



# Demographic Challenges in Europe and Central Asia

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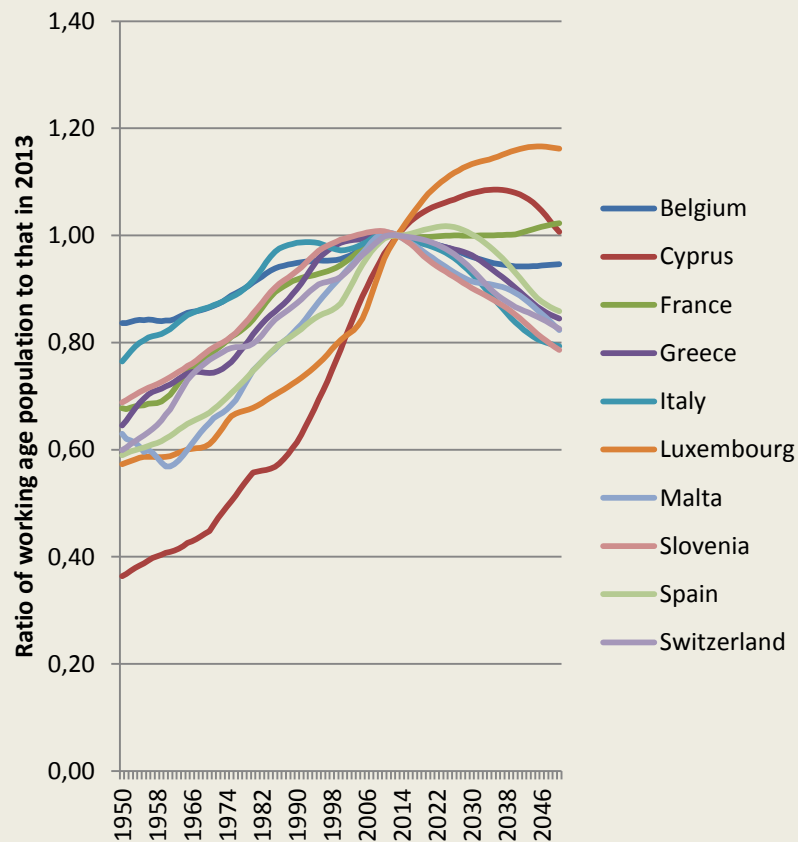
Lead Economist

