Pension Reforms in OECD Countries

Since 1990, around half of OECD countries have undertaken far-reaching pension reforms. Most of them were packages comprising a number of different measures. Some of these changes, such as increases in pension ages, are highly visible and often politically controversial. Others, such as changes in either the way in which earnings are measured when calculating benefits or pensions are indexed, are more technical and less transparent. Some countries maintained the structure of the pension system, modifying only parameters and some of the rules, while others overhauled the entire system. The Table distinguishes between changes to parameters and changes to the paradigm of pension schemes.

Changing pension-system parameters

Changes in *pension age* are the most common feature of reform packages. The rationale for these changes is clear: starting in the 1960s, life expectancy began growing rapidly for both men and women, but many countries cut their retirement ages. Recent reforms have reversed the trend of lower pension eligibility ages, with ten countries introducing gradual increases in pension ages for both men and women. When these reforms are complete, most OECD countries will have a standard retirement age of 65 years, although in some countries the pension age is or will be 67 or more. Only France, Hungary and Slovakia plan to have normal pension ages below 65.

Nonetheless, effective retirement ages – the age at which people actually stop working – are lower on average than the standard pension age in most countries. A common policy response, adopted by nine countries, has been to encourage older workers to stay longer in their jobs by changing pension *incentives to retire*. Pathways to early retirement, many of which were introduced in the 1970s in response to high and rising unemployment, have been closed to new entrants or restricted severely. Penalties for early retirement in old-age pension schemes have been introduced or increased in many countries. Some countries have increased the number of years of contributions required to receive a full pension. Other countries have introduced or increased the increments or bonuses paid to people retiring after the normal pension age (for more information see OECD 2007, Table II.1.1.).

Other changes to pension systems relate to the *calculation* of the earnings base for pension entitlements. Hungary based pension calculations on gross rather than net earnings. Japan extended pensionable earnings to include bonuses. Seven OECD countries have extended the period over which earnings are taken into account instead of just basing the benefit on a limited number of final-years or best salaries. Austria is gradually extending the averaging period from 15 to the 40 best years. France is moving from the best 10 years to the best 25 years. Finland, Poland, Portugal, Slovakia and Sweden are all moving to a lifetime average earnings measure. As a result of these reforms, most OECD countries will

Table

Main elements of pension reform packages in selected OECD countries

	Changing parameters						Changing paradigm		
	Pension age		Retirement incentives	Calculation		Indexation	DC	NDC	Life expectancy
	M	F		measure	revaluing				
Austria	•	•	•	•		•			
Finland			•	•	•	•			•
France			•	•	•				•
Germany	•	•	•						•
Hungary	•	•	•	•		•	•		
Italy	•	•	•			•		•	
Japan	•	•		•					
Korea	•	•							
Mexico							•		
New Zealand	•	•							
Poland			•	•		•	•	•	
Portugal		•	•	•	•	•			•
Slovakia	•	•		•			•		
Sweden				•			•	•	
Turkey	•	•							
United Kingdom	•	•	•						

Note: M = Male, F = Female, DC = defined contribution; NDC = notional defined contribution.

Sources: Martin and Whitehouse (2008), 8; OECD (2007), Table II.1.1.; Whiteford and Whitehouse (2006).

use a lifetime earnings measure. Furthermore, some systems revalue past earnings to take account of changes in living standards between the time pension rights accrued and when they are claimed. For example, France moved to price revaluation in the public scheme as early as 1985 and in the occupational schemes in 1996.

Finally, the way that pensions in payment are adjusted has been reformed. This process is called pre-retirement *indexation* but is also known as "valorisation". Many OECD countries have moved from adjusting pension benefits to earnings (earnings valorisation) towards full or partial indexation to prices (price valorisation). This preserves the purchasing power of pensions, but means that pensioners do not share to the same extent as workers in the general growth in living standards.

Changing pension-system paradigm

A number of countries opted for wholesale or systemic reform (Whitehouse 2007). The most common policy has been to remove all or part of the public defined-benefit (DB) pension system and replace it with *defined-contribution* (DC) provision. In DC schemes, the pension depends on contributions and the interest earned on them. Hungary, Mexico, Poland, Slovakia and Sweden have all introduced mandatory, privately managed individual accounts to replace part of the public pension.

Another change of retirement-income paradigm has been the shift in public pensions from DB plans to *notional accounts*. These schemes, adopted in Italy, Poland and Sweden, are designed to mimic some of the features of DC schemes. Hence, they are often called notional defined-contribution schemes (NDC). Again the pension depends on contributions but, unlike DC plans, the notional interest rate is set by government and often linked to wage or GDP growth. The schemes remain pay-as-you-go financed: no assets are accumulated.

The reforms of pension paradigms share one important feature: pensions will in future automatically adjust to changes in life expectancy. If life expectancy increases, the number of pensioners per contributor will increase and pension benefit will fall. When pension capital is accumulated in an individual account, it is usually transformed into a regular pension payment – an "annuity" – at retirement. Annuities will be lower, the higher life expectancy is at the time of retirement because the pension will be paid for a longer time. Benefits from notional accounts are calculated in a similar way. But such automatic adjustments to life expectancy can also be built into systems which have not undergone systemic reform. In Finland and Portugal, the value of pensions will be adjusted to changes in life expectancy at retirement. France, in the 2003 pension reform, linked the required number of years of contributions for a full pension with life expectancy. Germany will adjust benefits in a points system to reflect the financial sustainability of the pension system.

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