



THE INVERTING PYRAMID

*Pension Systems
Facing Demographic
Challenges in Europe
and Central Asia*

Demographic Challenges in Europe and Central Asia

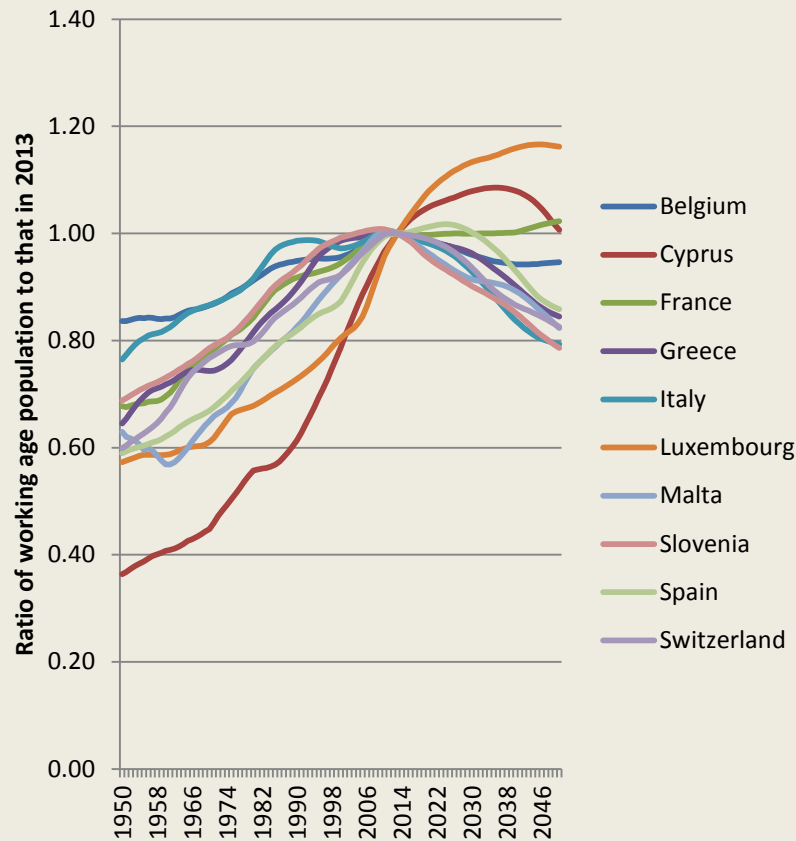
Anita M. Schwarz

