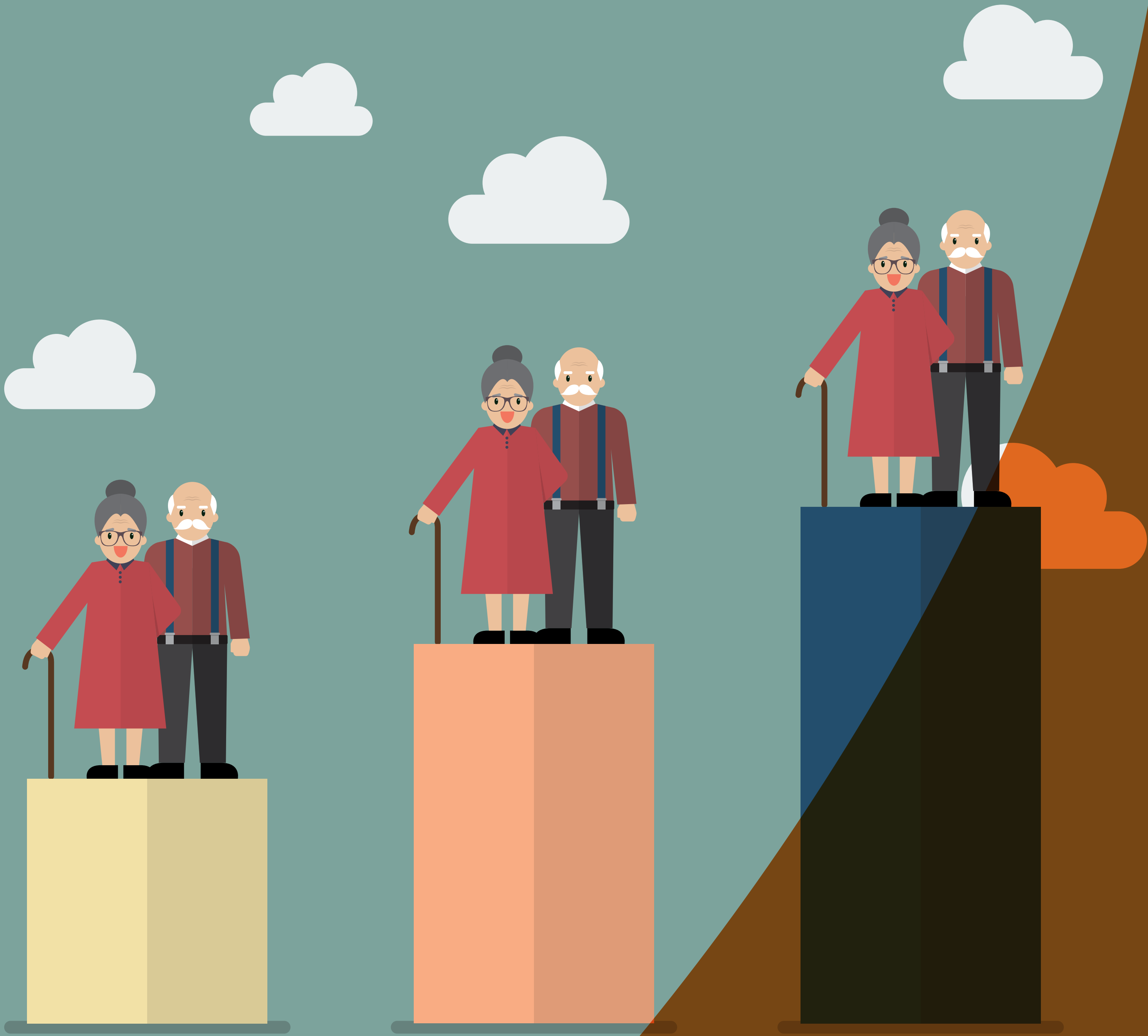


Adequacy and sustainability of pension systems in the context of demographic ageing

ITUC CSI IGB International Trade Union Confederation

FOREWORD

Adequacy and sustainability of pension systems in the context of demographic ageing

Social protection in old age is a **universal human right**, and governments have an obligation to deliver on this right. Globally, only **two out of three** people enjoy any form of pension. Under the pressure of demographic ageing and austerity, the right to social protection for elderly people is **in jeopardy** in many countries. In the next years, the number of people lacking adequate coverage **may increase further**. The global labour movement insists on the need to reverse these trends, taking serious steps to guarantee fair and decent levels of social protection to **everyone**.

