AN AGEING EUROPE AT WORK: ARE THE INCENTIVES TO WORK SUFFICIENT TO PROVIDE ADEQUATE AND SUSTAINABLE PENSIONS IN THE FUTURE? LESSONS FROM THE OPEN METHOD OF COORDINATION

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1 Introduction

Traditionally, pension systems have generally been designed for a different demographic and socio-economic situation than that prevalent today. Pension systems have typically been designed with contribution rates, working patterns, monthly benefits, and retirement ages that have been established to suit an era with shorter life expectancy, longer weekly working hours, shorter holidays, a different distribution of labour between men and women and higher fertility rates. The entry of women into the labour market has not been sufficient to address the increasing demographic dependency ratios due to longevity increases and low fertility rates.

The more than doubling dependency ratios in the European Union by 2050[1] illustrate the exertions on the public expenditure due to the ageing population and the growing proportion of the inactive population. The economic dependency ratios have worsened also due to shorter working lives (Figure 1). The relative costs of social security systems are expected to increase, including pension expenditure as well as expenditure on long-term care, health care and other social services for the elderly. At the same time a shrinking number of labour-active would bear the burden of the increasing expenditure.

On average, pension expenditure today, makes up more than 40 percent of social protection expenditure aggregated in EU Member States.[2] As the population ages, European countries have experienced a decade of ongoing reform to their old age pension systems to make them more financially sustainable and adaptable to changing demographics. On average, if there were no offsetting factors, such as the increase in employment rates, higher coverage of beneficiaries in schemes, increasing retirement ages, or lower benefit levels, demographic pressure alone would be estimated to relay into an increase in public pension by over 70 per cent in real terms in the EU15.Projections show that recent pension reforms will curb the rise in public pension expenditure from around 9 percentage points between 2007 and 2060 to 2.4 percentage points, so that so that projected expenditure would reach 12.5 per cent of GDP in 2060. At the same time, public spending on pensions is not expected to rise in parallel with the old-age dependency ratio. In 2060 people over the age of 65 will get, on average, a smaller share of GDP from public budgets.[3] This reflects, to a large extent, that the financial challenge addressed in pension reforms may have spilt over into a social or adequacy challenge.

Pension reforms providing expenditure sustainability must not do so solely at the cost of lower pensions, from a social sustainability point of view. The main instrument for policy exchange and coordination between the Member States in the area of pensions and social protection is the Open Method of Coordination (hereafter OMC). Lessons from the OMC implemented by the European Union has indicated the importance of emphasizing the need to increase the ratio of

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The views expressed in this paper are those of the author and do not necessarily reflect the opinions of the institution.

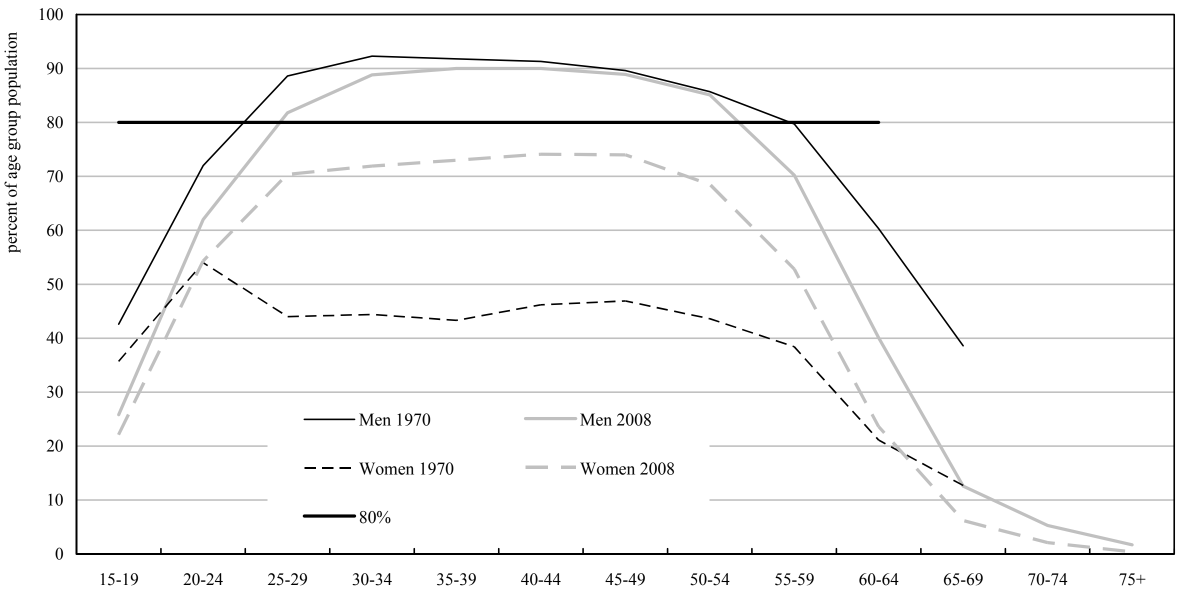
[1] The dependency ratio is measured as the ratio of people over 65 to people of working age (aged 15 to 64).

[2] Source: ESSPROS.

[3] Source: Calculations by the Ageing Working Group (AWG) of the Economic Policy Committee (EPC), Ageing Report 2009.

Figure 1

Employment Rates by Gender in the EU-15, 1970 and 2008



Source: OECD, OECD Stat database, *Employment in Europe* (2007).

labour active in order to ensure that financially sustainable and yet adequate pension can be provided despite demographic pressures and pension reforms.

The mathematics of the issue is straightforward. In an ageing society where more people are living longer and relatively people are working less, either more people have to work more or longer to sustain the same relative monthly pension benefits as in the past, contribution rates have to be increased or the relative monthly benefits have to be cut. Most countries have chosen a mixture of these solutions in order to deal with the pressures on their pension from an increasing number of benefit recipients. Many pension reforms have, therefore, incorporated legislations into their pensions systems to prolong working lives and to give increased incentives and possibilities for individuals to work longer.

The aim of this paper is to look at the effects of pension reforms on the prolonging of working lives and how successfully they help attain the goal of reaching financially sustainable and adequate pensions as observed within the OMC for the 27 Member states (EU27) of the European Union (EU). Section 2 of this report defines the role and summarize the main findings of the OMC in the area of pensions in the context of the Lisbon Strategy. Section 3 analyses the different types of incentive structures that have been used in pension systems in EU Member States. Section 4 discusses possible impediments to these incentive structures through related financial security schemes and labour market conditions, whilst Section 5 shows the importance of information formation in order to ensure the effectiveness of work incentives.

The main source of the findings in this paper are from the OMC, unless stated otherwise, primarily from the Joint Report of 2009 and the two part study on Promoting longer working lives through pension reforms by the Social Protection Committee (SPC).[4]

[4] For more information, please refer to: http://ec.europa.eu/social/main.jsp?catId=757&langId=en

2 The OMC and pension policy

2.1 The Open Method of Coordination in the field of pensions in the context of the Lisbon Strategy

Pension reforms require long term strategies. The process of reform itself is lengthy as pensions reforms are usually built on broad consensus as they are a fundamental part of our social protection systems and of social cohesion. Furthermore, Member States dedicate significant amounts of public expenditure to old age provision, which in light of demographic trends is set to grow significantly. Therefore reforms of pension systems should be seen both in the context of ensuring adequate and sustainable retirement provision, and in the context of sustainable public finances as a whole and sustainable growth across the EU.

The Laeken European Council of December 2001 recognised that there could be significant benefits by enhancing dialogue and cooperation on issues related to the reform of pension systems. It endorsed common objectives of adequacy, financial sustainability, adaptability, and a working method based on the OMC.

The basic structure of this coordination process is as follows: Member States and the European Commission have agreed to work within the OMC on social inclusion and social protection. The open method of coordination works through the common setting of objectives by the European Commission and the Council of Ministers, the reporting by the Member States on the basis of these objectives, and the Commission synthesising the findings in a report which is subsequently endorsed by the Council. Then, at the EU level, overall progress, challenges and arising areas of future concern are reported on, as are the type of action to be taken.

Common objectives for pensions

The common objectives of the OMC in the field of pensions are to provide adequate and sustainable pensions by ensuring: (g) adequate retirement incomes for all and access to pensions which allow people to maintain, to a reasonable degree, their living standard after retirement, in the spirit of solidarity and fairness between and within generations; (h) the financial sustainability of public and private pension schemes, bearing in mind pressures on public finances and the ageing of populations, and in the context of the three-pronged strategy for tackling the budgetary implications of ageing, notably by: supporting longer working lives and active ageing; by balancing contributions and benefits in an appropriate and socially fair manner; and by promoting the affordability and the security of funded and private schemes; (i) that pension systems are transparent, well adapted to the needs and aspirations of women and men and the requirements of modern societies, demographic ageing and structural change; that people receive the information they need to plan their retirement and that reforms are conducted on the basis of the broadest possible consensus.

Concerning pension reforms, there is agreement that pension systems should provide adequate retirement incomes in a financially sustainable way while adapting to societal and economic change and that the objectives of adequacy and sustainability are mutually reinforcing and need to be achieved together.

2.2 Main lessons learnt from the OMC

The pension's strand of the OMC has shown that pension reform in Europe has basically been triggered by long term projections showing increasing pension expenditure and the financial unsustainability of pension systems. In order to, simultaneously, ensure the continued financial sustainability of pensions and provide an adequate replacement income at retirement Member States employed a mix of different types of pension designs: public and private, pay-as-you-go and funded, mandatory and voluntary. At the same time they have also sought to underpin changes to pension systems by improvements in labour markets, notably by raising employment rates of women and older workers.

Over the last decade reforms have improved sustainability by braking and counteracting the effects of declining ratios of working years to retirement years and of workers to pensioners. The 2006 report reiterated that financially sustainable systems must be balanced with adequate benefits. The 2007 and 2008 joint reports included in-depth analyses of specific issues, dissemination of policy findings and development of indicators for progress towards the common objectives. Amongst these issues were the three main findings in the OMC to date:

- the identified need for more people working more and longer and the subsequent creation of incentives to prolong working lives and close early exit pathways,
- a reinforcement of the link between contribution and benefits balanced by a reinforcement of minimum pensions for those that will not manage a full contributory history,
- greater pre-funding of pension schemes to help to smooth the demographic transition by bringing forward some of the pension expenditure.

Most countries have recognised the need of more people working more and longer. Therefore, during reforms Member States have built work incentives into the design of pension systems. Some prolong working lives at the end of the individual's career, through actuarial benefit calculations based on remaining life expectancy calculations. Others provide financial incentives to promote labour activity throughout the career by increasing the minimum eligibility requirements of contributory years for a full pension or strengthening the link between contributions and benefits.

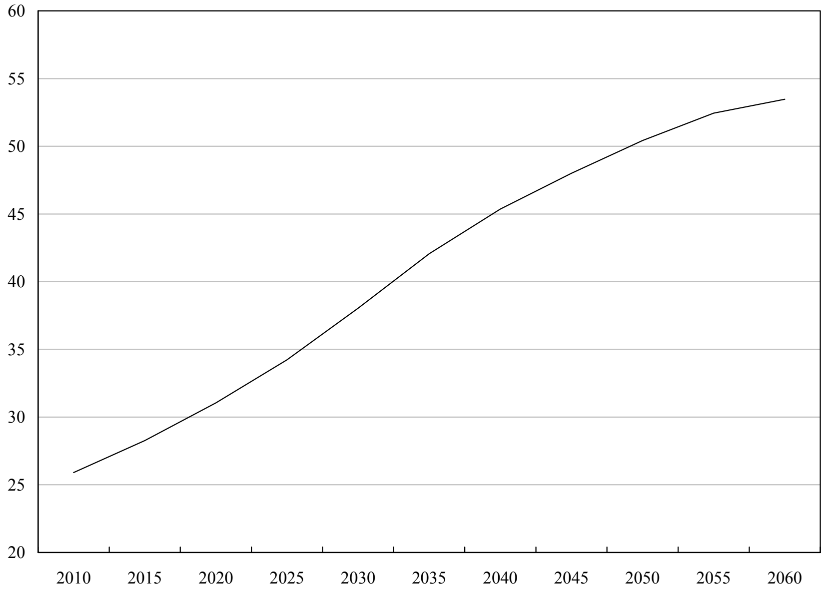
3 Incentive structures in pension systems

Meeting the pension challenge is essentially about balancing the periods of life out of work with those in work and hence closing the gap between shorter contributory lives and longer retirement periods – with the first resulting from later labour market entrance and decreased employment rates of older workers and the second triggered by premature exit and longevity. Maintaining the adequacy and sustainability of pension provision in an ageing society depends crucially on more people working more and longer. The 2007 Joint Report identified the need for 16 out of 25 Member States to promote longer working lives and increase the employment rates of older workers further in order to cope with future burdens on pension and social security systems without compromising the adequacy of benefits (CZ, DK, GR, ES, FR, IT, CY, LT, LU, MT, NL,

Figure 2

Projected Old-age Dependency Ratio in EU 27, 2010-60

(percent)[*]



[*] This indicator is defined as the projected number of persons aged 65 and over expressed as a percentage of the projected number of persons aged between 15 and 64.
Source: Eurostat.