Lead Economist

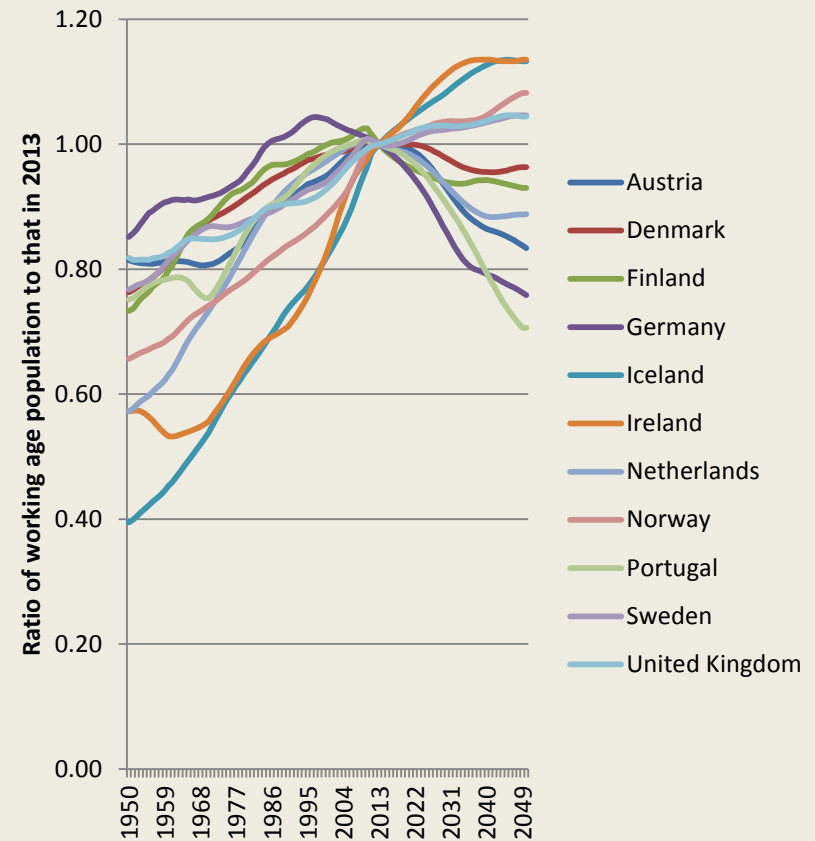


Structural Break in Growth of Working Age Population Around 2013

High Income Generous Spenders



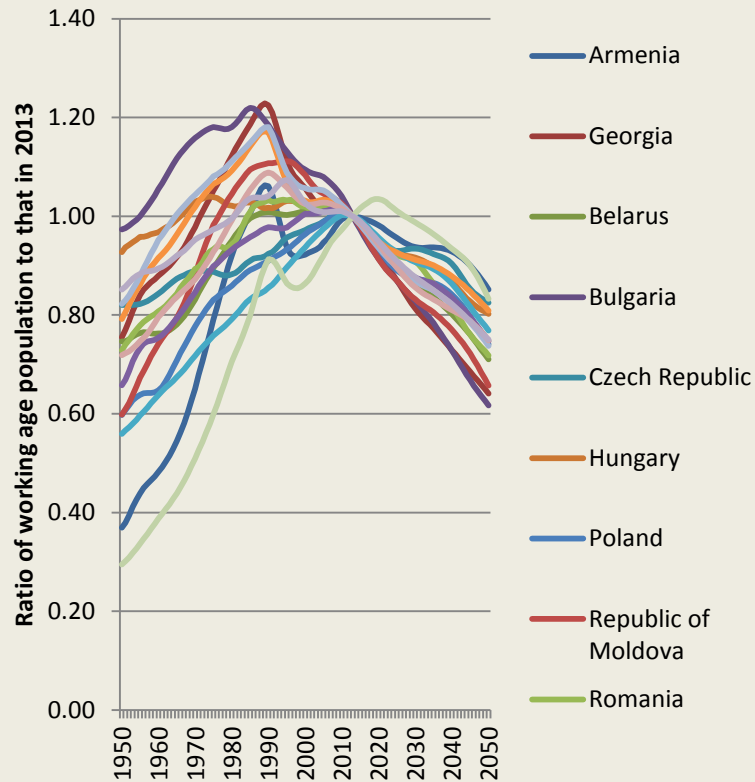