Austerity has had a devastating impact on workers' well-being, and the most vulnerable in society have paid the highest price. To deal with demographic ageing and financial constraints, states have reformed pension systems in different ways, including raising the retirement age, cutting benefit levels, raising workers' contributions, and strengthening links between contributions and benefits. These policies have had not only negative macroeconomic effects, but also disastrous consequences for the retired, endangering their right to a decent and healthy living. These measures have also directly contradicted international labour standards, including ILO Convention C102 and Recommendation 202, as well as the UN Agenda 2030 target to extend social protection.

In times of crisis, social protection is often framed as unaffordable, leading to cuts in public spending. However, social protection is not a luxury for good economic times – it is **a key factor for reducing poverty and inequality, and supporting well-functioning, sustainable economies**. Social protection helps to strengthen aggregate demand and boost local markets; it promotes skills development and employment; it protects people from shocks and feeds people's confidence in the economy and the state, and it encourages sustainable and inclusive growth. A society that invests in social protection is a **fair and just society**, pursuing economic security and development together.

Financing social protection, including decent and secure pensions, is possible. The ILO has estimated that **a mere 0.23%** of the world's GDP would suffice to provide social protection floors for the global population. As a point of comparison, an estimated 10% of the world's GDP is held in tax havens. States have a number of options at their disposal to ensure adequacy and sustainability of pensions, and they should use make use of them. They should **address untapped labour suppl**y by **removing barriers to labour market participation**. This means addressing employment gaps that penalise **women, young people and migrants**. This also requires supporting informal workers' **transition to the formal economy**. Tackling **tax evasion** and improving the progressivity of **taxation systems**, are likewise essential, including through leveraging wealth, corporate and financial taxes. Workers increasingly carry the burden of contributions to pension systems, but **employers need to pay their fair share of social security contributions**. Moreover, financing social protection could go hand in hand with measures to support **a just transition to a low-carbon economy**, for instance introducing resource levies or carbon taxes, and allocating these revenues to pension funds.

Ensuring adequate social protection is not fiction: it is a question of political will.

Sharan Burrow,
ITUC General Secretary

EXECUTIVE SUMMARY

The paper reviews several of the measures that States have taken with the intention of improving the sustainability of pension systems and evaluates their effectiveness. The paper highlights that many of the measures taken have had negative distributional impacts and have significantly compromised the primary function of pension systems: to provide a secure replacement income for people in old age and prevent their ability to fall into poverty.

While many governments and international institutions have framed pension reforms as an inescapable trade-off between adequacy and sustainability, unions insist that addressing the challenges of demographic ageing requires adopting a new overarching narrative, combining greater efforts to support labour market participation of excluded groups, enhanced revenue through progressive and innovative forms of taxation, and the guarantee of a decent income in retirement at the centre of this agenda.

The demographic challenge: less people working relative to those in old age

Societies around the world are experiencing a **dramatic increase in life expectancy coupled with a decline in fertility rates**. On average, life expectancy has increased by over 10 years since 1970[1].

By 2030, there will be more people over age 60 than children under 10 globally[2]. While 73% of the world's elderly will be living in developing countries[3], advanced economies will be impacted the most by demographic ageing. In the EU, more than one quarter of the population will be 65-and-older in 2050[4]. Japan, Italy and Germany are already among the top five countries with the oldest populations in the world[5].

These demographic trends have led **to a decline in the share of the working age population relative to the elderly**. In the OECD, the old-age dependency ratio (i.e., the number of elderly people relative to those in active age) was 14 out of every 100 people in 1950; by 2015 it had doubled to 28 out of every 100 people. By 2075 it is expected to double again, reaching 58 out of every 100 people[6]. **These trends have broad economic implications** for both countries with pay-as-you-go (PAYG) and fully funded pension systems. In PAYG countries, as more people leave the labour market, fewer contributions will be collected, thus fewer workers will have to provide sufficient income replacement for an increasing number of recipients over a longer period of time. In fully funded systems, the shrinking workforce can negatively affect productivity and growth, moderating financial markets' confidence, depressing interest rates and financial returns and eventually eroding pension fund assets.