AT, PT, SI, FI, and SE).[5] The 2009 Joint Report reemphasized this message stating the need for more people to work more and longer throughout their careers. Some Member States have sought to respond through new initiatives in pension and labour market policies as depicted in the latest round of National Strategy Reports for 2008-10. Despite progress in recent years in many Member States (for instance LV, BG, LT, DE, SK, EE and NL), there is still a need for extending working lives across the Union even further as the working age population shrinks in comparison to the overall population.

Pension systems can support labour market objectives through the inclusion of all labour active groups, by signalling appropriate ages of retirement and by establishing economic incentives (bonus/malus systems) in support of desired behaviour. Although activity and employment rates are influenced by a whole range of factors unrelated to pensions, the norms about retirement and retirement practices are primarily influenced by the institutional framework created by the state legislation. Rules of pension accruals, the pensionable age and designs of early retirement benefits represent signals for workers and employers that impact on the process of age management.

As Members States are seeking to reestablish a sustainable balance between contributory working years and years spent in retirement they are faced with a combined need for: lowering the entry age, widening the contributory base, lowering the incidence and length of careers breaks and increasing the effective labour market exit age. A number of Member States have widened the financial base of a pension system through increases in the contribution rates or by promoting coverage of groups previously not covered (self employed, atypical workers). However, most efforts have been directed at influencing the effective labour market exit age.

Recent pension reforms in EU member States have included different types of designs and incentive structures to encourage lengthier careers or a mix of these. Typically, most incentive structures for longer working lives in retirement systems are focused on extending working lives closer to retirement rather than earlier in the career. More focus is often put on postponing labour market exit and typically, the incentive structures include increasing statutory retirement and pension eligibility ages; improving flexible retirement options, allowing and encouraging people to

[5] Please see Annex 1 for a list of the EU 27 abbreviations.

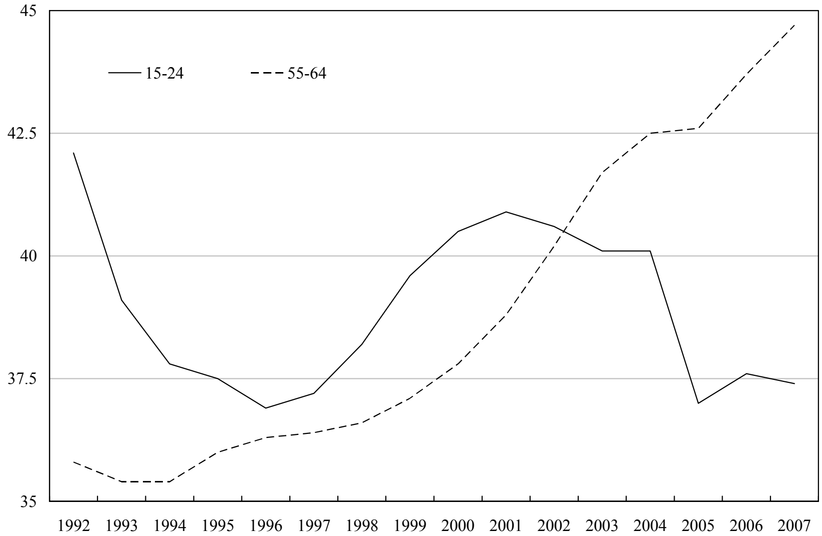
continue working, by allowing for possibilities to combine work and retirement; and introducing more actuarial calculations of pension benefits and bonus/malus systems which give reductions and increments in benefits for earlier or later retirement. The positive effects of reforms during the last decade to encourage delayed exits from the labour market effects can be seen in the improving employment rates of older workers.

In most cases, incentives to extend working lives need to be given also to younger workers, especially in light of the observed increase in labour market entry ages. High unemployment figures for younger workers also indicate that young people are not entering the labour market to the same extent as before. A common approach is to increase the link between contributions and benefits by moving towards a life cycle approach by extending the number of years needed to obtain a full pension.

Since the young of today are the old of tomorrow high unemployment levels among the young might

Figure 3

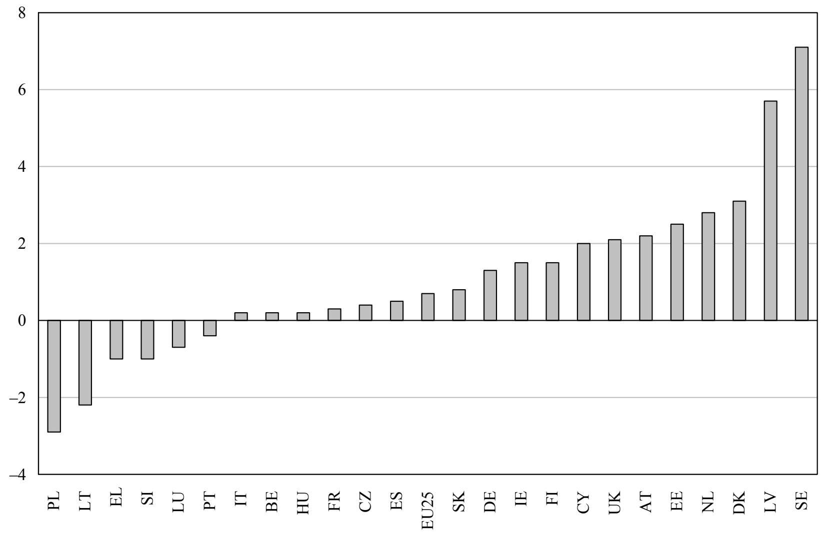
Employment Rates for Workers in Different Age Groups Over Time



Source: Eurostat, *EU Labour Force Survey*.

Figure 4

Change in Employment Rates Between 2000 and 2008 for the Population aged 65 and over in the EU
(percent)



Source: Eurostat, *EU Labour Force Survey*, 2000 Spring and 2006 Second Quarter Results.

lead to lower pensions in the future and thus higher future poverty rates. Even more so if persons caught in unemployment during their working life are unable to affect their pensions levels later by prolonging their working lives to make up for the long periods out of gainful employment. This can cause a persistent poverty trap. High and persistent unemployment rates among the young also threaten the generational contract between young and old, inherent in most pension systems.

It is also interesting to note that developments in employment rates for the age group 65 and over also show rises in the vast majority of Member States since the year 2000. This indicates a move toward older workers staying in work beyond the age of 65, which has traditionally been considered the age for retirement in most EU Member States. The overall change in the employment rates of those above the age of 65 and their actual level is still low at an EU level averaging at around 4 per cent.

3.1 Raising retirement ages and increasing flexibility

Politically, pension reforms are difficult to initiate and implement due to the inter-generational nature of pension systems. Legislating increases in the retirement age of the statutory scheme is one of the more effective and definitive methods of delaying retirement, but also one of the more difficult reforms to implement. The legislated retirement age is socially connected with a sense of right and tradition and thus is politically unpopular to increase. The inter-generational characteristics of most statutory pension schemes add a perceived sense of unfairness if an increase in the retirement age is implemented. Furthermore, rules regarding the receipt of benefits from other social protection systems may also be connected to the statutory retirement age, sometimes making it economically expensive to carry out such increases.

As of today, there are Member States where the statutory retirement age is below 65 with no current legislation to raise this age. (e.g., BG, EE, FR, IT LV, LT, HU, MT, SI, SK). A number of EU Member States have, however, legislated an increase in the statutory retirement age, but often the legislation is softened in its design. For example, most Member States have chosen to phase in the reforms on retirement ages over a long period, thus being raised primarily for younger cohorts (e.g., CZ, DK, DE, LT, MT, UK). This also tends to dampen some of the current political responsibility with regards to the actual implementation of these legislated reforms (see Annex 2).

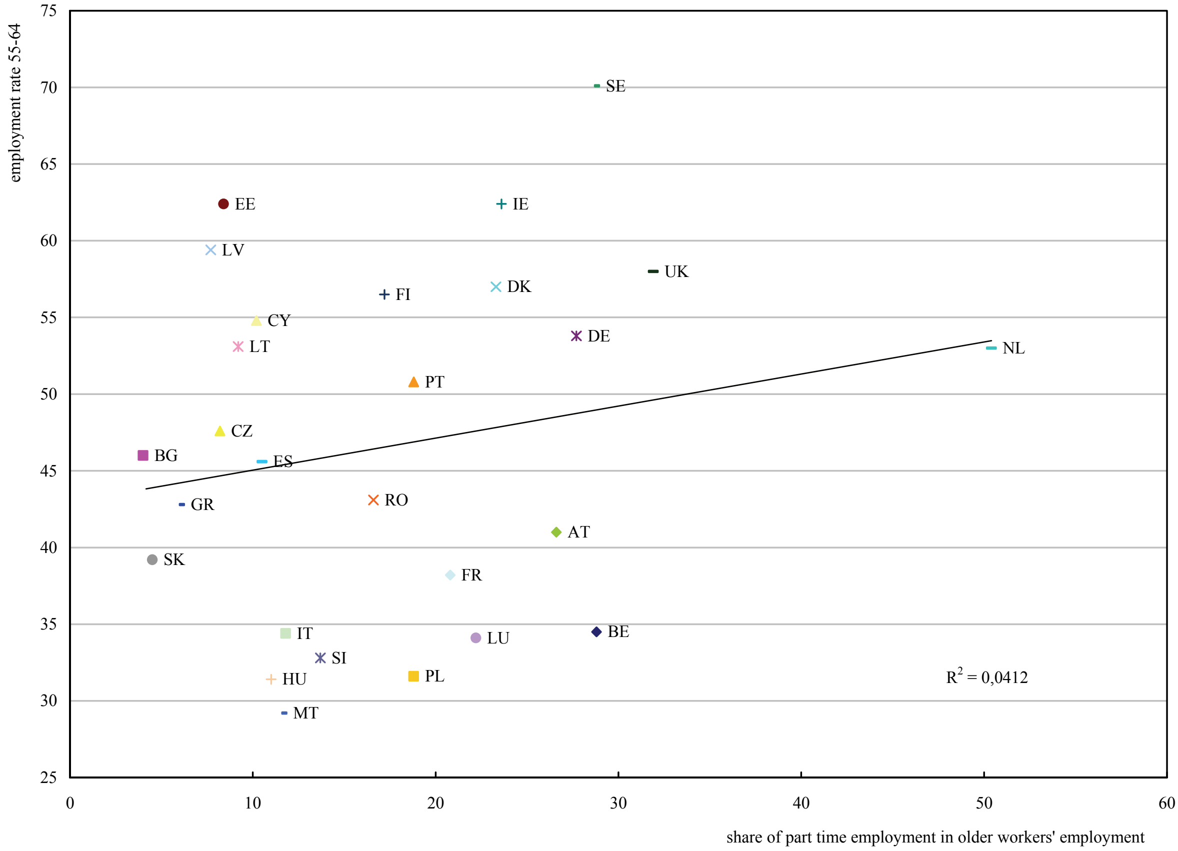
In many Member States, a more viable solution to increasing the retirement age is to primarily aim for an equalisation of retirement ages between women and men. Some Member States foresee such an equalisation in the near future (e.g., BE, LV, HU) whilst others, even in this case, have longer transitional rules (e.g., EL, EE, LT, MT, AT, CZ).Whilst closing the gap between the retirement ages for men and women, Some countries still do not legislate a full equalisation (e.g., BG, RO, SI), whilst others have so far not taken any steps in this direction (e.g., PL).