High Income Moderate Spenders



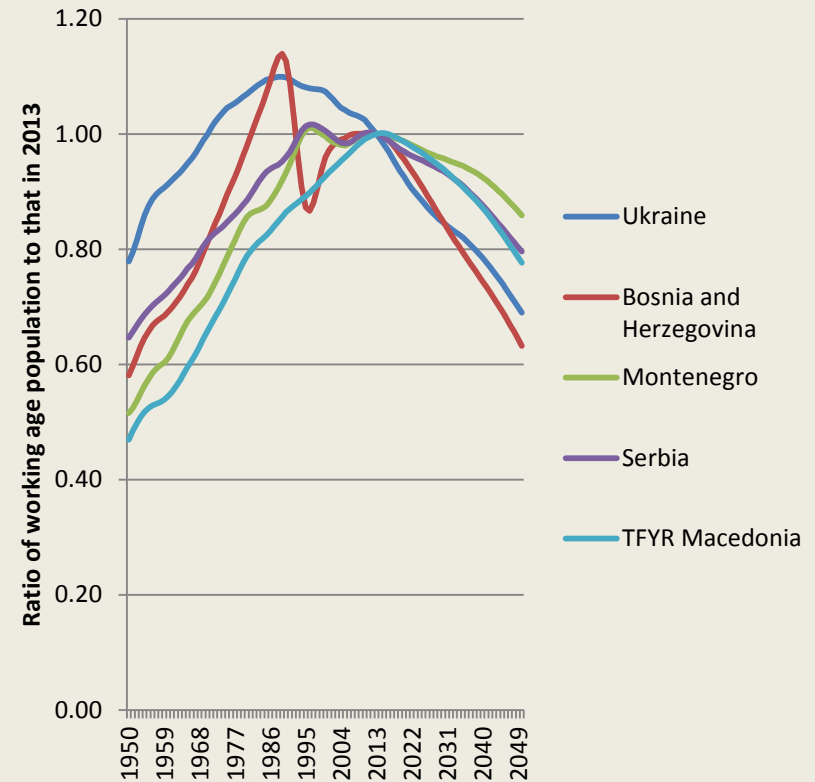


Structural Break in Transition Countries More Marked

Lower Spending Transition Countries



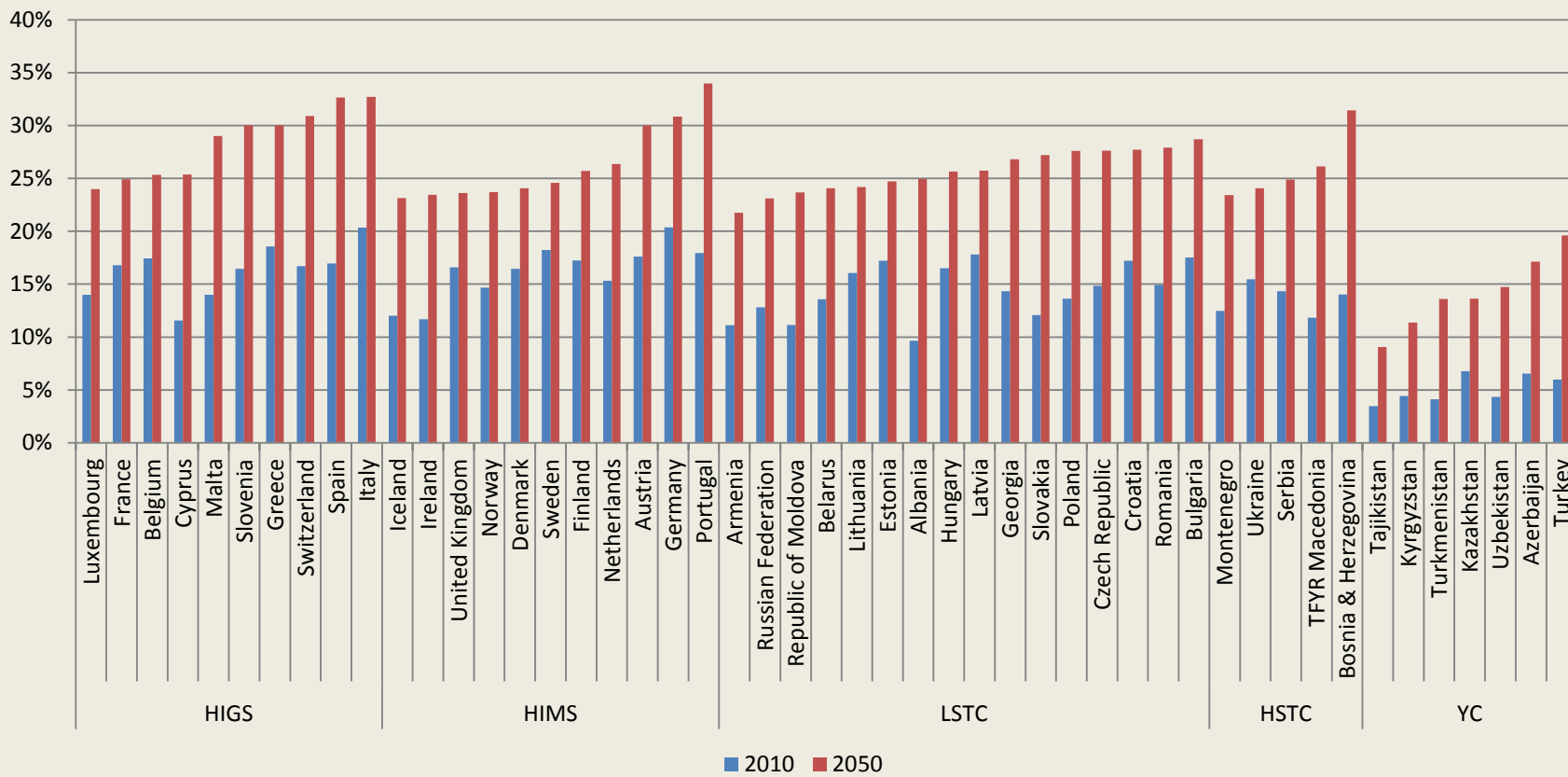
