*	63.6	69.8	63.6	69.8	60.6	64.8	60.6	64.8
IE	66	66	66	66	66	66	66	66
EL*	67	72.6	67	72.6	62	67.6	62	67.6
ES	65.7	67	65.7	67	63.7	65	63.7	65
FR	66.8	67	66.8	67	61.8	62	61.8	62
HR	65	65	62.3	65	60	60	57.3	60
IT*	67	71	67	71	64	68	64	68
CY*	65	69.9	65	69.9	65	69.9	65	69.9
LV	63.5	65	63.5	65	61.5	63	61.5	63
LT	63.8	65	62.7	65	58.8	60	57.7	60
LU	65	65	65	65	57	57	57	57
HU	64	65	64	65	64.3	65	64.3	65
MT	62.9	65	62.9	65	61	61	61	61
NL*	66.3	69.8	66.3	69.8	66.3	69.8	66.3	69.8
AT	65	65	60	65	60	60	58	60
PL	65	65	60	60	65	65	60	60
PT*	66.4	69.3	66.4	69.3	60	60	60	60
RO	65	65	61.2	63	60	60	56.2	58
SI	65	65	64.5	65	60	60	60	60
SK	62.5	64	62.5	64	60.5	62	60.5	62
FI*	63.5	67.7	63.5	67.7	61	64.8	61	64.8
SE	67	67	67	67	61	62	61	62
EA	65.0	67.3	64.7	67.3	61.9	63.5	61.7	63.5
EU	65.0	67.0	64.1	66.7	61.9	63.5	61.2	63.2

*Countries where the statutory retirement age is legislated to increase in line with life expectancy. Retirement ages for these countries are calculated on the basis of life expectancy in Eurostat's population projections.

Source: 2021 Ageing Report.

These hikes take place in a context of population ageing which puts pension systems under stress. Eurostat's April 2020 long-term demographic projections, which underlie the *2021 Ageing Report*, assume sustained increases in life expectancy at birth. In the euro area as whole, life expectancy is expected to increase by 6.6 years for men between 2019 and 2070 (from 79.9 to 86.5) and by 5.6 years for women (from 85.0 to 90.6). Neither new births nor migration are projected to be enough to offset the ageing trend, with fertility rates remaining below the natural replacement rate of 2.1 in all euro area countries, and net migration inflows stabilising at around 0.2% of the total euro area population per year. As a result, the euro area would move from having 28 working-age people for every 10 people aged 65 or above in 2019 to only 17 in 2070.

Graph III.3: Average effective exit ages from the labour market, baseline scenario



* Countries that link the statutory retirement age to gains in life expectancy.

Source: 2021 Ageing Report.

Increasing legal retirement ages and penalising early retirement encourages workers to stay longer in the labour market, translating into higher effective retirement ages. For the age group 55-64, the labour-market participation rate already increased from 38% in 2000 to 62% in 2019 in the EU, mainly due to increases in early and statutory retirement ages. In most countries that have recently adopted pension reforms, the reforms are projected to have

a sizeable further impact on the participation of older workers in coming decades. It is projected that, by 2070, these reforms will lift the participation rate of people aged 55-64 by about 9 pps on average, and by about 8 pps for the age group 64-75. Therefore, the baseline projections point to an increase in effective retirement ages – as proxied by labour market exit ages (Graph III.3) – although they would remain lower than legal retirement ages.

Later exits from the labour market reduce public pension expenditure through the coverage-ratio effect. Because people start to draw pension benefits later, the number of pensioners increases by less than the number of people aged 65 and over, lowering the coverage ratio. Nearly all the countries that plan to increase statutory retirement ages therefore see the coverage-ratio effect reducing their public pension expenditure as a share of GDP (see Graph III.2). Moreover, among the 6 euro area countries in which the coverage-ratio effect is expected to reduce public pension expenditure by at least 2 pps of GDP, 4 have set their statutory retirement age beyond 65 (Italy, Portugal, Estonia and France) and 3 have linked future increases to gains in life expectancy (Italy, Portugal and Estonia).

The ‘unchanged retirement age’ scenario

The actual implementation of pension reforms is subject to a significant policy risk. In light of the recent cases listed above, there is a risk that other reforms could be reversed in the future, especially as many of the increases in retirement ages legislated in the past decade have not yet been fully enacted but will be phased in gradually.

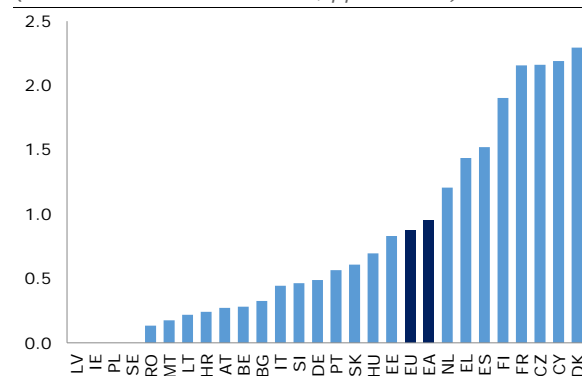
The *2021 Ageing Report* assesses the impact of such reform reversals through a specific scenario. This scenario assumes that retirement conditions (statutory and early retirement ages, as well as career-length requirements) are kept unchanged from the starting point onwards, i.e. it assumes that the planned changes that have already been legislated for do not occur. In practice, this means that effective retirement ages remain at their 2020 levels. The scenario focuses on reforms that have already been legislated but are not yet applicable.