Other Member states have instead chosen to introduce a flexible minimum pension eligibility age at which old-age pension benefits can be received (often below 65) but with actuarial reductions to the pension the earlier it is retrieved (e.g., FI, SE). Under specific circumstances more flexible paths out of employment into retirement can help to promote longer working lives especially if possibilities to combine work and retirement are given, particularly for groups that may not have chosen a full-time employment over full-time retirement.

The increase in the employment of older workers over the past decade is partly due to a rise in part-time work, notably by men. About 25 per cent of employment among older workers in the EU-15 is now part-time and 22 per cent in the EU-27. Therefore, a number of Member States have designed their systems allowing individuals to take a share of their pension whilst continuing to work (given particular conditions). This type of provision is reported in a number of Member

Figure 5

Share of Part-time Employed as Compared with Employment Rates for Older Workers in the EU, 2008



Source: Eurostat (2008), *EU Labour Force Survey*, annual.

States (CZ, ES, FR, IT, NL, FI, and SE).[6] Experience in Member States however shows that whilst possibilities for work time reduction can be essential for facilitating and encouraging people to remain in work after 60, introducing more flexible retirement provision requires a careful design to ensure the desired results. If the structure of incentives and the focus on a proper target group of workers (for instance in terms of age) is badly designed, the flexibility may lead to a shortening rather than an extension of working lives. Ineffective designs may also not be able to lure groups others than those that would have extended their working lives in any case leading dead weight costs for the pension systems.

The introduction of increased flexibility, therefore, also calls for increased monitoring of retirement behaviour and of the actual labour market exit age. In all but a few exceptional cases (Table 1), labour market exit on average takes place prior to the legislated retirement or old-age pension eligibility age, indicating the opposite effects of flexible rules and the possibility to exit the labour market early through other types of financial security schemes.

6 SPC Working longer study.

Table 1

Standard Pension Eligibility Age and Labour Market Exit Age

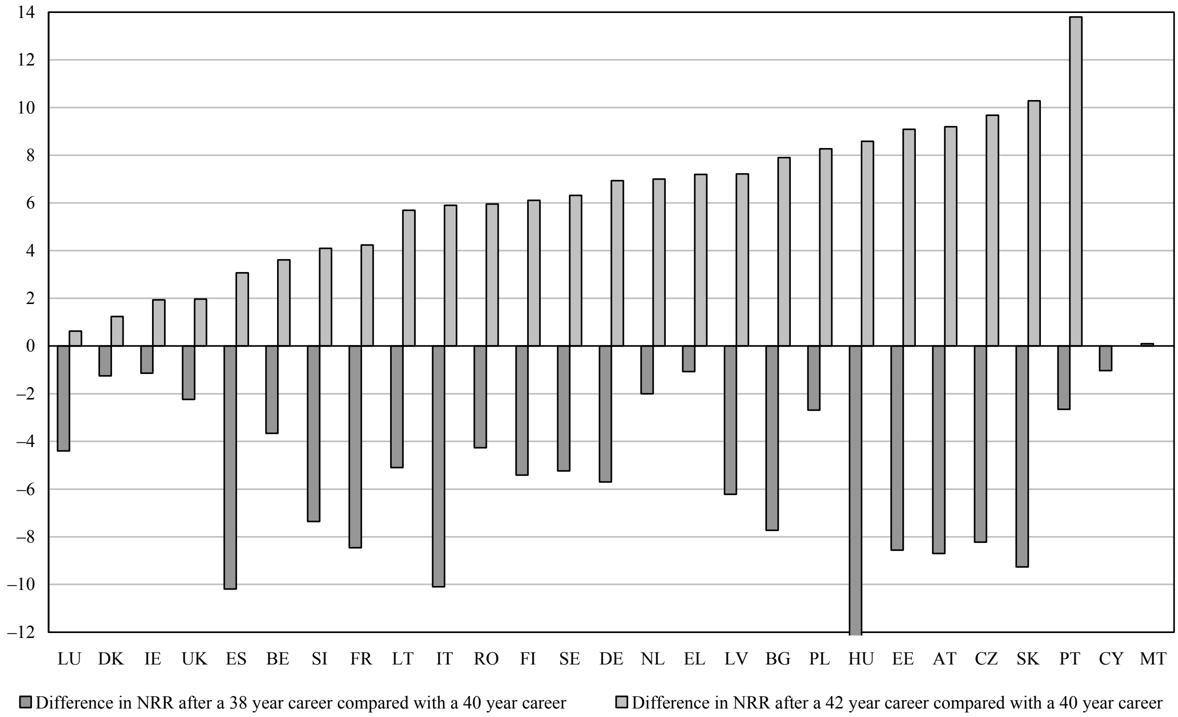
Country	Legislated Minimum Retirement Age		Effective Exit Age from the Labour Market	
	Males	Females	Males	Females
Belgium	65	64	61.2*	61.9*
Bulgaria	63*	59*	64.1	64.1
Czech Republic	61y 6m	59y 8m	61.8	59
Denmark	65	65	62.5	61.3
Germany	65	65	62.1	61.6
Estonia	63	59y 6m	62.6+	62.6+
Ireland	65	65	63.5	64.7
Greece	65	60	61.8	60.4
Spain	65	65	61.8	62.3
France	60	60	58.7	59.1
Italy	65	60	60.5	60
Cyprus	65	65	:	:
Latvia	62	61	:	:
Lithuania	62y 6m	60	:	:
Luxembourg	65	65	:	:
Hungary	62	60	61.2**	58.7**
Malta	61	60	:	:
Netherlands	65	65	62.1	62.1
Austria	65	60	61.3	60.6
Poland	65	60	61.4*	57.5*
Portugal	65	65	62.9*	62.3*
Romania	63*	58*	65.5	63.2
Slovenia	63	61	:	:
Slovakia	62	62	59.7*	57.8*
Finland	63-65	63-65	62.3	62.5
Sweden	61-67	61-67	64.2	63.7
United Kingdom	65	60	63.8	62.6

Source: Eurostat
Note: * 2007 data, ** 2005 data, *** 2004 data, + common data for both sexes.

Figure 6

Difference in Net Theoretical Replacement Rates for an Average Earner Working until the Age of 63 and 67 with 38 and 42 Contributory Years Respectively as Compared with Working until the Age of 65, 2044-48

*(percent)**



Source: SPC/ISG.

3.2 *Giving financial incentives to delay retirement*

A common way to promote longer working lives for older workers pursued in recent reforms is to strengthen the bonus-malus system in schemes with delayed and early retirement possibilities. This is a crucial instrument in prolonging working lives as pension eligibility ages become more flexible. Workers who decide to work longer are rewarded for every additional month or year in work.

In a number of Member States higher accrual factors as a reward for later retirement, or lower accruals as penalties for early retirement, were recently introduced or increased (e.g., BE, BG, CZ, ES, GR, HU, NL, PT and UK). The incentive structures differ significantly between Member States as can be interpreted using calculations on theoretical replacement rates.[7]

Calculations show that in most Member States delaying retirement results in higher theoretical replacement rates, while earlier retirement usually results in lower theoretical

[7] Theoretical replacement rates defined in accordance with the methodology agreed upon by the Indicator Sub-Group (ISG) of the Social Protection Committee (SPC), show the ratio of pension income to earnings at the point of retirement increase or decrease with delayed or early retirement. For more information, please refer to: http://ec.europa.eu/social/main.jsp?langId=en&catId=443&news Id =551&furtherNews=yes

replacement rates. In all but a few Member States (e.g., DK, ES, FR, HU, IT, LU, SI, UK), the increments in pensions for prolonged working lives are higher than the fall in replacement rates with earlier retirement. In most cases the difference is small, but there is a trend towards rewarding late retirement more than early exit is penalised.

Yet, experience is showing that the impact of these specific measures can be rather limited. For instance the pension bonus introduced in France by 2003 reform attracted only 7.6 per cent of older workers to defer retirement in 2007. In Sweden, the use of the flexibility in the retirement ages is being exercised, but just as many people tend to take out their retirement earlier as later compared with the previously fixed retirement age of 65. These examples show that people may be more attracted to the idea of early retirement rather than the financial incentives provided for delayed retirement. In many countries the flexibility of systems is not used also indicating a lack of information and the strong establishment of previously fixed retirement ages. The reestablishment of such norms is sometimes confirmed through other schemes and social insurance systems.

In some Member States no specific incentives are given for extending working lives beyond the actual retirement age in the statutory retirement schemes (e.g., IE, LU, MT, NL, CY). Typically, these schemes are defined-benefit where the possibilities for flexible retirement are restricted, as in Malta. In other cases they are flat rate schemes where the number of contributory years needed for a full pension is lower than those used in the calculations of theoretical replacement rates and thus do not show any incentives to work longer after 40 years of contribution and at the age of 65 (e.g., IE, LU, NL). In these Member States there are, however, greater incentives to work longer in the private sector occupational pension schemes. Although the work incentives are usually lower than in other Member States' statutory schemes in all the above mentioned countries except the Netherlands. In Member States where the pensionable age is planned to be higher than 65 in 2046 (e.g., DE, UK), the effects of deferring retirement beyond the legislated retirement age are not captured by the exercise.

On the other hand, those Member States with the highest changes in replacement rates per extra year worked are also typically countries that have large defined benefit components, but with more flexible retirement conditions (e.g., CZ, EE, AT, PT, SK). In notional-defined contribution schemes the financial incentives for delaying retirement are typically calculated on an actuarial basis taking into consideration remaining life expectancy at the point of retirement (e.g., SE, PL, LV, IT), whilst in defined contribution schemes the transformation of investments into an annuity are also often actuarially calculated.

The effectiveness of actuarially calculated incentive structures needs to be further monitored to ensure that the financial incentives are sufficient to postpone retirement. At the same time, the generosity of the incentives in defined-benefit schemes need to be balanced with their cost in the pension system and also deadweight problems connected to the risk of subsidising those who would in any case have postponed retirement.

3.3 Extending contributory periods

Minimum contributory periods in order to receive a full pension are generally being extended. As the time spent in retirement is generally increasing due to increasing longevity, so must the time spent contributing to one's pension in order to avoid an imbalanced burden on working age populations, which can decrease their incentives to work.

Contribution periods required for a full pension have been recently increased in some Member States (e.g., CZ, FR, AT), so the link between contributions paid into the system and benefits paid out has been tightened. In France, for example the statutory retirement age is the same as before, however, the contribution period needed for a full pension has been recently increased.