Higher Spending Transition Countries





While contributors are falling, share of elderly in population is rising

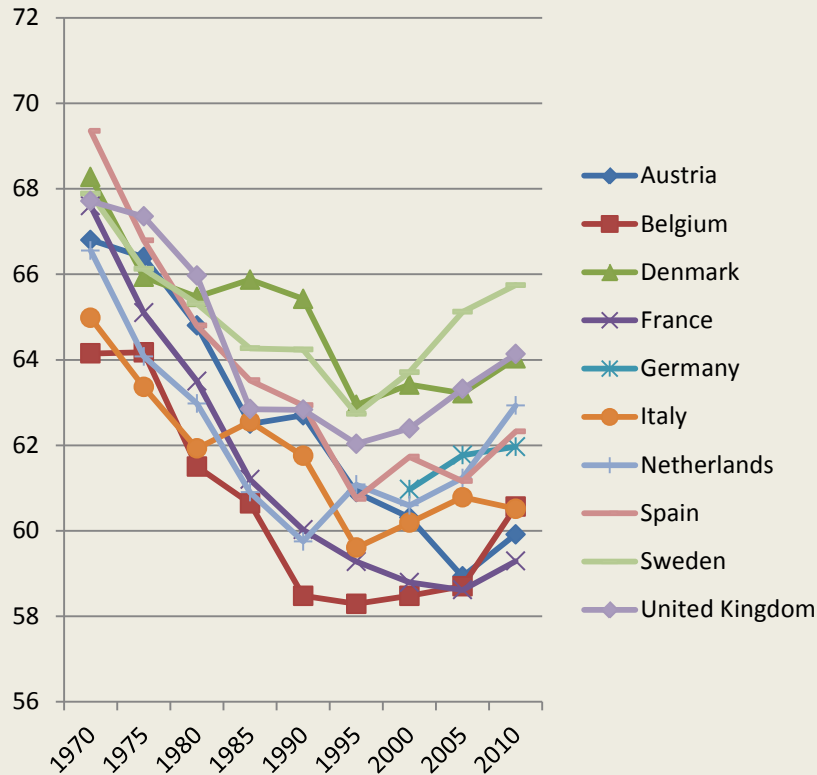
Percentage of Population Above Age of 65 in 2010 and 2050