Moreover, while people are living longer, they are not necessarily living healthier, often developing illnesses and disabilities in their last years of life. While on average in OECD countries, people at age 65 can expect to live 19.5 years, only 9.4 of those years are considered healthy life years (see figure in Annex). **Increased ageing therefore puts additional financial pressure not only on pension systems, but also puts increased demand on health and long-term care systems**.

According to ILO estimates, Japan's GDP would need to grow by at least 2% every year to offset the negative impact of a shrinking labour force[7]. Forecasts suggest that, in the next decades, almost all of the labour productivity gains of Italy, Germany and the US would need to be "absorbed" to counter the impact of ageing on productive capacity[8].

Adequacy and sustainability of pension systems: obstacles and policy responses

Addressing the sustainability of pension systems cannot be disconnected from a discussion around their adequacy. Low coverage of pensions and **insufficient benefit levels** are already major challenges in many countries, compromising older people's ability to live in economic security and dignity during retirement. Globally around one third of people worldwide do not enjoy any form of pension[9] and around one in 10 people over 65 live in poverty in the OECD[10]. This figure increases to one in five elderly people in Japan, one in four in Australia and Mexico, and nearly one in two in South Korea[11].

Women, informal workers, and people in low paid and precarious forms of work are particularly at risk because of insufficient pension contributions, and thus non-existent or insufficient pension entitlements later on in old age. Globally, only 26.4% of women are covered by a contributory old-age pension, and women's pension benefits are worth 40% less than men in the EU alone.

In the pursuit of improving the sustainability of social protection systems, states have lately pursued several main avenues of reform, which include: increasing the retirement age and phasing out early retirement; reducing benefit levels; tightening the link between contributions and entitlements; shifting towards occupational and private pensions; and increasing social security contributions. **In many cases such reform measures have further compromised the adequacy of pensions and further reduced their effectiveness in providing a secure retirement for older people**.

The implications of each of these measures is discussed in turn:

- **Raising the retirement age and phasing out early retirement options** have been popular tactics for states to respond to demographic ageing, under the rationale that as workers are living longer, they must remain in the labour market for longer. Such measures thus increase the period of contributions while reducing the duration of benefits. However, **such policies often neglect the barriers that may exist for older people to remain in the labour market** – as their skills may not been adapted to changing labour markets, and they also may face significant discrimination. Raising the retirement age has thus been shown not to be very effective in increasing the overall employment rate of older people, but rather can often lead older people to draw on other forms of social support such as unemployment benefits, social assistance or disability benefits[12]. **Such a policy may also neglect that healthy life expectancy is not rising as fast as overall life expectancy, forcing workers to continue working even though they may no longer be fit to do so**. This problem is particularly acute for lower skilled workers, who tend to have a shorter healthy life expectancy from a much lower age compared to other groups, as well as those who have worked in arduous or hazardous jobs[13]. Raising the retirement age may not be effective in securing financial sustainability. Estimations based on OECD data show that in order to stabilise the old-age dependency ratio by 2050, governments might need to shift the age boundary by a stunning 8.4 years – with such delays not being physically feasible for many workers[14].

- **Reducing benefit levels** has been another strategy used by some states to compensate for increasing life expectancy. The European Commission foresees a decrease in replacement rates by 5% in the majority of the EU member states for the average wage earners[15], and a further decrease of 15% in six states. At the global level, replacement rates will probably decrease by 20% in the long term[16]. Such policies risk significantly old age poverty, which is already unacceptably high, as well as reducing aggregate demand. Cuts to statutory benefit levels might also lead many pensioners to resort to complementary occupational or private pensions in order to ensure an adequate replacement income in retirement (if they can afford it and/or if their employers provide such occupational benefits), thereby reinforcing and exacerbating inequalities between socioeconomic groups.

- **Tightening the link between contributions and benefits** has also been undertaken in many countries. **Strengthening this link, however, can ultimately reproduce, if not amplify, inequalities in the labour market into inequalities in pension entitlements**. This is because such measures negatively impact the benefits of those who have shorter and non-standard careers, and hence interrupted or discontinuous contributory histories. As women are overrepresented in informal, underpaid, and non-standard arrangements, as well as experience greater gaps in their working histories due to care, they are thus disproportionately penalised by such measures compared to men[17]. For similar reasons, market "outsiders" such as the low-skilled, migrants, and those within atypical or precarious workers might end up getting to retirement age with low or no pension at all.