Table 2

Average Seniority at Retirement and Remaining Average Life Expectancy at 60, 2006

Country	Average Seniority at Retirement of New Flows of Retirees in Statutory Retirement Schemes Seniority (Including Non-contributory Periods)		Life Expectancy at 60	
	Males	Females	Males	Females
Belgium	42.6	30.5	80.8	84.9
Bulgaria	n.a.	n.a.	76.2	80.3
Czech Republic	44.4	39.6	78.2	82.4
Denmark	35.7	20.3	80	83.3
Germany	n.a.	n.a.	81.1	84.8
Estonia	45.6	42.9	75.9	82.2
Ireland	27.5	20.8	80.8	84.5
Greece	40.3	30.4	81.4	83.9
Spain	40	31.7	81.7	86.5
France	n.a.	n.a.	82	87
Italy	34.9	27.9	81.4**	85.9**
Cyprus	n.a.	n.a.	81.8	84.2
Latvia	30	29	75.2	81.1
Lithuania	37.5	34.2	75.5	81.5
Luxembourg	42.9	38.8	80.7	84.4
Hungary	39.9	38	76.5	81.6
Malta	29.1	23.5	80.1	83.8
Netherlands	n.a.	n.a.	80.8	84.5
Austria	n.a.	n.a.	81.1	85.1
Poland	36.5	33.3	77.7	82.9
Portugal	32.3	23.9	80.4	84.6
Romania	n.a.	n.a.	76.7	80.5
Slovenia	30	24	79.4	84.3
Slovakia	n.a.	n.a.	76.5	81.4
Finland	30.9	28.6	80.6	85.5
Sweden	40	34	81.8	85.2
United Kingdom	42	26	80.9*	83.7*

* 2005 data, ** 2004 data.
Source: National Data and Eurostat.

In other countries, the lengths of contributory periods have been redesigned to correspond more to the pension eligibility ages rather than the concept of a full pension. The pension is instead calculated in accordance with the number of years during which the pension is accrued. In both these cases there is clear move towards extending the number of contributory years in pension schemes, a so-called life-cycle approach.

The issue of the balance and the link between contributions and benefits as well as the transparency of this link are important for the financial sustainability of both defined-benefit pensions systems (that are common among statutory pay-as-you-go systems), and for defined-contribution schemes, for which it is inherent in the system.

Experience in some Member States shows that extending contributory periods is politically more acceptable than the increasing the pension eligibility age in statutory schemes. Increasing the link between benefits and contributory periods also encourages longer working lives during the whole period of the career rather than just at the end of the career. It encourages shorter career breaks, earlier entry into the labour market and delayed retirement.

A lifecycle approach to contributory periods also allows for a more fair calculation of pension benefits as it is closer to the concept of "getting what you paid for". This is often to the advantage of those with a longer and more flat earnings career rather than those with a short and steeply increasing earnings career. Therefore, if the right to receive a full pension depends on the contribution period, people who start working at a late age are not unduly rewarded. For example, women and low income earners often have earnings careers that develop more slowly than those of men and high income earners. For women, this is due to the wage structure in typically female dominated professions, career breaks and a higher degree of part-time work. Reforming pension provision to incorporate such a design gives encouragement to work longer, minimise career breaks and to move out of the black economy.

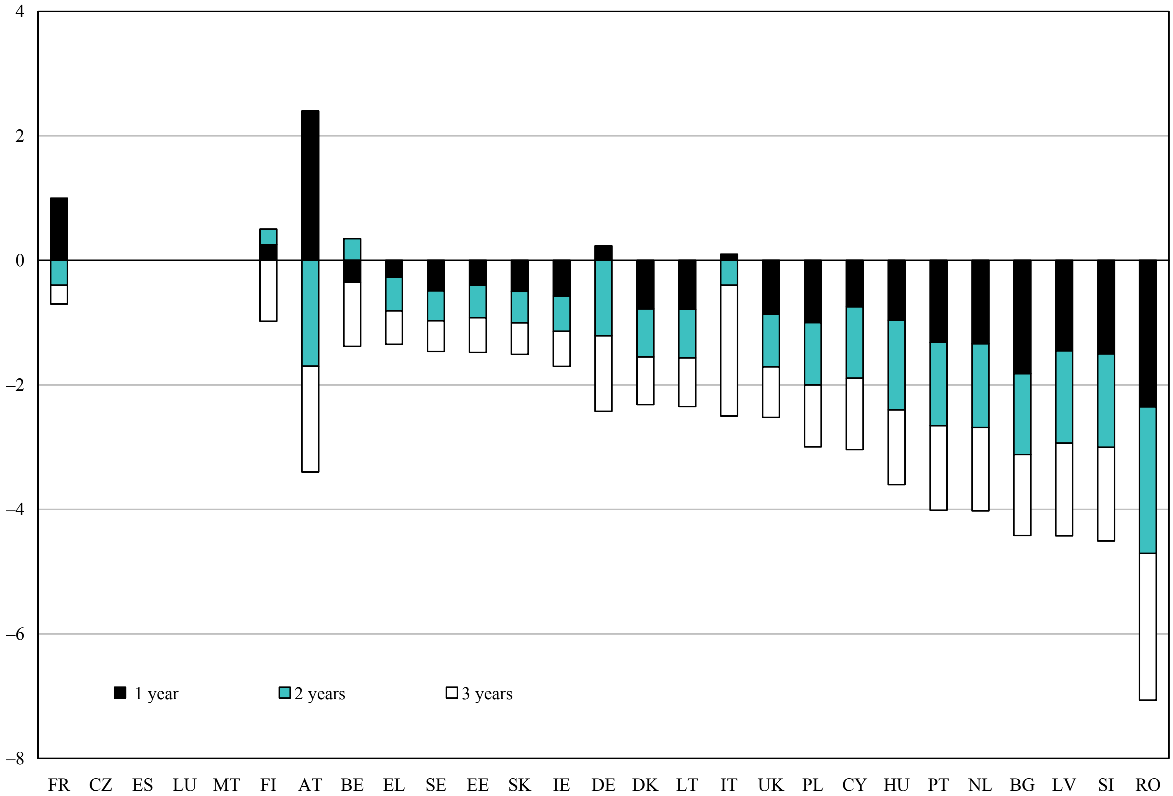
Reinforcing the link between contributions and benefits, however, has to be also combined with a careful monitoring of the accrual of pension rights during breaks in careers that reasonably should not be penalized, such as child care, other caring responsibilities, unemployment, sickness or education leave.

Calculations of theoretical replacement rates can show us how different types of career breaks are protected within the pension system. For example, given that the distribution of care burdens today are still mainly borne by women, it is important to monitor the effects of policies whereby replacement incomes and pension entitlements are given for care-related absences from the labour market in order to avoid the arising of new dependency traps. As caring years have a significant negative effect on women's long-term participation in the labour market in many Member States, a careful balance must be struck between care crediting and incentives to get women back into paid work.

In many Member states, absences from the labour market for childcare are typically protected to a certain extent for the first few years of absence and usually the protection is equally spread over these years (Figure 7). In a few Member States pension rights for up to three years of absence are so well protected that calculations show no drop in replacement rates (e.g., CZ, ES, LU, MT, FI). Whilst this improves the adequacy of benefits accruals during childcare absences, the work incentives in the system can be questioned. In the Czech Republic, the retirement age for women is decreased depending on the number of children they bear and the years of retirement before the age of 65 are accredited giving no change in the replacement rates. In Malta, where the minimum statutory retirement age is 61 and only 30 contributory years are needed for a full pension, the replacement rates do not change with a prolonged or shortened retirement age in this exercise which is based on a 36 year contributory period. However, recent legislation credits social security contributions for interrupted careers of up to 2 years.

Figure 7

Difference in Net Theoretical Replacement Rates for an Average Earner Entering the Labour Market at 25 and Retiring at the Statutory Retirement Age with a 1, 2 and 3 Year Career Break for CHILDCARE Compared with No Break, 2046*



* The calculations assume two children are born and that the timing of the childcare years is such that full childcare benefits are received for each child. Retirement at the legislated statutory retirement age for women is calculated here. Please note that the values for CZ, ES, LU and MT are equal to 0 and should not be interpreted as missing.
Source: SPC/ISG.

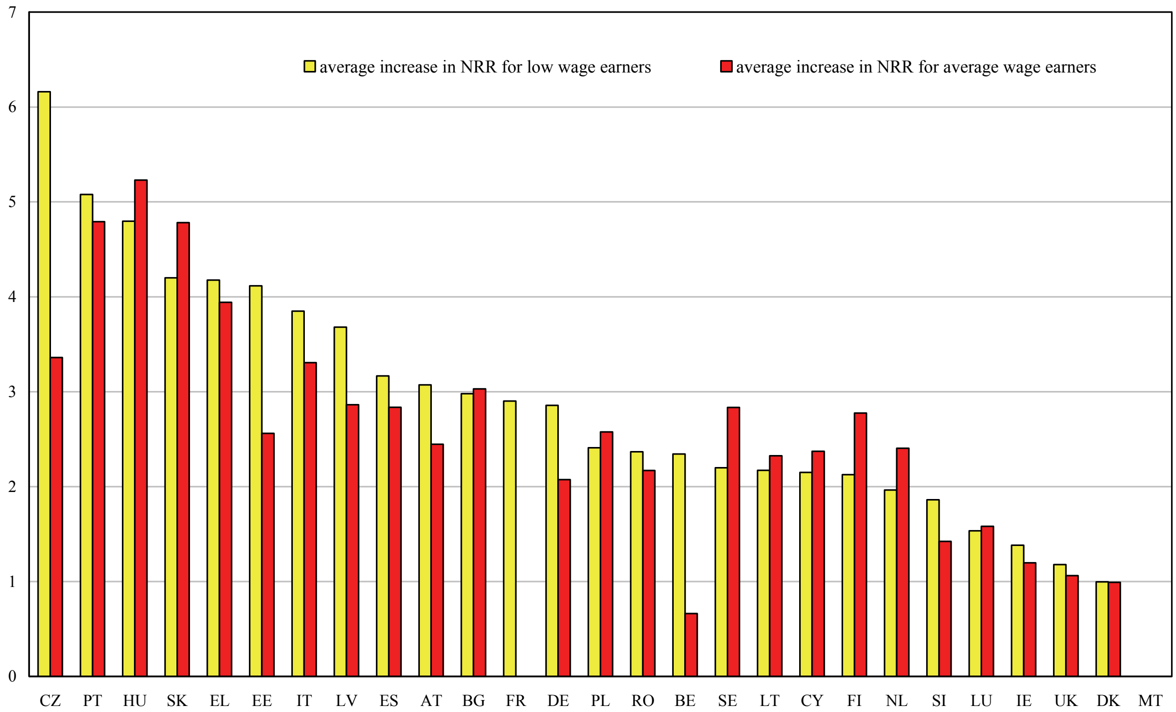
In some countries childcare credits are connected to the birth of the child rather than an absence from the labour market (e.g., DE, FR, IT) resulting in an increase in pension entitlements when a child is born. In Romania, childcare breaks are less well protected than in most other Member States. In the BE, IE, NL and UK the decline on the state pension side is marginal, and results depend more on whether private pension schemes award care credits or not.

3.4 *The effects of minimum pension provision on working longer*

When considering the role of minimum pension provision on the extension of working lives, however, it is important not to loose sight of the role of these pensions in maintaining adequate benefit levels and evading poverty in old age. Calculations showing the average increase in theoretical replacement rates for an extra year of work, indicate that incentives to work longer can be significantly lower for those more dependent on minimum pension provision incentives, therefore, the design of minimum pension need to be coherent incentive structures in standard earnings related schemes.

Figure 8

Average Change in Net Theoretical Replacement for an Extra Year of Work between the Ages 60-68 for an Average-wage Earner and a Low-wage Earner Rates, 2046
(percent)



Source: Calculations on Theoretical replacement rates carried out in the OECD APEX model.

The theoretical replacement rates for low wage earners would typically include minimum pension provision for these groups. By taking an average of the annual change in replacement rates for each year of prolonged working lives for an average earner and a low wage earner it is possible to see if minimum pension systems give a comparative disincentive to longer working lives. Most Member States retain incentives to work longer for those with lower incomes and in some the incentives are even stronger than for an average worker (e.g., BE, CZ, EE, HU, IE, LV, HU) (Figure 8). In these cases it is important to keep in mind that experience shows that low wage earners are often more reluctant to extend working lives than average wage earners. At the same time it is important to consider that the minimum pension guarantees are enough to give financial security and avert poverty in old age.

On the other hand, countries with a traditionally high level of minimum pension guarantee (e.g., SE, FI) or flat rate defined benefit pension with a lower number of contributory years than the 40 years used in the exercise display lower incentives to work longer for those with lower incomes in comparison to average workers (e.g., SK, AT). It is important to consider balancing the adequacy of pension benefits and the disincentives to work longer that they innately provide.