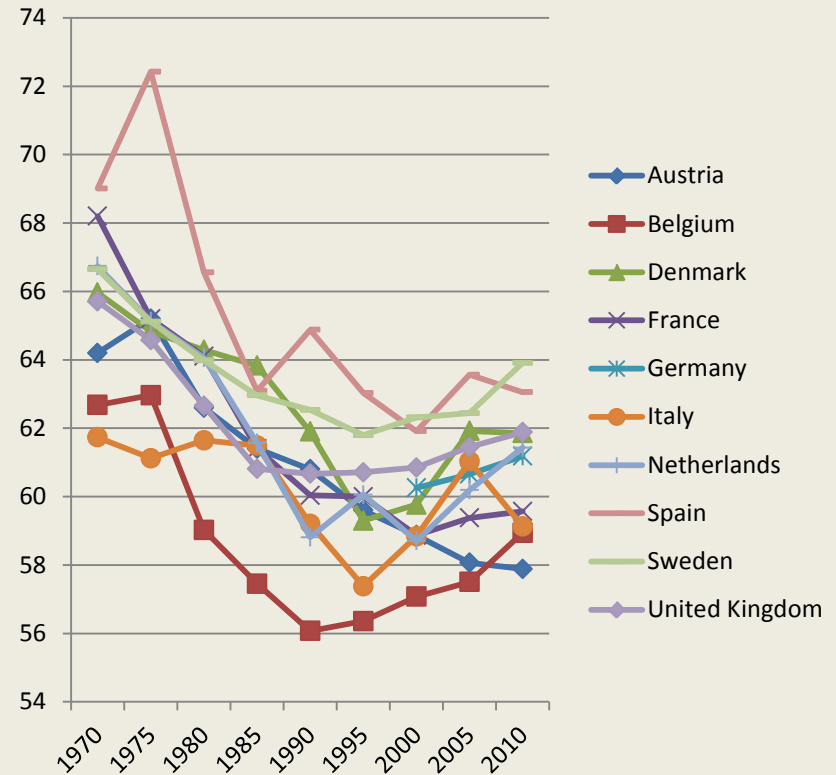


When contributors were growing, these countries increased generosity

Male Average Effective Retirement Age



Female Average Effective Retirement Age





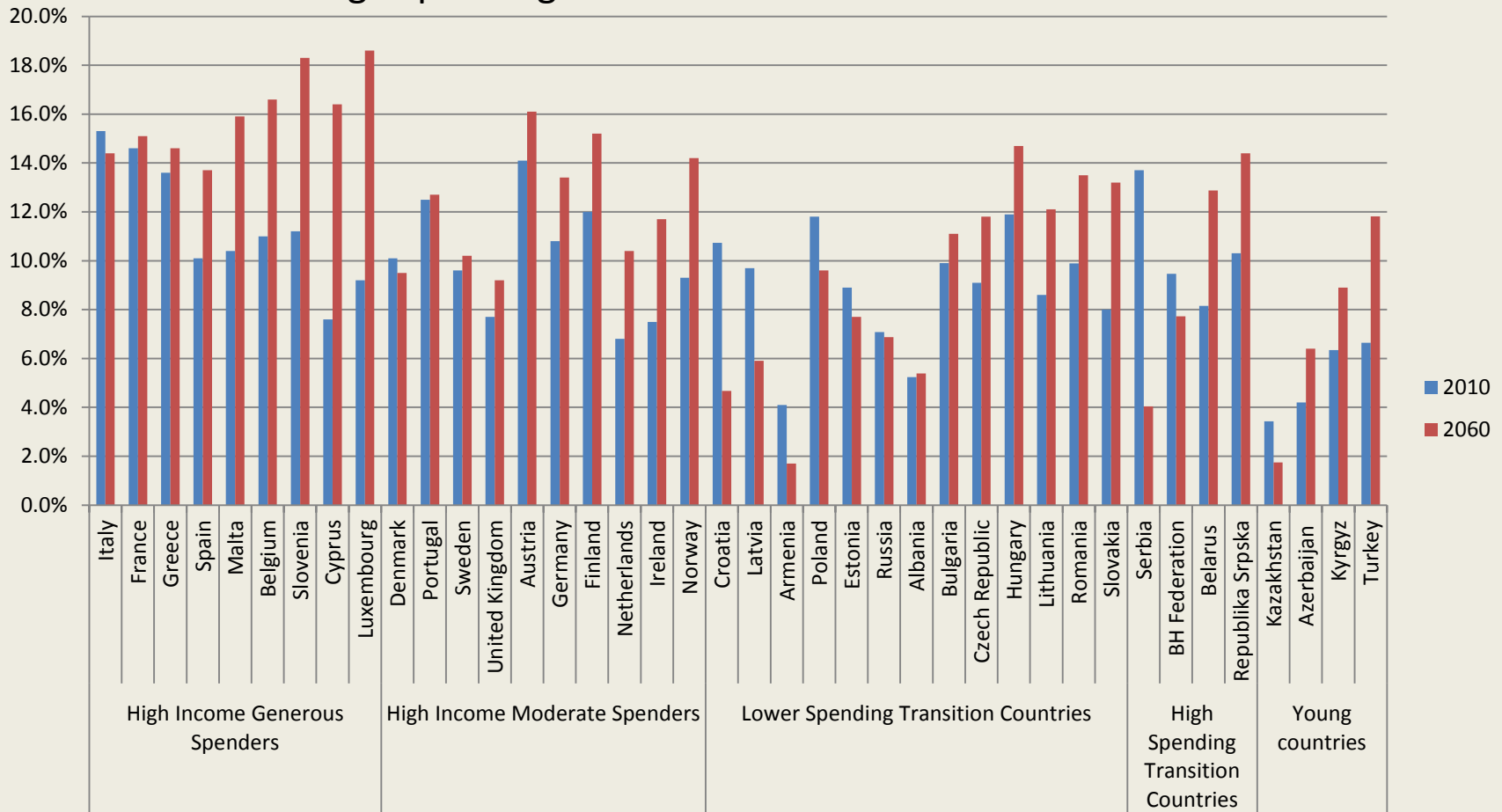
Benefit levels were also increased

- Initially thought of as a supplement to income from part-time work
- Became full source of poverty-alleviating income
- Became enough to guarantee a comfortable retirement
- Became enough to match working age income or even greater



Projected spending compared to spending as share of GDP in 2010

Average Spending in 2010 – 9.5% of GDP





Countries undertook all kinds of reforms

- General emphasis on tightly linking contributions to benefits
 - Defined benefit systems based on average lifetime wages; point systems; notional accounts
 - Wanted pension differentiation to match newly differentiated wages
 - Wanted to use incentives to combat informality
- 15 out of 30 transition countries adopted second pillar (fully funded defined contribution)
 - Linked benefits to contributions and reduced public pensions in long run
 - Mandatory contributions were divided so that one part went to public system and the other to private system
 - Led to larger shortfalls in pension systems in the short and medium run
- Others opted either by default or by choice for flat, universal benefits, sometimes complemented by second pillar



Some of the second pillar reforms were partially or fully undone due to fiscal constraints

- 7 of the 15 countries adopting second pillars reduced or eliminated contributions to the second pillar during the financial crisis, with 1 having now fully restored second pillar
- Financial crisis reduced contribution revenues due to falling wages and rising unemployment, while pension payments remained the same or even rose
 - Pension deficits rose
 - Governments chose to divert contributions from second pillars back to public systems to reduce the deficits in the public systems
- However, this means that the expected reduction in long-run public pension spending will now not take place