- **Strengthening complementary pensions:** Some states have gradually reduced their responsibilities in social security systems, retrenching statutory schemes whilst promoting the increased use of occupational and/or private pensions. **Such policies tend to have regressive effects**. They often leave out those in precarious forms of work, whose employers might not contribute to occupational pension scheme, as well as low income earners who have a lower capacity to save within private schemes. They may also penalise the self-employed, who might be excluded from occupational pensions schemes or unable to afford paying into them. As the link between contributions and benefits in occupational and private pension schemes are very strong, such schemes again tend to translate labour market inequalities into inequalities in pension entitlements. Finally, in countries where occupational/private pensions are voluntary and/or where they provide for poor replacement rates, moral hazard and economic constraints may prevent people from enrolling themselves and/or lead them to contribute at lower rates than needed for a decent pension.

- **Adjusting social security contributions**. Several states have opted for an increase in mandatory contribution rates for employers and/or workers. While social security contributions can be an effective way of leveraging finance for social protection, such **rises in contribution rates have often not been balanced between workers and employers, and have run contrary to the objective of distributional fairness**. In Chile, for example, the government recently agreed to introduce a 4% employer contribution rate phased in over an eight-year period in order to reduce financing shortfalls for social protection, however employees are required to continue to contribute 10% of covered pay. In Romania, social security contributions for employers were significantly reduced, but shifted on to workers – leading to a significant loss in employee's real wages, which are already among the lowest in the EU. While ILO Convention 102 on social security sets out that employees should not shoulder more than 50% of contributions, states are often ignoring this provision within their reform efforts.

Ensuring both sustainability and adequacy: the way forward

Facing demographic change and harsh financial constraints, many **governments have framed pension reforms as an inescapable trade-off between adequacy and sustainability**. However, sustainability cannot be considered as the stand-alone objective of pension systems– they must also be adequate in order to fulfil their primary function of providing a secure replacement income for people in old age and preventing poverty.

To overcome this Manichean debate between adequacy and stability, a well-designed, multi-faceted strategy is needed, making sure that future adjustments leave no one behind. This requires governments to adopt a new overarching narrative, combining greater efforts to support labour market participation of excluded groups, enhanced revenue through progressive and innovative forms of taxation, and the guarantee of a decent income in retirement at the centre of this agenda.

Supporting labour force participation is especially critical. In the context of a shrinking share of the working-age population relative to the elderly, **States must step up their efforts to support the labour market participation of those who have been excluded. Addressing such underutilised labour supply can help to increase tax and social security contributions, increase productivity and support overall economic growth**. To this end, states should:

- **Intensify measures to reduce the gender employment gap:** Globally the gender gap in labour force participation rates stands at 26.5 percentage points (75% for men versus only 48.5% for women)[18]. In addition, women are less likely to work full time because of difficulties reconciling work and family life. Closing gender gaps in employment can be supported through effective work-life balance measures and measures to reduce the unequal distribution of work and care between women and men. Ensuring the availability of affordable childcare and long-term care, promoting a balanced use of parental leave between parents, and supporting flexible working arrangements available to both women and men have all been shown to be helpful in this regard. Robust antidiscrimination measures and effective enforcement are moreover essential.

- **Address youth unemployment:** The ILO has estimated that young people account for over 35 per cent of the unemployed population worldwide in 2017. It is moreover estimated that 22 % of the world's youth are neither in employment, education or training. These trends signal a waste of young people's skills and potential in the labour market, and are also a threat to social cohesion and intergenerational fairness. States must therefore look at how to address the barriers young people are facing in entering and remaining in the labour market. The ''youth guarantee'' model, whereby a young person is ensured a quality offer of employment, continued education, apprenticeship or traineeship within 4 months of becoming unemployed, can be a useful example for States in this regard[19].

- **Support the formalization of the informal economy:** According to the ILO, more than three in five workers in the world – 61.2 per cent or two billion people – are in the informal economy. These workers are often lack basic protections and rights at work and are typically exempted from minimum wages and social protection coverage. Formalising informal workers can greatly improve the security and livelihoods of these workers while simultaneously enhancing general tax revenue and social security contributions. Governments should take measures to support the transition to the formal economy in line with ILO Recommendation 204, including by providing incentives for, and promoting the advantages of, the effective transition to the formal economy; facilitating the declaration of economic activities and the payment of taxes and social security contributions; and improving access to finance, education and skills training.