Most Member States perceive minimum income benefits as providing negative incentives towards longer working lives. This can depend on a number of issues. Firstly, if the eligibility criteria of the minimum pensions are set at a reasonably high fixed age, such pension cannot be used as an early exit pathway from the labour market. In most Member States minimum guarantee pensions are rarely, if ever, available before a fixed statutory retirement age. The qualifying period for a minimum pension has, for example, recently been extended in some Member States (e.g., CZ, CY, ES, and RO). If a minimum pension scheme guarantees the major part of pensioners' income, and the contribution period is too short, it can act as a disincentive to stay in the labour market.

Secondly, if the level of the minimum pension is low, this may provide an incentive to work longer, yet bringing the adequacy of the protection provided by these pensions into question. In contrast, too high a minimum level of pension could provide a disincentive to prolong working lives beyond the minimum eligibility age. This, especially in combination with other labour market early exit routes may provide disincentives to work longer for some low-wage groups with incomplete contribution records, as the added value of working for these individual's pensions is in many cases minimal compared with spending the last few years before retirement on unemployment, sickness or disability benefits..

Thirdly, the means testing criteria can affect retirement behaviour. For example, if extra accruals of pension entitlements result in a one to one reduction of the minimum pension working longer may not be perceived as worthwhile. In some Member States, experience shows that disregarding work income in means tests gives possibilities to increase incentives to work longer. Ireland has introduced an income disregard of 100€ on earnings from work in the calculation of means tested pensions. Simultaneously cumulating minimum benefits and income from work is not possible in a few Member States (like in LT). Most Member States provide the possibility to cumulate at least a share of earnings from work and retain minimum benefits or pensions (e.g., DE, DK, NL, FI, SE).

4 Obstacles to work incentives in pension systems: early exit routes

The incentives to work longer incorporated in pension systems are often affected by other design features in the pension scheme or by other financial security systems. In the design of work incentives it is also important that complementary schemes and systems do not impediment the built-in incentives in the pension scheme. This, however, is often the case.

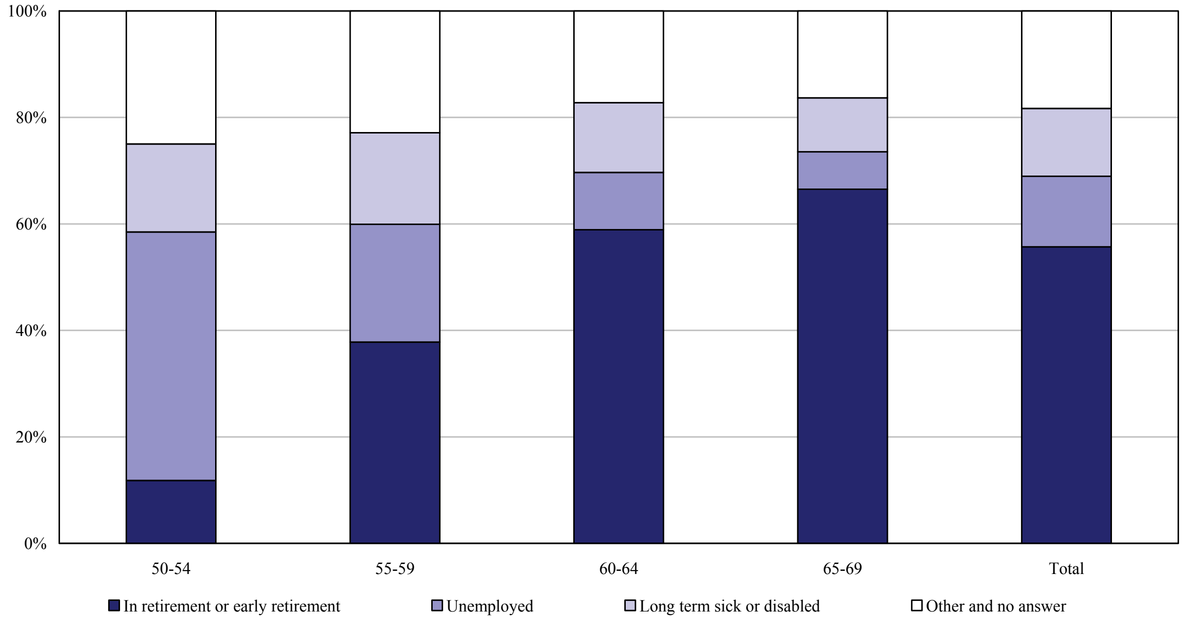
As pension and social security systems become more complex, there are also more actors involved in the design of these systems. Statutory pension schemes have different components with different purposes; some might be of a social safety net nature whilst others aim to provide an income related benefit. Statutory pension schemes are more commonly being complemented or replaced by privately managed provision where the work incentives might differ. This also gives a bigger role to private actors, rather than policy makers in the cumulative work incentives in a multi-tier pension scheme.

With increasing flexibility in the retirement decision, the role of other complementary social security systems, often under the jurisdiction of different policy makers, may end up affecting the incentives in the statutory pension schemes. In order to design efficient incentive structures it is vital that these are designed collectively with complementary systems.

The average age of exit from the labour market is often lower than the average age at which an old-age pension is drawn (See Table 1 above). Experience shows that transitions from the labour market into retirement are not direct and only half of older workers leave their last job or business to take up an old age pension. Only 35 per cent of older workers leave their last job or business to take up a pension. 20 per cent take up an early retirement benefit, 13 per cent leave due to unemployment and 12 per cent for reasons of long-term sickness or disability. Furthermore, a slight decline in direct transition from the labour market into retirement can be observed in the EU 25 Member States (Figure 9).

Figure 9

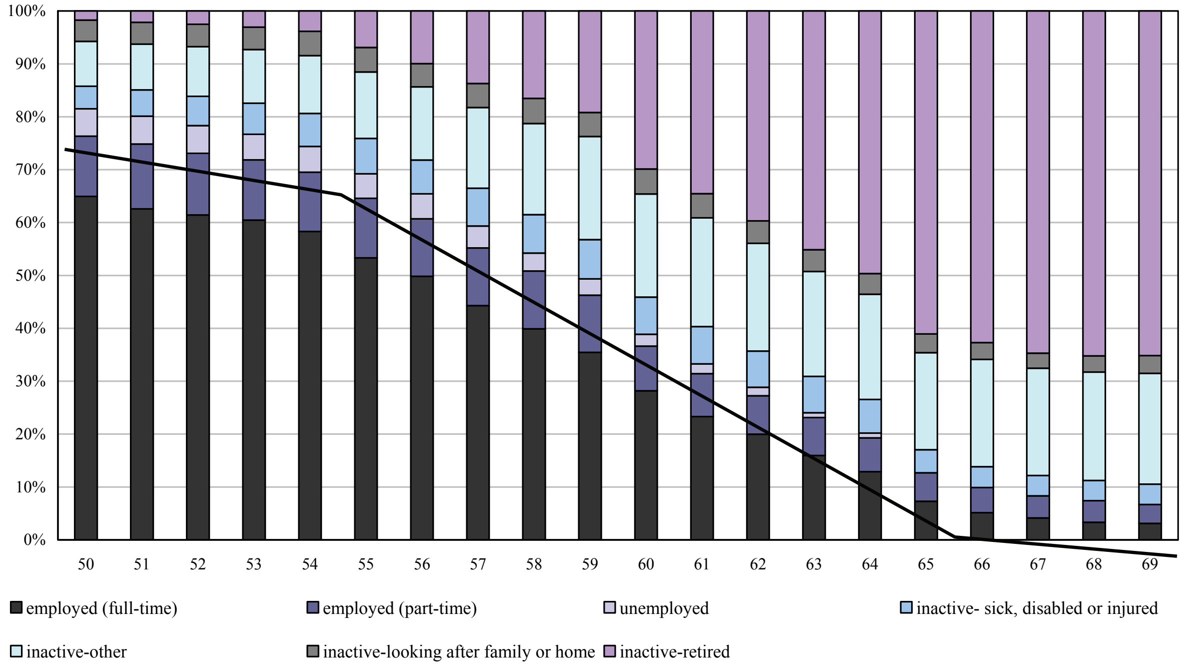
Main Labour Status just after Leaving Last Job or Business in EU by Age, 2006
(percent)



Note: The variable is based on self assessment. Unemployed may include government training, persons waiting to start a job, etc.
Source: 2006 *ad hoc* module LFS.

Figure 10

Economic Activity by Age in EU27, 2006



Source: LFS.

Table 3

Take-up of Early Retirement Schemes in EU27

	Low (<3%)	**Medium (Between 3% and 10%)**	**High (≥10%)**
Take up as a share of population 55-59	DK, ES, FR, LT, PT, SE	BE, DE, HU, LU, RO, SK	PL
Take up as a share of population 60-64	CY, FR, HU, PT, RO, SE	DE, ES, IE, SK	BE, LU, DK, PL

Figures generally refer to 2006.
These figures are generally taken from administrative sources are not necessarily completely comparable. Member States for which information is not provided do not have such information available. This table refers to specific early retirement schemes opened for all categories of the population.
Source: National replies to a questionnaire submitted to Members of the Social Protection Committee.

The main labour market exit pathways that have been identified are through invalidity or sickness benefits, early retirement schemes and unemployment benefits that have been specifically designed for older workers. Few workers may also leave the labour market through other systems such as with survivor's pension, or due to specific tax concessions granted to older workers leaving the labour market, but the take up rates of these benefits are minimal. For example survivor's benefits are often granted to those who have not been labour active in any case, whilst taxation rules show indications of curbing rather than promoting early exits in most member states. Whilst incentive structures in pension systems are being increased, complementary systems both with the social security systems and private schemes (often occupational) may affect negatively these incentives.

4.1 Early exits through early retirement schemes

Specific early retirement schemes creating exceptions from general rules for certain occupational groups are common in a number of member states. The proportion of early or indirect exits varies considerably from one Member State to another, but can be a main reason for early labour market exit in some Member States. Differences range from approximately 20 per cent of those aged 55-59 in receipt of early retirement benefits in Poland and close to none in Sweden.

The type of early retirement scheme, the eligibility criteria and the groups to which it is directed are for great importance. Usually early retirement schemes are open to all categories of the population. Some countries with less flexible retirement options use such schemes to provide flexibility of working careers and a smoother transition to retirement (e.g., BE, RO, FI). In some countries, however, they are designed as a source of protection for professional groups that are identified as having arduous or hazardous occupations, a list that varies greatly between Member States. In a few Member States they are explicitly made available due to major economic restructuring (e.g., ES, FR, HU). In some cases the schemes were primarily expected or are still expected to contribute to reducing statistically recognized unemployment levels (e.g., BE, ES, IE, LU, PT).

The possibility to retire early along with flexible transition from work to retirement is recognized as key to actually prolonging working lives. In some statutory old age pension schemes this flexibility has been incorporated. If the idea is to utilise special early retirement schemes to provide this flexibility it is important to create incentives for delaying the take up of early retirement benefit in these schemes as well. This also pertains to the flexibility in the transition to retirement for special occupational groups, often for those in so-called hazardous or arduous occupations. Most Member States allow certain categories of worker to take out early retirement benefits prior to the legislated statutory retirement or pension eligibility age. In some of these Member States this is also possible without actuarial reductions to old age pension benefits. However, the extent to which these schemes can be an impediment to work incentives also depends greatly on the earliest retirement age. In some member States this is as low as 50 years.

The use of early retirement benefits in economically strained times to cope with labour market issues can on the other hand become a long term disincentive to longer working lives. This is primarily due to the fact that once these financial security systems have been put into place it can be politically difficult to dismantle them, thus having a serious long term impacts on the employment rates of older workers. Employers may also encourage early retirement possibilities in times of financial strain to ease necessary redundancy processes. This, however, would give a disproportionate affect on the labour market participation of older workers in times of economic strain. Ensuring that employers bear all or at least a significant share of these costs can reduce such behaviour (e.g., BG, DK, HU, SI).