Findings

Failing to increase legal retirement ages as planned would increase public pension expenditure in most

EU countries. The budgetary impact would be considerable for most of the countries that currently have a link between pensions and life expectancy, especially Denmark, Cyprus, Finland, Greece and the Netherlands (Graph III.4). There would also be a large impact in three other countries (Czechia, France and Spain), where a freeze in the effective retirement age would push up pension expenditure by at least 1 pp of GDP by 2070 relative to the baseline projections. By contrast, the estimated impact is near zero for the countries that, based on current legislation, have an unchanged retirement age in the baseline, such as Ireland, Poland and Sweden. In the euro area as a whole, pension expenditure would rise by nearly 1 pp of GDP by 2070 relative to the baseline.

Graph III.4: **Unchanged retirement age scenario: impact on public pension expenditure in 2019-2070**
(deviation from the baseline, pps of GDP)



Source: 2021 Ageing Report.

This scenario illustrates the risks of policy reversals for future pension expenditure. Withdrawing plans to increase retirement ages would have adverse long-term implications for both growth (through lower labour input) and public finances. Conversely, fully implementing adopted laws is essential to make economic policy predictable and credible.

For future reforms, gains in life expectancy provide a useful benchmark for the increase in retirement ages. A dedicated policy scenario included in the *2021 Ageing Report* assesses the implications of linking legal retirement ages to gains in longevity. To account for the likelihood that, in practice, more people might retire from the labour market under this scenario through sickness and disability schemes, the scenario increases effective retirement ages by three quarters of the increase in life expectancy. The resulting decline in the number of pensioners makes pension expenditure fall in

comparison to the baseline – in spite of the fact that longer careers imply higher average benefits, thus also contributing to the adequacy of pensions. In addition, stronger labour activity pushes up economic growth.

III.4. What if governments took measures to prevent pension adequacy from falling?

Adequacy in the baseline projections

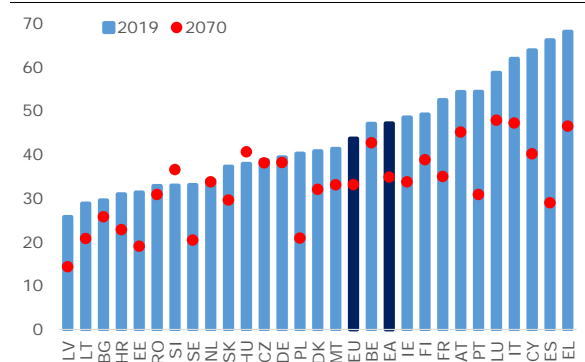
Pension adequacy is the extent to which pension benefits can guarantee retirees a decent standard of living. It therefore focuses on the lower end of the income distribution. Adequacy covers three things: (i) the ability to prevent and mitigate old-age poverty; (ii) the ability to replace income earned before retirement; and (iii) the ability to ensure that a reasonable share of a person’s life is spent in retirement ⁽⁵¹⁾. Two important indicators to assess adequacy are the benefit ratio (the average pension benefit compared to the average wage in the economy) and the replacement rate (the average first pension as a share of the average wage at retirement).

countries where the current benefit ratio, and therefore pension adequacy, are already relatively low, such adjustments could further weaken pension adequacy. The *Ageing Report’s* baseline projections point to strong and persistent drops in benefit ratios for the public pension schemes, feeding substantial adequacy risks, in particular for countries that currently already have low benefit ratios (Graph III.5).

The ‘offset declining benefit ratio’ scenario

The projected fall in benefit ratios suggests that social and political pressures may emerge to prevent adequacy from declining too strongly. To account for this possibility, the *2021 Ageing Report* includes a scenario in which the benefit ratio cannot fall below 90% of its base-year value. This scenario is relevant for countries that have a low benefit ratio today, as this initial situation already requires correction. The scenario is also relevant for countries with comparatively high current benefits, because a large perceived loss in purchasing power by a growing cohort of retirees could stir up political pressure.

Graph III.5: **Earnings-related public benefit ratios: 2070 vs. 2019**
(% of average wage)

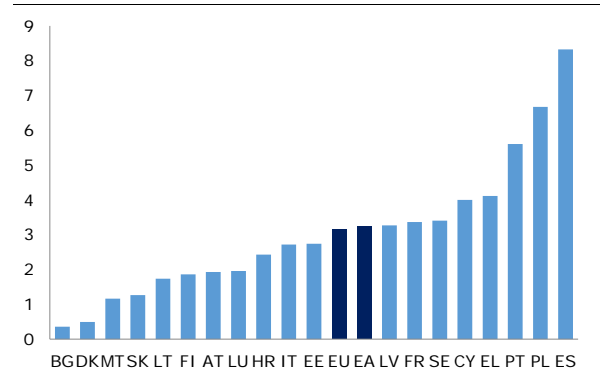


Earnings-related pensions are benefits for which entitlements depend on personal earnings/contributions to the old-age and early pension schemes.
Source: 2021 Ageing Report.