World Bank

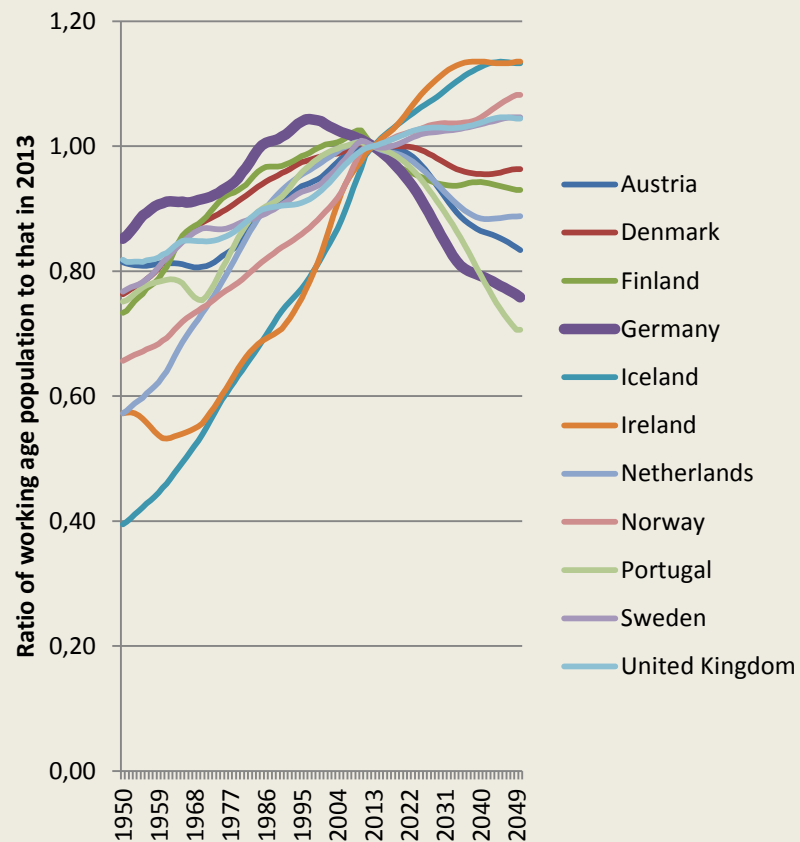


# Structural Break in Growth of Working Age Population Around 2013

## High Income Generous Spenders



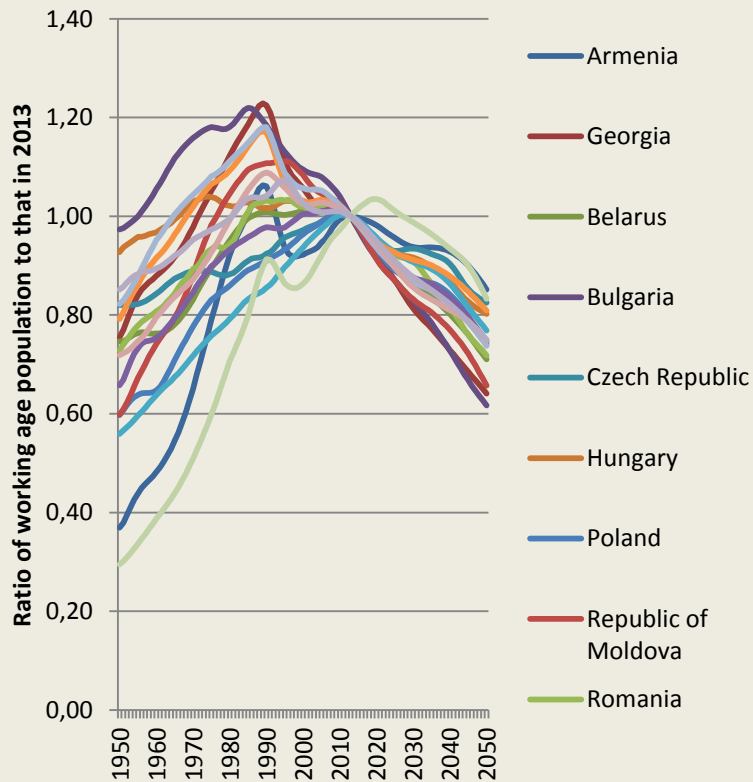