Nevertheless a number of Member States are adopting reforms to discourage the take-up of or close access to early retirement paths from the labour market, but not without difficulties. These reforms include increasing the age of entitlement to early retirement (e.g., BE, CZ, SK, UK), equalising the rules of access for both genders (e.g., DE, HU), plans to limit the number of professions entitled to benefits (e.g., PL), tightening the rules of access to recently introduced schemes that turned out to be unexpectedly popular (e.g., FR), or simply phasing out the schemes (e.g., IE). Other Member States strengthen the financial disincentives to retire early, by increasing the value of penalty factors (e.g., CZ, GR, PT, UK). Another solution adopted is suspension of early pension benefits for those who earn more than a minimum wage (e.g., HU). Since January 2006 the Netherlands has tightened fiscal treatment of early retirement and pre-pension schemes, and a reform of unemployment benefits is aimed at preventing the use of the scheme as an early retirement path.

Yet some Member States have delayed planned reforms (e.g., IT, AT, PL) decided to slow down the process of tightening the minimum requirements for early retirement. To what extent this is a result of the current economic recession or simply due to the political unpopularity of such decisions is difficult to determine. Also announcing restrictions on early retirement schemes can provoke early retirement choices as individuals feel pressured to take up such benefits before the restriction are imposed (e.g., FR, LT, PL, SK). However, shorter working lives and less hours worked implies lower economic growth and activity and through this lower and less sustainable pensions.

4.2 Early exits through disability schemes

In some member states, the take up of sickness benefits and disability schemes in older workers are quite high. The high take up rate and in countries with increasing life expectancy and healthy life years raises issues as to whether there is a issue of such benefits being used as a way to exit the labour market early or if there is genuinely a health issue that needs to be addressed. For example, invalidity and sickness benefits may have become a tool to manage labour market difficulties in the 1980s and 1990s. Recent work from the OECD[8] highlights that developments in

8 M. F. Forster Sickness (2007), *Disability and Reintegration strategies: A Comparative Overview*, Santander, 16-20 July, available at: http://www.oecd.org/dataoecd/43/60/39154239.pdf

Table 4

Take-up of Specific Invalidity Benefits in EU27

Take-up of Invalidity Benefits as Share of Population 55-59		
Low (< 5%)	**Medium (5-15%)**	**High (>15%)**
	BG, LV	EE, HU, LT, PL, RO, SK
IE, PT	BE, DK, LU, SI	MT, UK
ES	CY, DE, FR, NL	FI, SE
Take-up of Invalidity Benefits as Share of Population 60-64		
Low (< 5%)	**Medium (5-15%)**	**High (>15%)**
LV, SK	BG, EE, PL, RO	HU, LT
PT	BE, IE, SI, UK	DK, LU, MT, NL
CY, ES, FR	DE	FI, SE

Source: National replies to questionnaire submitted to Members of the Social Protection Committee. Figures generally refer to 2006.
Note: These figures are generally taken from administrative sources are not necessarily completely comparable. Member States for which information is not provided do not have such information available.

sickness and disability benefits are not necessarily related to trends in objective or subjective health indicators but are influenced by policies and social phenomena. Namely, in some countries it can be socially less stigmatising to be out of work because of health reasons than unemployment. It can also be observed, that many people with health problems can work, and want to work. Having policies based around an assumption that they cannot work can be fundamentally flawed. Helping those people to work is potentially a "win-win" policy: it helps people avoid exclusion and have higher incomes, at the same time as raising the prospect of higher economic output in the long term.[9]

A number of member states have identified the above mentioned as a reason to reform their sickness and disability benefit schemes. Member States have sought to extend working lives by curbing exits through sickness and disability schemes (e.g., CZ, DK, ES, HU, MT, NL, PL, AT, SE). Measures generally involve rehabilitation efforts in connection with stricter eligibility rules and greater cooperation between institutions involved to allow for a quicker transition back into the labour market.

Changing attitudes to the acceptance of being in receipt of sickness or disability benefits, changing eligibility criteria for different types of health conditions, and putting more financial responsibility on employer's for the cost absences for ill health (both work and non-work related) are common approaches.

Restricting the use of sickness and disability schemes as pathways for early exit should, however, not preclude the use of such schemes for the contingencies they were meant for. Member

[9] *Sickness, Disability and Work: Breaking the Barriers (Vol. 1): Norway, Poland and Switzerland*, published 7/11/2006, available at: http://www.oecd.org/document/25/0,3343,en_2649_37411_37600345_1_1_1_37411,00.html and *Transforming Disability into Ability*, published 27/02/2003, avaible at: http://www.oecd.org/document/14/0,3343,en_2649_37411_35290126_1_1_1_37411,00.html

States are looking for ways to integrate people into the labour market according to their capabilities and the dichotomy of "employable" versus "unemployable" persons with disabilities is being challenged.

4.3 Private pension provision and the incentives to work longer

Member states have identified that relative benefit levels in pension systems are bound to decline in the future given pension reforms that have been carried out. To avoid this projected decline whilst still sustaining financial stability in pension expenditure, Member States have been promoting the development of private pensions.

Individually funded and pre-funded pension provision has often been viewed as providing a possibility where the costs of future pensions are shifted to the present as opposed to pay-as-you-go schemes and as being schemes where the returns on contributions are higher.

In most Member States a combination of providing incentives to extend working lives and increasing privately managed pension provision is being implemented. Some Member States promote or mandate extra contributions for occupational and private pension provision (e.g., BE, DK, DE, IE, SE, UK). A number of Member States that have introduced mandatory funded schemes by allowing for a transfer of contributions from old pay-as-you-go systems to the funded schemes or by an increase of overall contribution rates to statutory pension schemes (e.g., BG, EE, HU, LT, LV, PL, RO, SK, SE).

The interplay of the two strategies, providing work incentives in statutory defined benefit, pay-as-you-schemes and increasing privately managed pension provision, is vital to the success of providing adequate pensions in the future.

Privately managed pension provision typically shifts a lot pension risk from the provider to the beneficiary. This is especially true for defined contribution funded (both pre-funded and individually funded) schemes, which are becoming more predominant. Privately managed pension provision in most countries involves that individuals make active choices regarding their pension. This type of an active choice instigates an interest at an earlier stage in a person's contributory life in even other types of choices that can affect the pension of an individual, such as career choices, through a sort of spill-over effect. In many countries, however, most systems allow for a default choice when and active choice is not made which works adversely to this aim.

On the other hand, supplementary pension schemes occupational or private, mandatory or voluntary can give a significant addition to the statutory pension. These pensions, historically, have also had elements that have reversed certain work incentives legislated in the statutory pension schemes contributing to earlier retirement. These impediments can include the possibility to withdraw an occupational pension earlier than the statutory retirement or pension eligibility age or the receipt of lump-sum payments facilitating earlier exits from the labour market.

In a few Member States, early exits through supplementary private pensions used to be a common practice, though now diminishing (e.g., BE, UK). In Some Member States there are still specific private pension schemes designed to provide early retirement (e.g., FR, IE, NL, SI, SK, FI, SE), but in a growing number of Member States supplementary pensions cannot be used for bridging early exits from the labour market and old age retirement through statutory retirement schemes (e.g., DK, EE, PL, BG, CZ and CY).

The early take-up of private pension benefits depends strongly on eligibility rules and age limits. In some cases, a lower age is fixed by law (e.g., BG, DK, PL, FI) or by wide extending agreement between labour market actors as in the case of Sweden. The eligibility age for private pension provision can be as low as 50 in some cases (e.g., UK, IE and CZ) In some Member States, private pension benefits are, however, actuarially reduced in case of early withdrawal (e.g., IE, UK, SE) providing the same kind of incentives to work longer as in statutory schemes with the similar design. Some Member States consider the frequent use of private pensions to bridge between early exit and statutory retirement age attributable to low awareness of the consequences of such behaviour. For instance, in the UK, employees are often even unaware of actuarial reductions of their private pension in the case of early labour market exit.

The effects of the current economic situation on privately managed pension schemes where the beneficiary bears much of the investment risk is an area that need to be monitored carefully in terms of longer working lives. Most existing funded schemes have experienced a fall in asset values during the recent financial turbulence. Low returns can lead to pension benefit levels that force the incapable to continue to work longer but it is important to note that the share of income from such schemes is quite limited for those in or close to retirement today. However, the experiences of the turbulence in financial markets can act as an early warning signal of the need to evaluate the situation as we move towards a higher amount of funded and prefunded pension provision. A lack of knowledge of the effects of investments on these systems can also lead to people making the wrong investment or retirement choices. For example, early withdrawal of a pension in a time of downturn can lead to unnecessary low benefits.

In this sense, the importance of information and knowledge regarding one's pension is crucial for incentives to be effective. This also has significance with regard to an individual's choice to invest in individual private pension savings. An incomplete picture of one's pension provision from different schemes affects the choices that individual's make concerning their retirement decision, such as career choices, including breaks from gainful employment, saving levels for retirement and labour market exit and the extension of working lives. . Early exits through unemployment schemes

Unemployment benefits are a key reason for early labour market exit in some Member States. As calculations for theoretical replacement rates show how results drop for unemployment breaks in an individual's career (Figure 11). In many Member States unemployment breaks lead to a bigger drop in replacement rates than for instance childcare breaks (e.g., CZ, DE, EE, EL, ES, IT, CY, LU, AT, PL, SK, FI, SE, UK).[10] In some Member States, the drop in replacement rates are six percentage points or more in after three years of unemployment (e.g., SK, RO, FI), bringing the adequacy of protection of pension entitlements during unemployment into question, which has to be balanced with the financial incentives for individuals to return to the labour market.

At the same time, in a number of Member States specific unemployment schemes are opened, that do not count in the general unemployment level. This provides a form of hidden unemployment of older workers that may not be visible in the normally calculated unemployment figures. Specific schemes of this type may include, extended benefit disbursement periods (e.g., CZ, EL, FR, IT, LT, AT, PL, SI, FI) extra benefits paid after the expiration of standard unemployment benefits (e.g., BE), or relaxing of other eligibility criteria, for example with regards to job search. Whilst these types of special conditions or too generous benefits systems for periods of unemployment may protect older workers from a difficult labour market situation, they can also act as a disincentive to work longer, and become an old-age poverty trap. Therefore, while many Member States do not have any distinguishing rules for unemployment benefits for older workers, others are attempting to progressively phase out such rules (e.g., DK, DE, FI).

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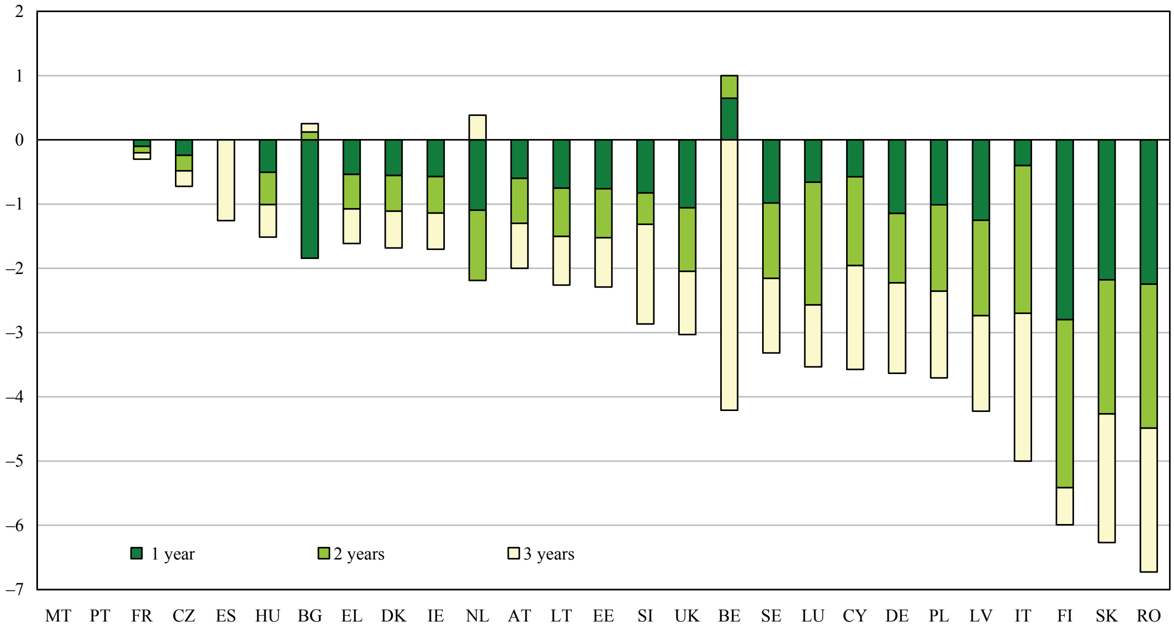
[10] In BE, this has to do with the nature of the calculation. Unemployment is assumed to take place at the end of the individual's career. In BE this entails that the individual loses the entitlement to the pension bonus which is given to those who work beyond the age of 62, as compared with a person who continues to work. If the unemployment is instead assumed to take place earlier in the career the results would be as those for the childcare case.