Past measures to preserve the sustainability of pension systems may reduce pension adequacy. As explained in the introduction, changes in the benefit ratio are the main cause of lower pension spending (Graph III.2). In many cases, this is due to reforms adopted in the past decade to strengthen the viability of pension systems. For

In concrete terms, the scenario does not allow the earnings-related public benefit ratio to fall below 90% of the base-year level. Reaching that threshold is supposed to trigger measures that freeze the benefit ratio at this lower point for the remainder of the projection period, i.e. apply higher indexation. The year of activation and the level at which the benefit ratio is frozen are country-specific and determined by the baseline projections.

Graph III.6: **Offset declining benefit ratio scenario: impact on change in public pension expenditure in 2019-2070**
(deviation from the baseline, pps of GDP)



Source: 2021 Ageing Report.

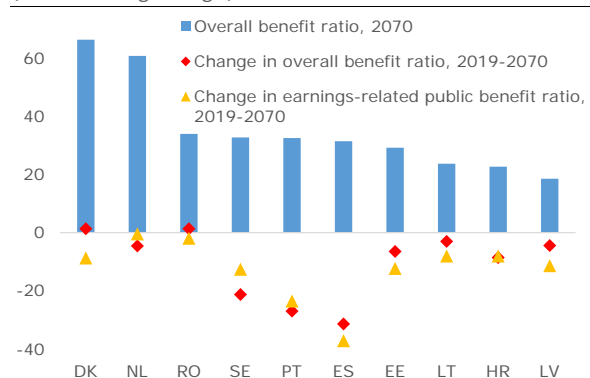
⁽⁵¹⁾ European Commission (DG EMPL) and Social Protection Committee (2021), ‘2021 Pension Adequacy Report’.

Findings

Preserving the adequacy of public pensions close to current levels would put large upward pressures on spending over the long term. In the euro area, pension expenditure would increase by an extra 3.2 pps of GDP on average by 2070 (Graph III.6). The euro area countries most affected would be Spain (+8.3 pps of GDP) and Portugal (+5.6 pps). The impact would reach 2-4 pps of GDP in 6 euro area countries (Italy, Estonia, Latvia, France, Cyprus and Greece) and 1-2 pps in 6 other euro area countries (Malta, Slovakia, Lithuania, Finland, Austria and Luxembourg).

Private pension schemes may partially mitigate the decline in public pension benefit ratios. Projections for these supplementary schemes are available for a subset of 10 Member States (Graph III.7). In most cases, they partially compensate for the projected lower generosity of public pensions, cushioning the decline in the total benefit ratio. Still, in some euro area countries such as Estonia, Latvia and Lithuania, low pension adequacy remains an issue, even when accounting for private schemes. Moreover, in some Member States, overall benefit ratios are projected to decline more than public benefit ratios (the Netherlands, Sweden and Portugal).

Graph III.7: **Public and overall benefit ratios** (% of average wage)



Source: 2021 Ageing Report.

Overall, this scenario illustrates a policy trade-off. All other things being equal, preserving the generosity of the pension system on social grounds comes at the expense of containing developments in pension expenditure. This may create a major challenge for the sustainability of pension systems, unless the additional spending is financed by higher contributions or longer working lives, two measures that can also be socially and politically sensitive.

III.5. Conclusion

Reforms enacted in recent decades generally mitigated fiscal sustainability risks stemming from rising pension expenditure. For instance, effective retirement ages have been rising and the adoption of automatic adjustment mechanisms in some Member States has made pension systems more resilient against ageing. However, the *2021 Ageing Report* points to lasting challenges in a number of Member States, underscoring the importance of monitoring carefully the growth in pension expenditure. This section discussed two types of uncertainty around these baseline projections.

The first type of uncertainty arises because the reform momentum seen in 2010-2015 was partly negated by a string of revisions or even outright withdrawals of past reforms, especially the prospective increases in the legal retirement age. If one were to assume that effective retirement ages are fixed at their current levels, pension spending would be about 1 pp of GDP higher in the euro area in 2070 compared to the baseline projections that incorporate legislated retirement age increases.

In parallel with these reform reversals, measures have been taken to improve the adequacy of pension benefits, a trend that can be expected to continue. Indeed, with unchanged policies, the *2021 Ageing Report's* projections point to a general decline in pension adequacy. This highlights a second significant policy uncertainty surrounding the baseline projections: in some countries, public pressure might urge authorities to stem the decline in old-age income by raising benefits. If such pressure capped the decline in average pension benefits at 10% of average wages, expenditure would be about 3 pps of GDP higher in the euro area in 2070 than implied by current rules.