## High Income Moderate Spenders



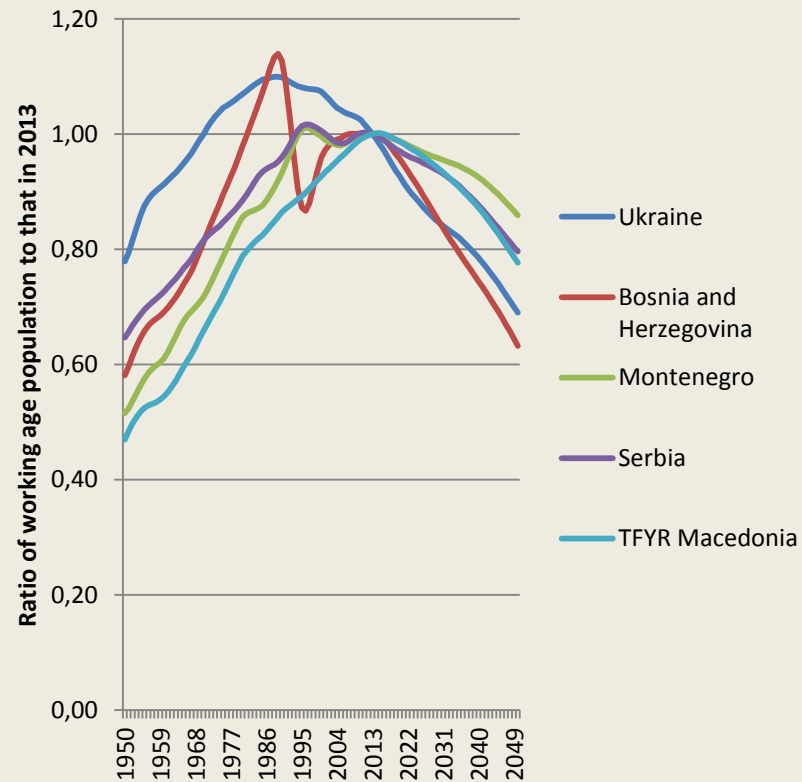


# Structural Break in Transition Countries More Marked

## Lower Spending Transition Countries



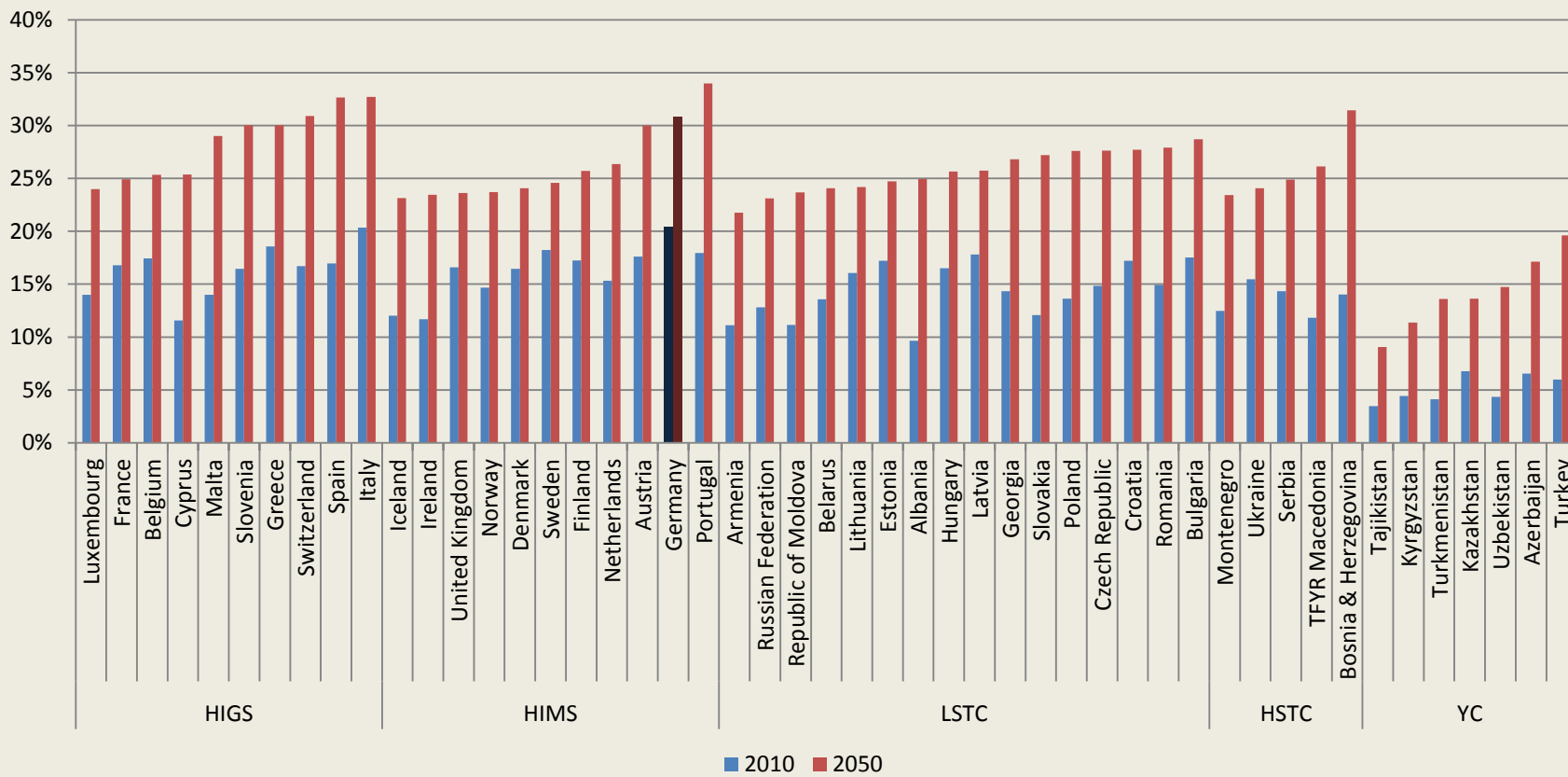