Figure 11

Difference in Net Theoretical Replacement Rates for an Average Earner Entering the Labour Market at 25 and Retiring at the Statutory Retirement Age with a 1, 2 and 3 Year Career Break for Unemployment Compared with No Break*



* The unemployment break is assumed to take place in the years just prior to old age retirement which is assumed to take place at the legislated statutory old retirement age for men.
Source: SPC/ISG.

5 Information and the effectiveness of incentives

With these increasingly complex structures it is also vital that collective information including all complementary schemes gives individuals a clear picture of their retirement options and their subsequent effects on benefit levels. In order to ensure effectiveness of the incentives to work longer it is important to ensure transparency and information regarding the design of these incentives and how they affect a person's pension benefits ad entitlements. For example, the link between contributions paid in and benefits paid out has to be clear for the general public, since pension contributions, by and large, are viewed by the public as general taxation rather than as a build-up of individual pension rights. This can especially be the case if employers pay the contributions. Some Member States have clarified the link between benefits and contribution by imposing a part of the contributory burden on the individual (e.g., CZ, DE, EL, FR, IT, LV, LT, LU, HU, AT, PL, FI, SI, SE SK).

Pension reforms have taken place in most Member States and have often become a continuous process. In this context, it is becoming increasingly difficult for the people concerned to understand how the changes introduced affect them and how they should respond. At the same time pension reforms are also demanding more choices of the individual that affect their pensions by increasing flexibility around retirement conditions and prolonging maximum and minimum contributory criteria. Therefore, without transparency and general knowledge of the systems the incentives to work longer that may have been built into the system will be futile.

Table 5

Take-up of Specific Unemployment Schemes for Older Workers in EU27

	Low (< 3%)	**Medium (3-6%)**	**High (>6%)**
Take up as a share of population 55-59	UK, SE, SK, LU	EE, CZ, LT, MT	BE, CY, FR
Take up as a share of population 60-64	CZ, BG, LT, PL, UK, SE, SK, LU	FR, CY, NL	BE, FI

Note: These figures are generally taken from administrative sources and are not necessarily completely comparable. Member States for which information is not provided do not have such information available. In DE a special scheme for 58+ unemployed individuals could make up an estimated 5 per cent of the population aged 55-64. However, this scheme is about to phase out as of 2008.
Source: National replies to questionnaire submitted to Members of the Social Protection Committee. Figures generally refer to 2006.

There is widespread recognition in Member States that the level of financial literacy among the general public is inadequate for people to be able to make educated choices between the various options open to them. All the increased individual responsibilities and risks imply that information policy should play a more important role in pension policy.

Additional to this there is also a recognised problem of short-sightedness suggesting that even knowing and understanding the significance of different choices may not ensure sound consumer choice simply due to a lack of interest in one's pension, or interest arising too late. This is especially pertinent in systems where there is a life cycle approach to earning pension entitlements making decisions made in the early years of a person's career important to the pension eventually paid out.

In efforts to complement other types of pension formation a growing number of Member States are now also providing or developing calculations of how these pensions rights may translate into a pension income, based on projections given certain economic assumptions (e.g., BE, DE, DK, IE, ES, FR, LT, FI, SE, UK). In Finland, the projections are only provided for those closest to retirement, as projections for younger cohorts are considered too hypothetical. Yet with a move towards longer contributory periods it would seem important that individuals understand the effects of shorter careers early on. As the pros and cons of different approaches are weighed, even younger cohorts might appreciate forecasting tools which provide different scenarios depending on economic assumptions, contributory years and point of retrieving the pension.

However, many countries have recognized that at the same time projections are usually provided for each scheme in isolation even though individuals ideally would need to know how their different entitlements combine into a full package of potential retirement income. But in a few of the Member States with widespread occupational and private pension provision, steps are being taken to develop web-based pension portals where people can check how their pension accruals from different schemes would come together in an overall amount of pension income (e.g., DK). This will help citizens to avoid making retirement decisions based on incomplete or fragmented information.

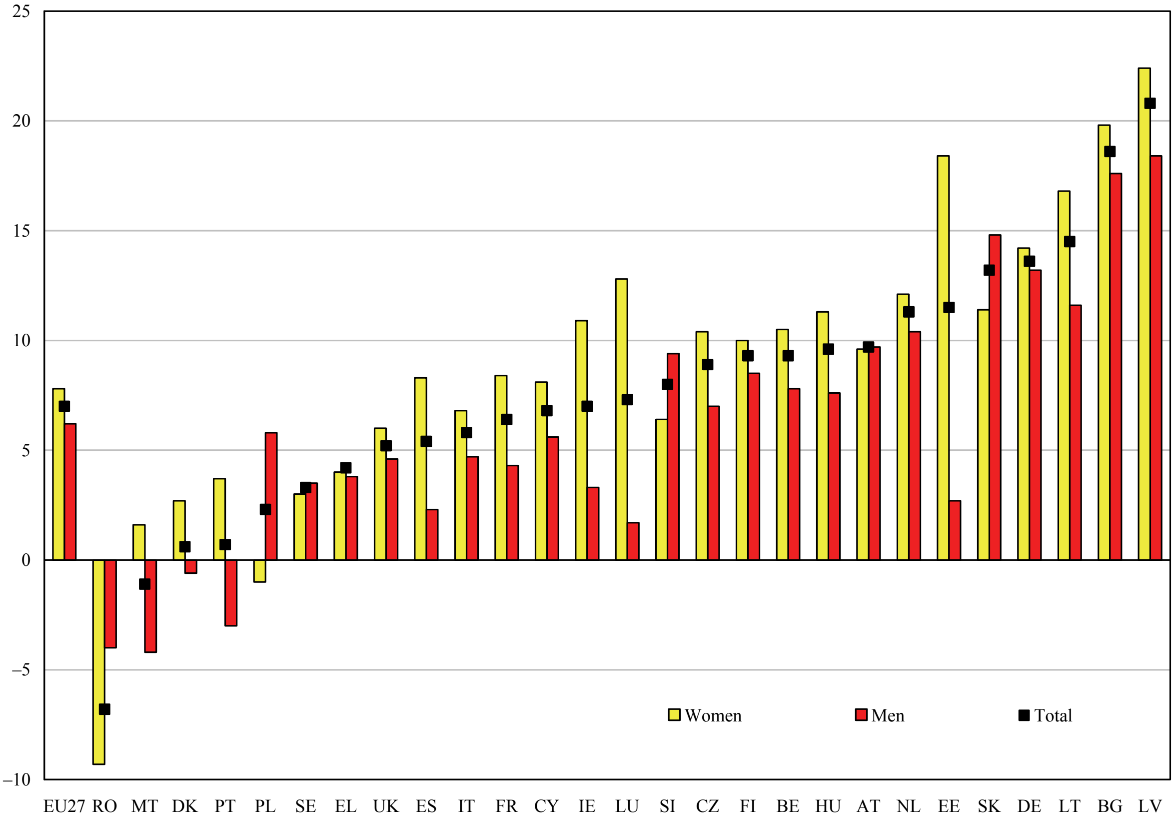
6 Labour market conditions for older workers

6.1 Developments 2001-08

The European Union has identified a target under the growth and jobs strategy is to reach a

Figure 12

Change in Employment Rates of Older Workers (55-64), 2001-07
(percent)



Source: Eurostat, *Labour Force Survey*, Annual averages.

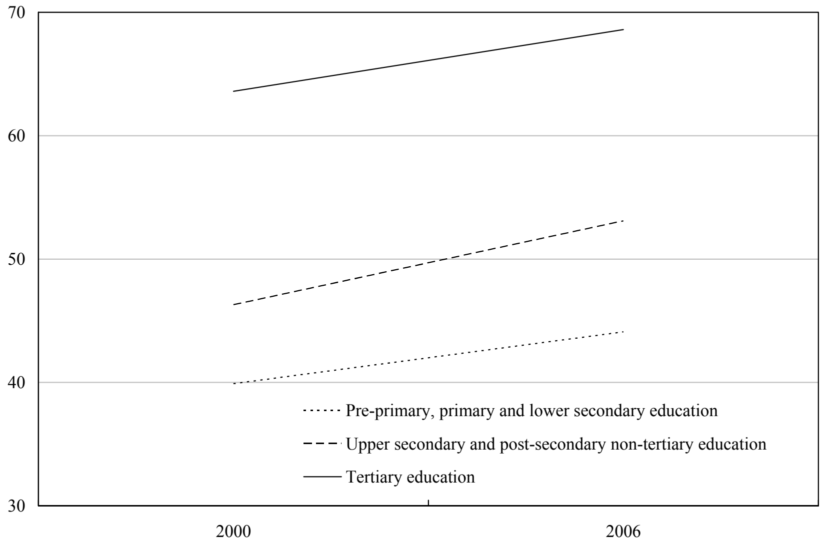
50 per cent employment rate for older workers by 2010. In 2007, the employment rate for older workers in the EU-25 was 45 per cent compared to 37 per cent in 2001, and 11 countries now exceed the 50 per cent target (Figure 12). This general increase in employment rates results from two main factors. Firstly, the relative share of people aged 55-59 – who have a higher employment rate – has grown due to the ageing of the baby-boom generation. In addition, most Member States experienced a higher increase in the employment rate for women than for men between 2001 and 2007.

Moreover, since 2000 the increase in the employment rate among 55-64 year olds has benefited all categories of workers, although it has been relatively slower for the less qualified within the EU25: it has been 5 points for the less qualified, compared to 6 or 7 points for medium or highly qualified (Figure 13). At the same time the evolution of employment rates for the less qualified was more favourable for the age bracket 25-54, probably reflecting targeted employment measures.

The employment rates of older workers are often monitored as an indicator of the effect of pension reforms on the extension of working lives. It is, however, clear that incentives structures included in pension reforms have only a small role to play unless complemented by a labour market that supports these initiatives.

Figure 13

Employment Rates of Men 55-64 by Skill Levels, EU25



Source: Eurostat, *Labour Force Survey*.

The National Strategies show that there are two commonly used instruments to boost the labour market activity of older workers. First, Member States are actively adopting a culture of lifelong learning, offering more training designed to make older workers' skills more adaptive and to help them keep their jobs (e.g., AT, BG, and CZ). This plays in line with the life-cycle approach to contributory periods in some pension schemes as well. Second, subsidies are offered to employers to boost financial incentives to employ older workers (e.g., AT, DK, ES, LT, HU, and SE). In Germany, financial incentives are also given to unemployed older workers to reenter the labour market by offering a compensation allowance to unemployed people aged 50 or more who accept a low-paid job. On a European level, the European Social Fund (ESF) contributes to the financial sustainability and adequacy of pension systems by encouraging activities related to life long learning, active ageing and prolonging working lives (e.g., AT, HU, SK). Some Member States are also using European anti-discrimination law in their promotion of better age management (e.g., DK, NL, UK).