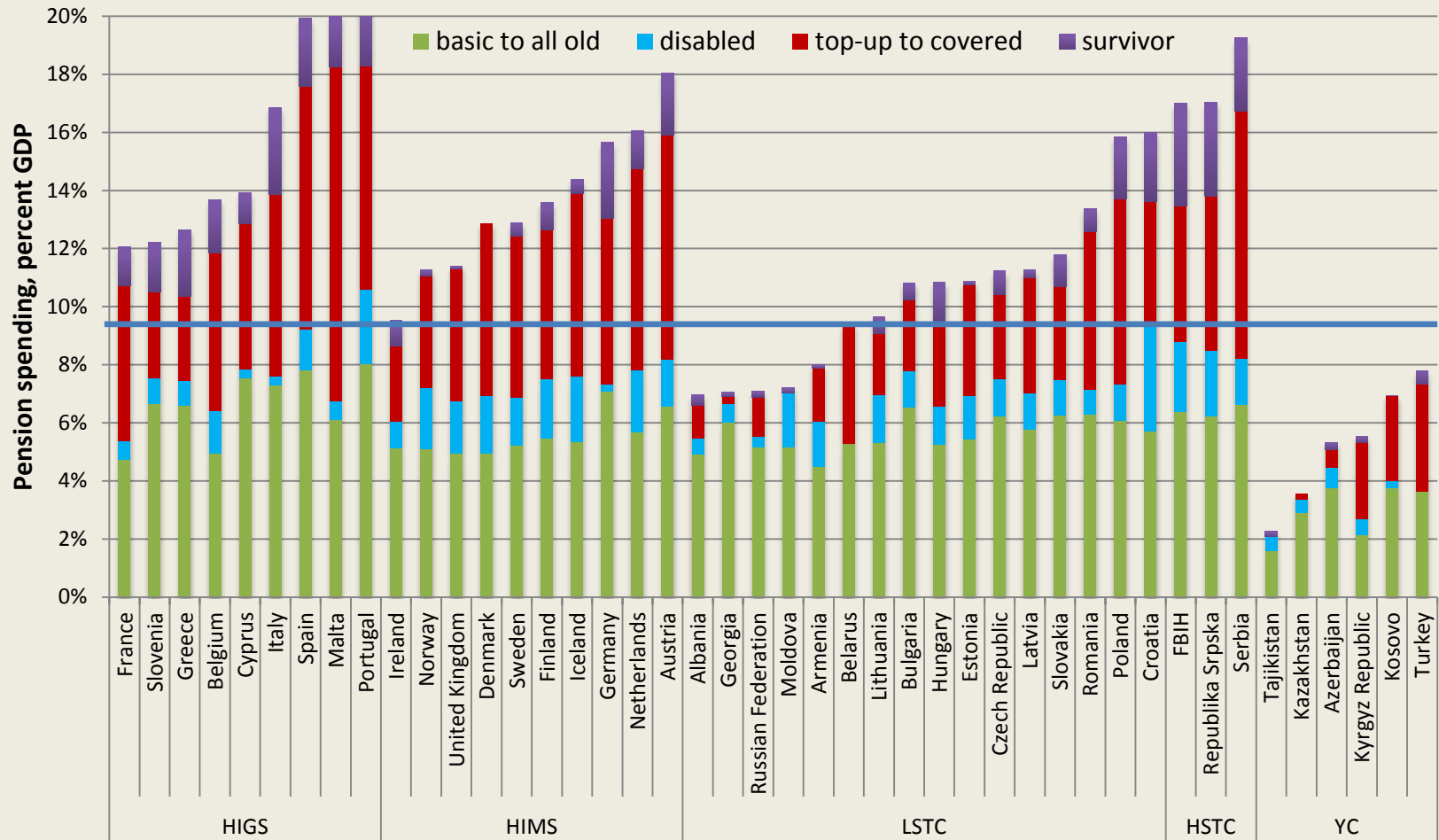


Given the demographic challenges, is the projected spending efficient?

- Pensions provided and withdrawal from the labor force well below the age of 65
 - Impact both on pension spending and contribution revenues, but also on economic growth
- Pension levels unsustainably high in some cases and too low to be adequate in other
- Survivor benefits sometimes encourage women not to participate in the labor market
 - Affects contribution revenues and economic growth
- Spending does not include spending on noncontributory benefits required to prevent all elderly from poverty
 - Fewer future elderly expected to be eligible to collect pensions