## Higher Spending Transition Countries





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

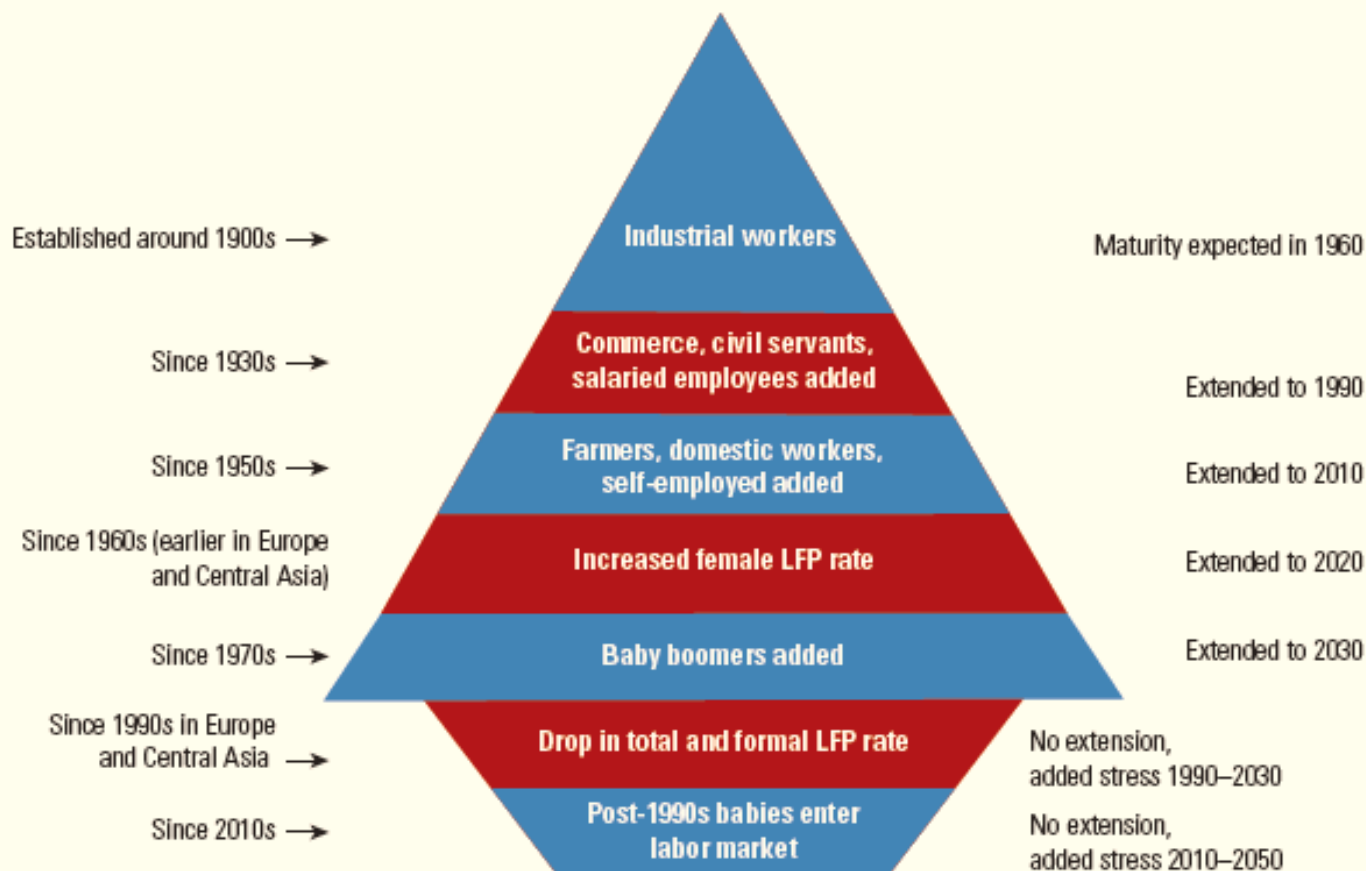
## Percentage of Population Above Age of 65 in 2010 and 2050