- **Consider the positive effects of migration on labour supply:** In some states, migration may help to compensate for a declining labour supply, especially as migrants tend to be younger than the native-born population. In many states, including Germany, the United Kingdom and Italy, newcomers have been shown to provide a stable supply for services, elderly care activities, and domestic jobs[20]. Immigrants have been shown to contribute far more in taxes and contributions than they receive in social protection and services. In Italy alone, according to the Moressa Foundation, migrants produced 130 billion euros of added value in 2016, equivalent to 9 percent of GDP, and made 11.5 billion in social security contributions, thereby significantly relieving pressure on the statutory social security system[21]. States can support migrants' integration in the labour market by providing a legal status to economic migrants along with a right to work; ensuring equal treatment through implementing and enforcing, antidiscrimination laws; providing a pathway for recognizing migrants' previously-acquired education and skills; supporting the portability and transferability of social protection benefits; and enhancing access to quality education, language skills, and vocational training.

- **Support the employability of older workers:** Older workers often face significant barriers to remain in the labour market –at times experiencing illness and sometimes disability and the end of their professional careers, difficulty adapting their skills to a changing labour market, and in age discrimination within hiring and firing processes. Within OECD countries, the employment rate starts to fall sharply with age from age 55[22]. States can support older workers by ensuring effective employment protection, stepping up measures for training and lifelong learning, taking measures to stop discrimination against older workers, and actively challenging stereotypes. Moreover, while it has been explained earlier that raising the overall retirement age is not necessarily feasible nor fair for everyone, particularly for workers in arduous jobs, some workers who derive satisfaction from their work might wish to work for longer and could be supported in doing so. An EU survey reports that a sizeable minority (23%) of elderly people would like to combine a part-time job with a partial pension, rather than retire fully[23]. Older workers who wish to remain in the labour market for longer should be supported in doing so, and States could support them by considering flexible formulas progressively leading to retirement for such workers. Such measures should not compromise other workers' rights to a decent pension upon reaching the retirement age, nor should they jeopardise conventional early retirement measures or those justified by difficult working conditions[24].

In addition to labour market measures, **States have numerous possibilities at their disposal to raise additional tax revenue and ensure additional sources for pension funding**. Some strategies are highlighted below:

- **Leveraging progressive forms of taxation:** Enhancing the progressivity of labour taxation and making use of corporate taxes, wealth taxes and capital gains taxes might contribute to the reduction of inequality whilst bolstering the sustainability of public finances.

- **Tackling tax evasion:** According to the IMF, an estimated 10% of the world's GDP is hidden in tax havens[25]. Enhancing financial transparency, tax collection and enforcement measures could thereby significantly contribute to expanding the financing base for pensions as well as other social protection expenditures.

- **Considering innovative forms of taxation:** Some states have also looked at improving system stability through introducing new forms of taxation, such as a natural resource levy, a carbon tax for industrial activities, or a financial transaction tax[26]. Such new forms of taxation may also have the additional benefit of incentivizing decarbonisation efforts and reducing income inequality.