Additionally, European legislation on age-based discrimination (Council Directive 2000/78/EC) states that less favourable treatment of employees on the grounds of age needs to be objectively justified. A recent court ruling has, however, confirmed that reaching the pension eligibility age or statutory retirement age could be a sufficient reason to terminate the employment without it being considered discriminatory.[11]

However there is still a need to fight age discrimination and to open up employment opportunities for older workers, including opportunities for training and retraining.

6.2 The effect of the crisis on labour market conditions

In May 2009, the European Commission revised its forecast with regard to the financial and economic downturn in the EU. The forecast predicts a contraction of GDP in the EU by 4 per cent in 2009 and to stagnate during 2010. In line with this, employment rates are expected to fall

[11] Case C-388/07 The Incorporated Trustees of the National Council for Ageing.

significantly and EU-wide unemployment rates are expected to reach almost 11 per cent in 2010 as compared with 7.0 per cent in 2008.[12]

The economic crisis has already had an impact on the labour market and employment growth has come to a standstill whilst unemployment rates have started to rise. The number of employed people will decline by 2.5 per cent in 2009 and by 1.5 per cent in 2010 or by about 8.5 million jobs. Some categories of workers are expected to be more affected by the stagnation on the labour market such as new and young workers, the low skilled, employees holding temporary contracts, EU mobile workers, migrants and the elderly.[13]

The current situation can cause further delay in the establishment of younger workers on the labour market. This can have a long term impact on the pension levels of these individuals, possibly causing pension benefit adequacy problems later as is displayed by the calculations in Figure 11. This can be especially pertinent in systems where contributory years have been extended. This problem is compounded by the increase in long term unemployment.

The long-term unemployment share for older workers (percentage of unemployed for more than 12 months) is especially high, at 55 per cent. Sustaining a well-functioning labour market and a high activity rate among the population of working age can be especially difficult in times of economic downturn. Often groups that are extra vulnerable are more susceptible to unemployment and lay-offs, including older workers who can often be considered both a more expensive yet more ineffective source of labour. Such labour market behaviour can, however, lead to more significant problems later on in the sustainability of pension systems and other financial security systems. The reason for this is that often older workers are more difficult to reintegrate into the labour market. For example, if early retirement systems or specific unemployment's schemes are used these may provide more long-term and generous benefits than those provided to other groups, as a way of enticing an easier redundancy. The individual incentives to reenter the labour market are then often smaller and the labour market demand for a person who has been absent for a longer period tends to diminish.

In earlier economic crises, older workers tend to be amongst the majority of those affected by redundancies. It is important to implement proactive labour market policy strategies that keep older workers in the labour force and that help to curb such labour market distortions as the impact of the current labour market and economic situation such as redundancy packages, and early retirement.

Most Member States have taken measures to preserve employment, support activation and promote reintegration in the labour market, and anticipate and manage the impact of restructuring. However, most of these measures build on existing labour market policies that have developed along the principles of flexicurity and active inclusion. It is important that all labour market actors work together in order to keep a balance in the age distribution of the labour market and those in unemployment considering that certain groups such as young and older workers are already proportionately underrepresented on the labour market.[14]

Integrated plans in Member States to cope with the current economic downturn indicate an understanding of the multi-faceted nature of the crisis.[15] A common approach is to cushion the impact of the crisis by giving support in the field of employment to both employers and workers

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[12] European Commission Economic Forecast Spring 2009, available at: http://ec.europa.eu/economy_finance/publications/publication_summary15046_en.htm

[13] Source: DG ECFIN.

[14] Source: National replies to questionnaire submitted to Members of the Social Protection Committee.

[15] Updated joint assessment by the Social Protection Committee and the European Commission of the social impact of the economic crisis and of policy responses, available at: http://ec.europa.eu/employment_social/spsi/spc_opinions_en.htm

and by investing in the economy. Labour market measures that have been observed include flexible working-time arrangements (e.g., BE, DE, NL, SI); measures to raise the employability of workers, including the most vulnerable through enhanced training programs (e.g., DE, HU, NL, AT, PT); or public support to SMEs (e.g., BE, BG, AT, PT, FI, SE). Other examples of measures to preserve jobs entail cuts in non-wage labour costs (e.g., BE, BG, DE, PT, SI, FI, SE) and corporate income taxes (e.g., PT, SI). Specific measures are also targeted at older workers and aim at avoiding the use of early retirement schemes (e.g., PL, PT).

Measures to support activation and promote reintegration in the labour market, especially of the most vulnerable include the strengthening of public employment services allowing in particular for more individualised support (e.g., BG, DK, DE, FR, SI); greater access to training (e.g., BG, DE, FR, FI, PT, UK) including training schemes targeted at specific groups of workers (e.g., PT), subsidised employment for those furthest away from the labour market (e.g., FR), and to child care (e.g., AT) and other enabling services.

Preserving a close link to the labour market for those made redundant is an important measure. Although the current social costs of this may be high, it is important that a long-term thinking is maintained.

6.3 *The crisis and the take up of benefits*

In light of the current economic downturn, it is also important to monitor the effects on the situation of older workers in the labour market and on their path to full retirement.The direct impact of the recession is most apparent in the increase in the take up unemployment benefits in 2008, and especially during the second part of the year. The impact of the crisis has also had a slight impact on the percentage of older workers claiming early retirement schemes (e.g., LV, LT, PL and SK).[16] The number and age and gender distributions of claimants of social assistance is not clear yet, however, most MS expect increased pressure on minimum income safety net schemes.

Areas more frequently pointed out as deserving special attention when adopting recovery packages or specific measures in the current context are linked to unemployment, the adequacy of safety nets, funded pension schemes, and access to housing. Moreover a number of Member States have also delayed pension reforms or the activation of automatic mechanism which in the current climate would otherwise lead to lower pension benefits.

Member States have taken action to reinforce the support to people’s income through measures that include increasing the level of minimum income or minimum wage, extending the coverage or duration of unemployment benefits, reinforcing other social benefits, introducing tax rebates or exemptions for specific groups. They have done so either by advancing measures that were already planned or by adopting new measures, either on a temporary or permanent basis. These measures build on the active inclusion strategies that many Member States have started implementing, and attention is paid to avoiding that the new measures compromise efforts to build integrated approaches that combine income support, access to services and reintegration incentives.

7 Conclusions

Pension reforms have to deal with demographic developments and in particular increased longevity, which is a key driver for increasing pension expenditure in the future. This increase in a financially balanced scheme would require either higher contributions by workers or lower benefits

[16] In Poland the increase is also due to the ongoing reforms.

for pensioners, if the increase in life expectancy were spent in retirement. However, increases in life expectancy can be shared between the years in employment and retirement, thereby resulting in a better balance between life-time contributions and benefits.

The hesitation to maintain older workers, into the labour market can also depend on what is socially acceptable. There is, however, a growing recognition amongst policy makers and also amongst the general population for the need to extend working lives. The clearest example of this success is the recognition that has been given to the need to increase retirement ages. This is now becoming a politically legitimate and viable reform in some countries.

Giving flexibility to retirement choices and putting more responsibility on the individual in determining the pension ultimately received, also allows for a social dimension in work incentives. Individuals are allowed to prolong working lives according to individual ability and choice.

Creating incentives to work more and longer in pension systems is only part of the solution to extending working lives. The success of these incentives is dependent on their interaction with other benefit systems and on labour market conditions. If incentives in pension systems are counteracted in other social security systems, private or public, the incentives will not be as effective in attracting people to prolong their working lives. Moreover even the best designed incentive scheme will fail to take effect if the demand for older and younger workers is lacking on the labour market. This is clearly more of a problem in phases of employment destruction, but also in periods of employment growth it is important to ensure labour markets are open for younger and older workers.

ANNEX 1

List of Abbreviations of EU Member States

BE	-	Belgium
BG	-	Bulgaria
CZ	-	Czech Republic
DK	-	Denmark
DE	-	Germany
EE	-	Estonia
EL	-	Ireland
ES	-	Greece
FR	-	Spain
IE	-	France
IT	-	Italy
CY	-	Cyprus
LV	-	Latvia
LT	-	Lithuania
LU	-	Luxembourg
HU	-	Hungary
MT	-	Malta
NL	-	The Netherlands
AT	-	Austria
PL	-	Poland
PT	-	Portugal
RO	-	Romania
SI	-	Slovenia
SK	-	Slovakia
FI	-	Finland
SE	-	Sweden
UK	-	United Kingdom

ANNEX 2

Recently Enacted Changes in Retirement Age in the EU Member States

MS	Measure	Decision	Implementation
BE	Equalisation of retirement age: gradual increase in retirement age up to 65 for women	1996	Gradual increase to reach age of 65 in 2009
BG	Increase in retirement age up to 60 for women and 63 for men	2000	Since 2000 retirement age increase by 6 months per year: age of 63 for men reached in 2005.Age of 60 for women in 2009
CZ	Increase in retirement age from 60 to 65 for men and from 57 to 65 for women (and to 62-64 for women who raised two or more children)	1995, revised 2008	Since 1996 retirement age increased by 2 months per year for men and 4 months per year for women
DK	Increase in retirement age from 65 to 67 for both genders (and further possible increases)	2006	Between 2024 and 2027. A framework for further increases in the retirement age after 2030 (adjustment mechanism based on trends in the remaining life expectancy)
DE	Increase in retirement age from 65 to 67 for both genders	2006	Gradual increase between 2012 and 2029 (one month per year starting from 2012 and two months per year from 2024)
EE	Increase and equalisation of retirement age (63 years)	1999-2000	Gradual equalisation till 2016
GR	Increase in retirement age for women insured before 1993 in IKA-ETAM[17] from 57 to 60. Increase in retirement age for women insured after 1992 to 65.	1992	Retirement age of 65 for those women insured since 1993 (to be achieved in 2058)
IT	Increase in minimum retirement age from 58 to 61	2007	Gradual increase between 2008 and 2013 combining age and years of contributions

[17] IKE-ETAM is social insurance fund covering most of private sector employees.

MS	Measure	Decision	Implementation
LT	Increase in retirement age from 60 years for women and 62.5 years for men to 65 years for both genders		Gradual equalisation between 2012 and 2026. Yearly increases by 4 months for women and by 2 months for men
LV	Increase and gender equalisation of retirement age (62)	1996	Increases in retirement age by 6 months per year: men reached retirement age of 62 in 2003, and women in 2008
HU	Increase in retirement age from 60 years for men and from 55 for women to 62 for both genders	1996	Gradual increase by year every two years so that the retirement age of 62 was reached in 2001 for men and in 2009 for women
MT	Gender equalisation: increase in retirement age from 60 years for women and 61 years for men to 68 years for both genders	2006	Equalisation of the retirement age till 2013
MT	Increase in retirement age from 62 to 65 for both genders	2006	Gradual increase between 2014 and 2026
AT	Equalisation of retirement age: increase from 60 to 65 for women	1990s Constitutional Court ruling	Increases by 6 month per year between 2024 and 2033
RO	Increase in retirement age from 57 to 60 for women, and from 62 to 65 for men	2000	Gradual increase between 2001 and 2014
SK	Equalisation of retirement age: increase from 60 years for men and 57 years for women to 62 years for both genders (women with children lose their right to retire at the age of 53-56)		Gradual increase for men between 2004 and 2006, and for women between 2004 and 2010 (women with 5 children and more till 2015)
FI	Increase in retirement age from 63 to 65 for both sexes	2009	Retirement age will be raised by two months per year starting in 2011
UK	Gender equalisation: increase in state pension retirement age for women from 60 to 65	2007	Between 2010 and 2020
UK	Increase in state pension retirement age for both genders from 65 to 68	2007	increase to 66 between 2024 and 2026, 67 between 2034 and 2036, and 68 between 2044 and 2046
UK	Increase in age when private or occupational pension can be drawn from 50 to 55	2008	From 2010

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