# The Inverting Pyramid

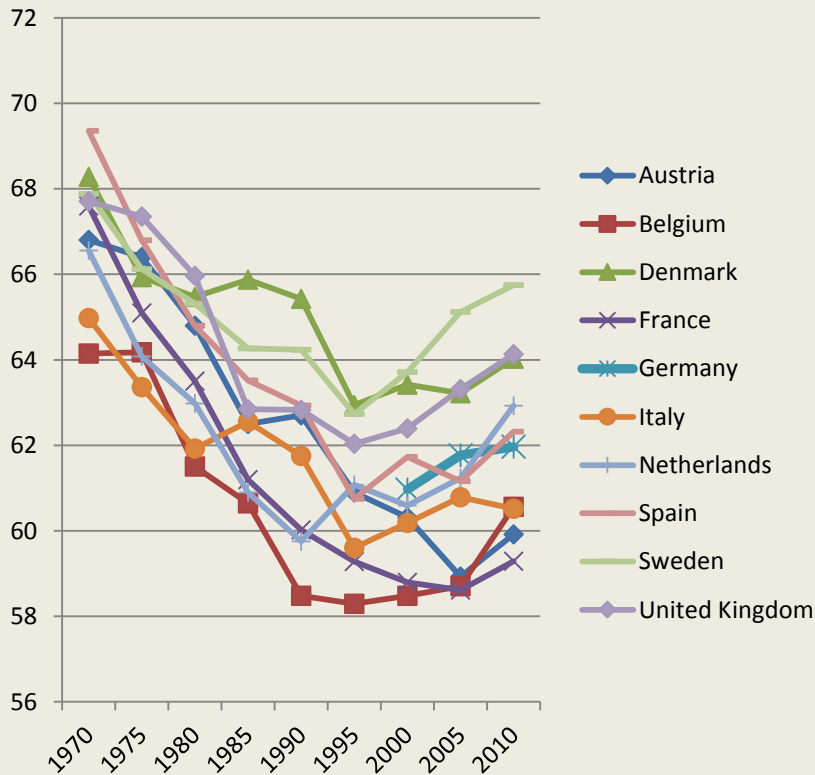
## Extension of Coverage and Its Impact on Pension Systems in Europe and Central Asia, 1900s through 2050