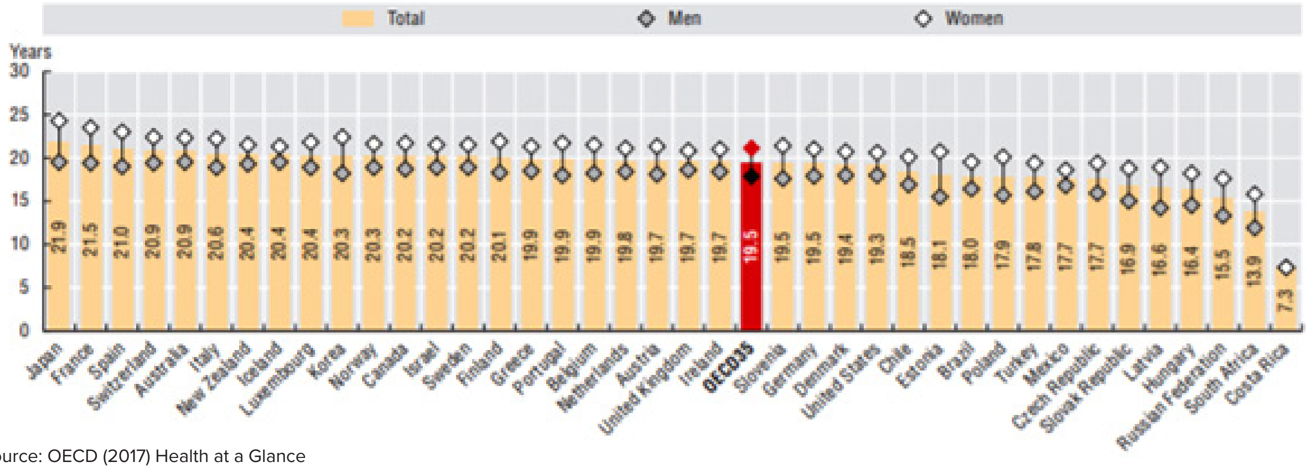
Finally, in order to address the adequacy challenge in addition to the sustainability challenge, it is important to ensure the **guarantee of a decent pension for all, irrespective of one's contribution history**. Governments, unions and employers agreed to the need for guaranteed non-contributory pensions within **ILO Recommendation 202 on Social Protection Floors** - adopted by 185 countries and further endorsed by G20 leaders and the United Nations.

Some States have achieved this guarantee through universal citizens' pensions, which have proved effective in reducing inequalities in pension entitlements and reducing the risk of poverty in old age. Such schemes exist in Denmark, for instance, which has generous public pensions ("people's pensions") that are universal, non-contributory and financed by general taxation[27]. Similar universal pensions exist in South Africa, which have greatly contributed to reducing poverty and hunger in the country[28].

Other States have succeeded in effectively combining contributory schemes with non-contributory ''pension floors'' (otherwise known as guaranteed minimum pensions or basic pensions) for those with non-existent or insufficient contribution histories, in order to ensure universal coverage. Kenya, for instance, recently introduced in 2017 a non-contributory pension for those workers who do not qualify for a contributory pension. Such floors can provide an effective shelter against risks for people unable to accumulate sufficient contributions before old age, and also help to mitigate income inequalities between genders, occupations and socio-economic groups.

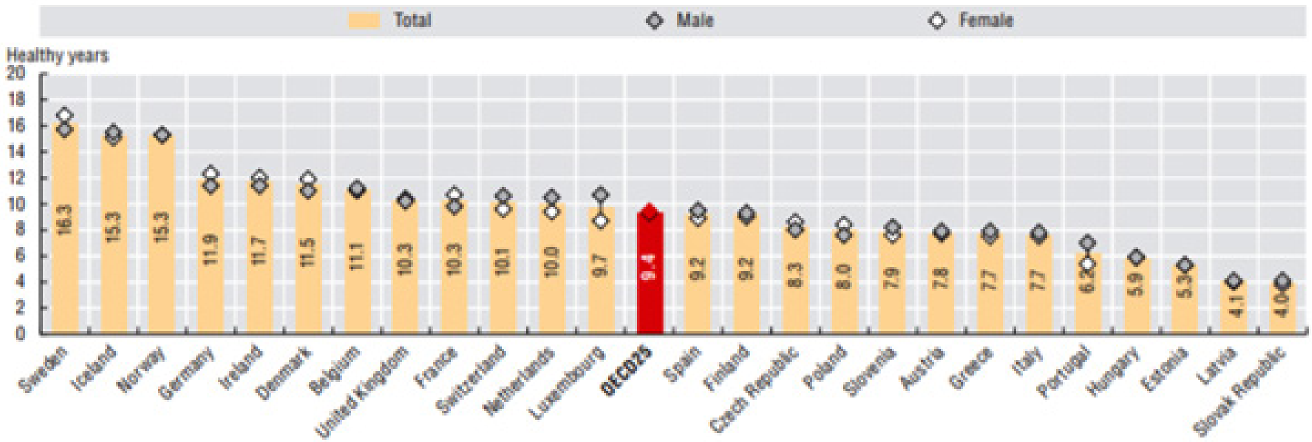
Annex: Illustrative figures

Life expectancy at age 65



Source: OECD (2017) Health at a Glance

Healthy life years at age 65



Source: OECD (2017) Health at a Glance

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