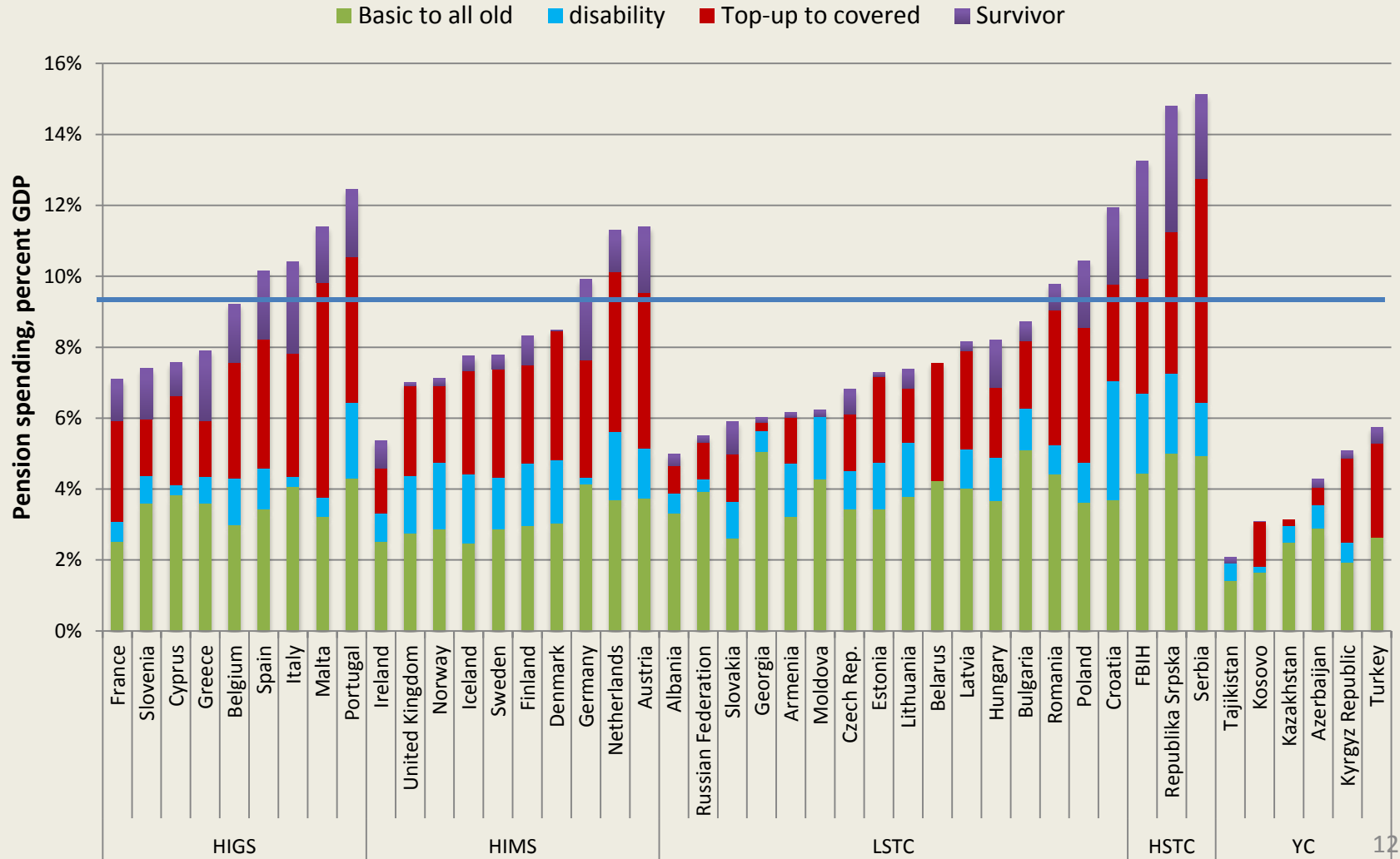


An Example Of Prioritizing Pension Spending and Costing It Out If Effective Retirement Age Is 65 with Prime Age Labor Force Participation Until Age 64





Same Priorities As Before But With Retirement Age Where Life Expectancy Equals 15 Years and Prime Age Labor Force Participation Until Then





Bottom Line: It Is Possible To Provide Old Age Security Even With Challenging Demographics!

- Will need some changes in expectations
- Future may be more like past in one of two ways:
 - Pensions given when people are too old to work
 - Pensions only guarantee poverty prevention
- In both cases, savings will play a central role, in the first to enhance benefits and in the second to provide earnings-related benefit
- Labor markets will also need to adapt to older workers
 - Allow more flexibility (part-time work, combine work and retirement, moving away from wages based strictly on seniority)
 - Workplace adaptations to accommodate older workers
 - Lifelong learning with training programs designed for older brains