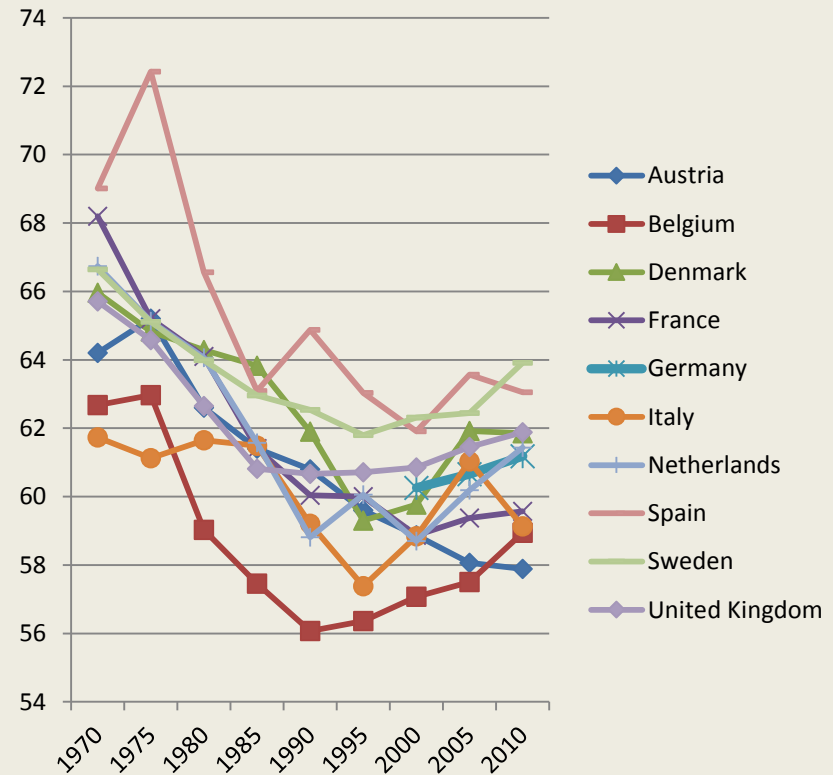


# When contributors were growing, these countries increased generosity

## Male Average Effective Retirement Age

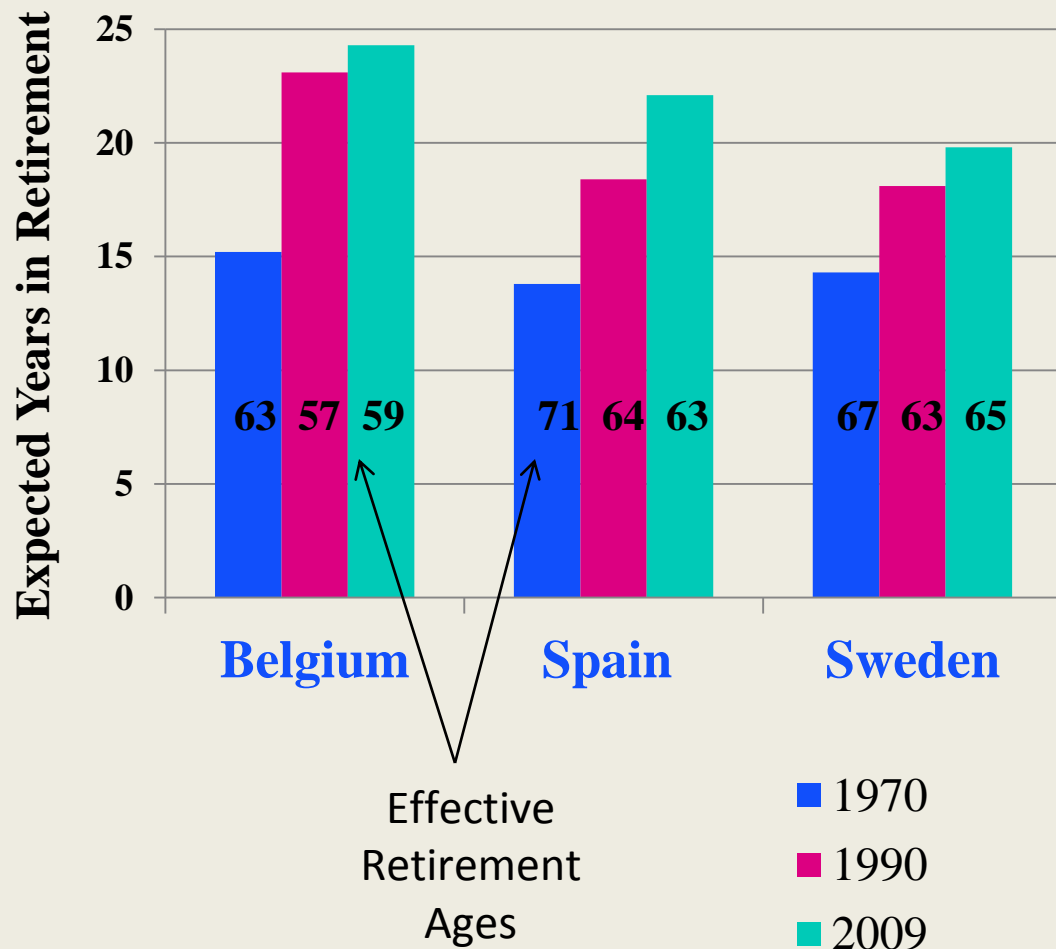


## Female Average Effective Retirement Age

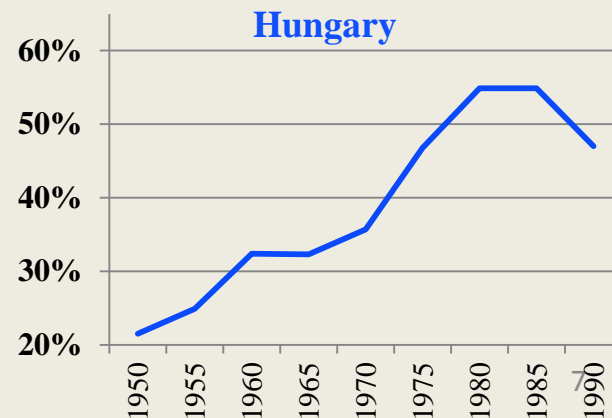
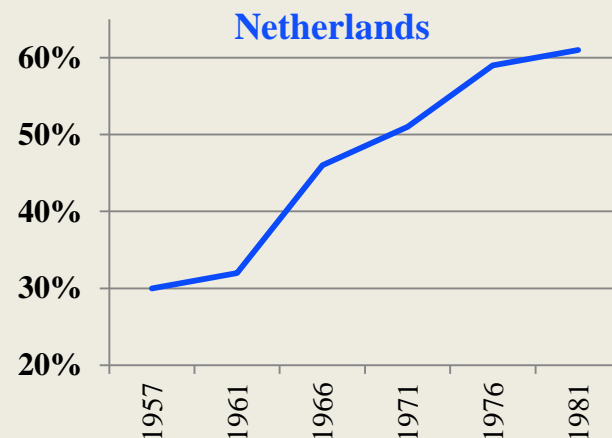




# Benefits were paid longer and at a higher rate



## Average Pension Compared to Average Wage





# Concept of Retirement Changed

- 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





# Countries now undertaking all kinds of reforms:

## Public pensions reforms

- Reforms focused partly on reducing spending
  - Restricted eligibility criteria
    - Raising retirement age
    - Tightening disability conditions
    - Raising years of service requirements
  - Reducing benefits in the long run
    - Basing benefits on full career salary
    - Indexing only to inflation
    - Lowering accrual rate
- Also focused on ensuring poverty prevention through generous indexation of minimum benefits
  - Some adopted by default or by choice for flat, universal benefits, sometimes complemented by savings pillar
- 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



