COMMENTS ON SESSION 1
PENSION REFORM AND THE LABOUR MARKET

Tomász Jędrzejowicz[*]

I would like to thank Daniele Franco and Banca d'Italia for the opportunity to participate and discuss two inspiring papers of this session. The first one, by R. Vegas *et al.*, is an empirical study, dealing with retirement decisions in Spain, conducted using detailed data on labour and pension histories. The second one, by A. Ahuja and R. Paserman, is an overview paper, focused on pension policies in European Union countries from a macro perspective, which draws on policy exchange and coordination between EU Member States in the area of pensions and social protection conducted in the context of the Open Method of Coordination. The two papers are therefore quite different, but both deal with the key issue of determinants of retirement decisions, in particular in case of early retirement.

Pension wealth is generally found in studies to be one of the key drivers of retirement decisions. This result is confirmed by the Vegas *et al.* paper, where social security wealth turns out to play a greater role in the retirement decision than variables representing the increase in pension an individual could obtain by working longer, which also turn out to be significant. A higher replacement rate in principle also encourages early retirement, but in practice OECD studies show it to be less relevant and Vegas *et al.* obtain a similar result, with the replacement rate turning out to be insignificant. Other public income support programmes available prior to pensionable age, such as disability, unemployment and special early retirement schemes, also play a role, as do the levels of health, education and income.

An issue related to retirement decisions, which recently has been receiving some attention in the literature is that of involuntary retirement. The issue is potentially relevant for both papers. In case of the paper by Vegas *et al.*, involuntary retirement may not be captured directly, because of the nature of the dataset used. The issue is to some extent addressed indirectly, as the authors use a GDP growth variable to proxy the macroeconomic environment, but the results obtained are counterintuitive. Perhaps it would be useful to explore different variables representing the overall labour market environment, such as the level of unemployment or the number of jobs lost in a given period.

Another potentially important issue in the context of retirement decisions is the minimum pension guarantee which would generally promote early retirement among low-income workers. The significance of this effect is likely to increase with reforms lowering average replacement rates, less intra- and inter-generational redistribution and more common temporary employment. The level of minimum pension is susceptible to political pressures and therefore subject to frequent ad hoc adjustments, which lead to uncertainty about its future level.

For the case of Spain, Vegas *et al.* find that the minimum pension guarantee increases the probability of retirement at 60, but the effect appears to be relatively small and is reversed for workers aged 61 to 65. Though not directly comparable, these results seem to be qualitatively different from those of Jiménez-Martín and Sánchez (2006), according to whom the minimum pension guarantee in Spain increases retirement at age of first entitlement and early retirement in general by almost 50 per cent. The importance of the minimum pension guarantee in the Spanish pension system is also referred to in Boldrin *et al.* (2008), as well as OECD reports.

---

[*] Narodowy Bank Polski.

The paper by Ahuja and Paserman states that indeed, most EU Member States perceive minimum income benefits as benefits as providing negative incentives towards longer working lives, a conclusion generally consistent with empirical literature. However, while looking through the publications produced in the framework of the Open Method of Coordination, I have found an earlier one devoted specifically to the issue of minimum income provisions for older people (SPC, 2006), which gives a rather different message, stating that there is “no real evidence to prove or disprove labour market or savings behaviour impacts of minimum income benefits for older people”.

Another important and much debated issue raised by the Commission authors is that of a move to funded pension schemes. The paper points out that such a move was usually motivated by the desire to pre-fund the future pension burden, as well as obtain higher returns on contributions in the private pension pillar. While the second argument has been questioned in the literature, the first one is fully viable, especially as it also entails other advantages of a political nature. Firstly, a move to an individual defined contribution pension scheme implies making the implicit future cost of ageing of the populations explicit, thus supporting the recognition and acceptance of the need for pre-funding of the pension burden. Secondly, once a defined contribution system with individual pension accounts is set up, a reversal of the reform would entail very significant political costs. These would most likely be higher than in case when the government were to abort pre-funding conducted at the government level, via debt reduction or building government reserve funds.

But as the authors rightly point out, the move to funding also entails some risks which may need to be addressed. Firstly, one needs to note the shifting of the pension risk from provider to the beneficiary. This may be viewed as an opportunity to get participants more involved in pension planning, but in order to make this happen, costs will have to be incurred in reach them.

In addition, the current financial market turmoil has shown that pension accounts may be at risk due to financial market volatility. While swings in asset prices are normal, although “normal” depends on the magnitude of these swings, it is important to ensure that funds of persons close to retirement are invested in low-risk assets.

Speaking of the current downturn, the Commission authors point to a number of challenges arising in connection with the financial turmoil and global economic downturn. These include first of all rising unemployment, resulting in delayed establishment of younger workers on the labour market and, consequently, lower accumulation of contributions in defined contribution pension schemes, both funded and notional. Older workers will also suffer by becoming more susceptible to layoffs, with increased take-up of early retirement being the likely consequence. Some Member States are also delaying pension reforms or the activation of automatic mechanism which in the current climate would otherwise lead to lower pension benefits. Funded pension schemes are facing increasing challenges with the recent fall in asset value and increased risk of pension adequacy problems. In addition, one general challenge, which is already evident, is related to the massive increase in deficit and debt levels in connection with the current downturn. This will have significant implications for the size of fiscal adjustment required to cope with the ageing challenges.

Finally I would like to conclude by devoting some attention to Poland, which may serve as an example for many issues raised in the paper by Commission authors. Before the pension reform in 1999, Poland had a fairly generous defined benefit pension system, with a relatively flat pension levels, thanks to which the elderly were a group less prone to poverty than the remainder of the population. The system also featured very generous profession-specific early retirement provisions, which in many cases were not justified by medical considerations. In addition, during the early years of economic transformation, the social insurance system had been used to cushion the social cost of restructuring and layoffs, in particular through the use of early retirement, disability benefits and special pre-retirement benefits. All in all, this provided for a very costly system with strong disincentives to long careers and low participation rates. In 1999 a comprehensive pension reform was introducing a notional defined contribution pillar, as well as a mandatory funded pillar and elimination of the vast majority of early retirement provisions (finally completed in 2008). As a result, according to EPC Ageing Working Group projections, Poland is in a very good position to cope with the ageing pressures. Nevertheless, a number of problems and risks remain. Women's retirement age remains at a low level of 60 years, resulting in low future pensions from defined contributions pension schemes. The shift of responsibility and risk of pension provision to beneficiaries may also be problematic in the longer run, as they are not well equipped to deal with this risk. This is evidenced by the rush of workers to register as self-employed, which means paying lower social contributions, but ultimately will result in lower benefit levels. The minimum pension will also gain significance as under the new system many low-income workers, especially those with sizeable breaks in their careers, will likely not accumulate sufficient funds in their individual pension accounts and will therefore draw on the minimum pension. Given the risk of discretionary adjustments of the minimum pension as a results of political pressures, this may undermine the idea of the reform.