

What's happening to Pension Ages in OECD countries?

Introduction

The Organisation for Economic Cooperation and Development (OECD) has published its fourth edition of "Pensions at a Glance" (2011) which compares the policies of 34 member countries. This short article summarises key points from the report in relation to how countries are managing the age of eligibility for public pensions – a topic of keen debate in New Zealand.

"Pensions at a Glance" broadly describes how OECD members are dealing with what Bill Clinton in his 1999 State of the Union address called a "high class problem". As the OECD puts it:

"Retirement used to be a luxury enjoyed only by the few; now it is an expectation for the many. The huge increase in life expectancy in the 20th century is a wonderful achievement....however, when added to the decline in the birth rate the result is rapid population ageing and a rapidly growing cost of paying for pensions".

The OECD asks the question: "how can governments maintain retirement-income adequacy without endangering financial sustainability?" then identifies three main routes:

1. Have people spend more years in the workforce (and so pay pensions for a shorter period) by:
 - a. Raising the pension eligibility age; or
 - b. Reducing incentives for people to take their pension early (there are no such incentives in New Zealand)
2. Concentrate efforts of public provision on the most vulnerable (i.e. redistribution). The OECD uses New Zealand, along with Canada and the Netherlands, as examples of countries that have achieved low rates of income poverty in old age while spending a relatively low proportion of GDP on public pensions. In New Zealand's case, this redistributive effect is largely due to the universal nature of New Zealand Superannuation (NZS)
3. Shift more responsibility from government to individuals to save for their retirement, given the prospect of public pension expenditure needing to be reduced. Although KiwiSaver is currently a voluntary scheme and there are no plans to reduce the level of NZS, the introduction of KiwiSaver is an example of a measure to encourage more individuals to save more for retirement.

In an editorial at the front of “Pensions at a Glance” the report’s principal authors conclude that:

“The public sector’s role in providing incomes in old age will remain very important, but will diminish. Working longer and private pensions will inevitably have to fill the gap....Taking the long view, a diversified pension system – mixing public and private provision, and pay-as-you-go and pre-funding as sources of finances – is not only the most realistic policy but the best policy”.

The age of pension eligibility

In common with most other OECD countries, New Zealand has an ageing population. In June 2007, 527,000 people (one in eight of all New Zealanders) were aged 65 or over. The number of people aged 65+ is expected to more than double between now and 2051, and by then they will make up one-quarter or more of all New Zealand residents. The number of New Zealanders aged 85+ is expected to more than quintuple, from 61,000 in 2007 to 335,000 in 2051¹.

People are living longer and over the last fifty years, have been spending more years in retirement. As things stand, these trends are projected to continue. In 1960, average life expectancy at national pension eligibility ages was 13.4 years. By 2010 it had reached 18.5 (for men) and 23.3 (for women) and these figures are projected to be 20.3 and 24.5 years in 2050, despite many countries planning increases in pension ages (see the table below)².

In general, the OECD believes that increases in the effective retirement age will be required to maintain control of the cost of pensions:

“Governments’ long-term projections for public expenditure on pensions are heavily reliant on the assumption that people will retire later in the future....In 2050, only an effective retirement age of 66.6 for men and 65.8 for women would leave the duration of retirement at the same level as it is now (i.e. 2011) - based on the United Nations population projections”.

In fact, the average pensionable age is projected to reach around 64.5 by 2050, as shown below.

¹From the Retirement Commission’s 2007 Review of Retirement Income (p.19) citing Statistics NZ (2007) New Zealand’s 65+ Population: A statistical volume, 2006-base national population projections, abridged period life tables 2004-2006 (life expectancies quoted in the above are based on death rates in 2004-2006) and Ministry of Social Development (2007) Positive Ageing Indicators

²In 2011, the age of eligibility for New Zealand Superannuation is 65 for men and women. On average, 65 year old New Zealand men can expect to live till they're 85, and women till they're 87. New Zealanders reaching 65 in 2031 will probably expect to live until they're 87 (men) and 89 (women): Statistics NZ figures

Pensionable age in OECD countries, 2010-2050

	2010	2020	2030	2040	2050	Average increase per decade (years)
Men	62.9	63.5	64.1	64.4	64.6	0.42
Women	61.8	62.9	63.7	64.1	64.4	0.65

There is a wide range in projected retirement ages in 2050, from 60 (Belgium, Greece, Luxembourg) to 67 (Australia, Denmark, Iceland, Norway, United States)³ and 68 (United Kingdom)³. The same countries also show a wide range in the projected cost of their pensions as a proportion of GDP, as shown in the next table:

Projections of public expenditure on pensions (% of GDP)

	2010	2035	2050
Australia	3.6	n.a.	4.9
Belgium	10.3	14.4	14.7
Denmark	9.4	10.5	9.6
Greece	11.6	19.4	24
Iceland	4.6	n.a.	6.9
Luxembourg	8.6	16.6	22.1
New Zealand	4.7	7.3	8
Norway	9.6	13.2	13.3
OECD average	8.4	n.a.	11.4
United Kingdom	6.7	7.8	8.1
United States	4.6	4.9	4.8

Links between pension ages and life expectancy

The OECD finds it surprising that few countries have formally adopted what it calls the most obvious form of link between pensions and life expectancy – to increase the pensionable age as people live longer. Nevertheless, many reforms undertaken in the last 10-15 years mean that in future, pensions will take account of both projected increases in life expectancy and the uncertainty surrounding the estimates. A few countries have introduced an automatic link between life

³ The UK Government has announced plans to bring forward an increase in the state pension age - to 67 to as early as 2026

expectancy and eligibility age, but not many are doing it at a rate that matches the rate of increase in life expectancy.

Denmark will have such a link once its pension age completes an increase from 65 to 67 in 2027. Italy and Greece will link pension age to life expectancy from 2015 and 2020 (respectively). However it will still be possible to claim the pension at any age with 40 years of contribution in both cases.

The Pensions Commission in the United Kingdom proposed an increase in the pension eligibility age that would leave life expectancy at pension age constant but the measure actually adopted by the Government, while likely to stabilise the expected time in retirement, has no *automatic* link with life expectancy. France has linked the expected duration of retirement to the expected length of career, by gradually increasing the number of contribution years required for a full pension from 40 to 41.5 years.

An alternative approach is to link life expectancy with lower pension levels (instead of eligibility age) although this may pose a threat to income adequacy, particularly in very old age. In Finland and Portugal, future payments will be reduced by a factor directly related to life expectancy. Since 2004 (and until 2023) Japan has been cutting public-pension benefits by 0.9% a year for new retirees, assuming a constant increase in life expectancy of 0.3% per year. On balance, the OECD prefers policies that link life expectancy with pension ages rather than with benefit levels.

In addition to increases in pensionable ages, countries have introduced reforms to reduce incentives to retire early and to increase incentives to retire after the normal pension age. Ten OECD countries have mandatory schemes whereby citizens contribute to their own personal retirement accounts (defined contribution) – effectively shifting the risk of them living longer (and receiving a lower pension) - from the state to the individual. Another four countries run “notional account” schemes where accumulated contributions and interest are converted into a periodic payment at a rate that depends on life expectancy.

Conclusions

Overall, the OECD concludes that links between pensions and life expectancy “can act as a mechanism for spreading the pension cost of longer lives between generations and helping the long-term financial sustainability of the retirement income system”. In other words, such measures can promote intergenerational equity. It is not too much of a leap to suggest that as a result, they might also strengthen the political and social sustainability of public pension schemes.

However the trade-offs are complex and OECD countries are adopting a variety of retirement income policies to address issues they face in common.

The Retirement Commission's 2010 Review of Retirement Income Policy notes that New Zealand's superannuation scheme "pools" longevity risk (the risk for individuals that they will outlive their income) because it is a universal, life-long entitlement. The review also recommended a gradual increase in the age of eligibility for New Zealand Superannuation (NZS) starting in 2020 and rising by two months per year until it reaches 67 years (from the current 65) in 2033. A change in the way that NZS is indexed would also share the adjustment cost between generations, consistent with objectives of equity, social cohesion and national identity.

In terms of reducing the overall cost within the economy, the proposal to change the age of eligibility and indexation holds the proportion spent on NZS at just over five per cent of GDP in 2035 rather than around seven per cent under current settings (and eight per cent in 2050). In absolute terms, the difference is the equivalent of three to six billion dollars per annum at 2011 values.

Without change, the percentage of GDP spent on NZS is not high compared to some other OECD countries, but those countries' abilities to sustain such expenditures is being called into question and they face some very difficult adjustments. Because of its simple system New Zealand is relatively well placed, but it is not completely off the hook. Ultimately, it is a political judgement as to whether or not New Zealand's current settings for retirement income policy are either affordable or need to change in order to proactively address emerging demographic and economic challenges.