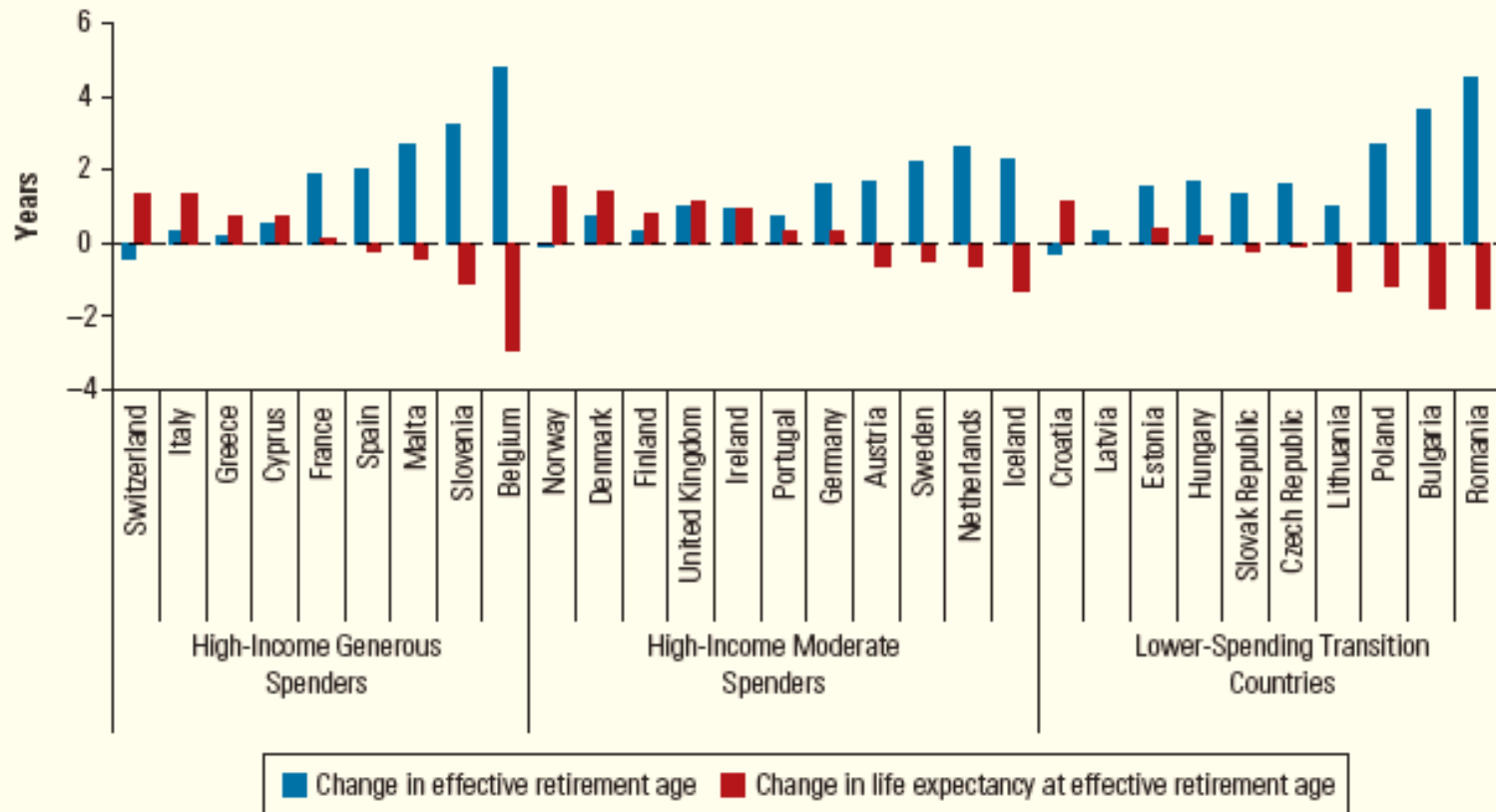
# Adding Savings Pillars

- 15 out of 30 transition countries adopted second pillar (fully funded defined contribution)
  - Linked benefits to contributions and reduced public pension 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



# Retirement ages increased, but duration of retirement generally did not fall

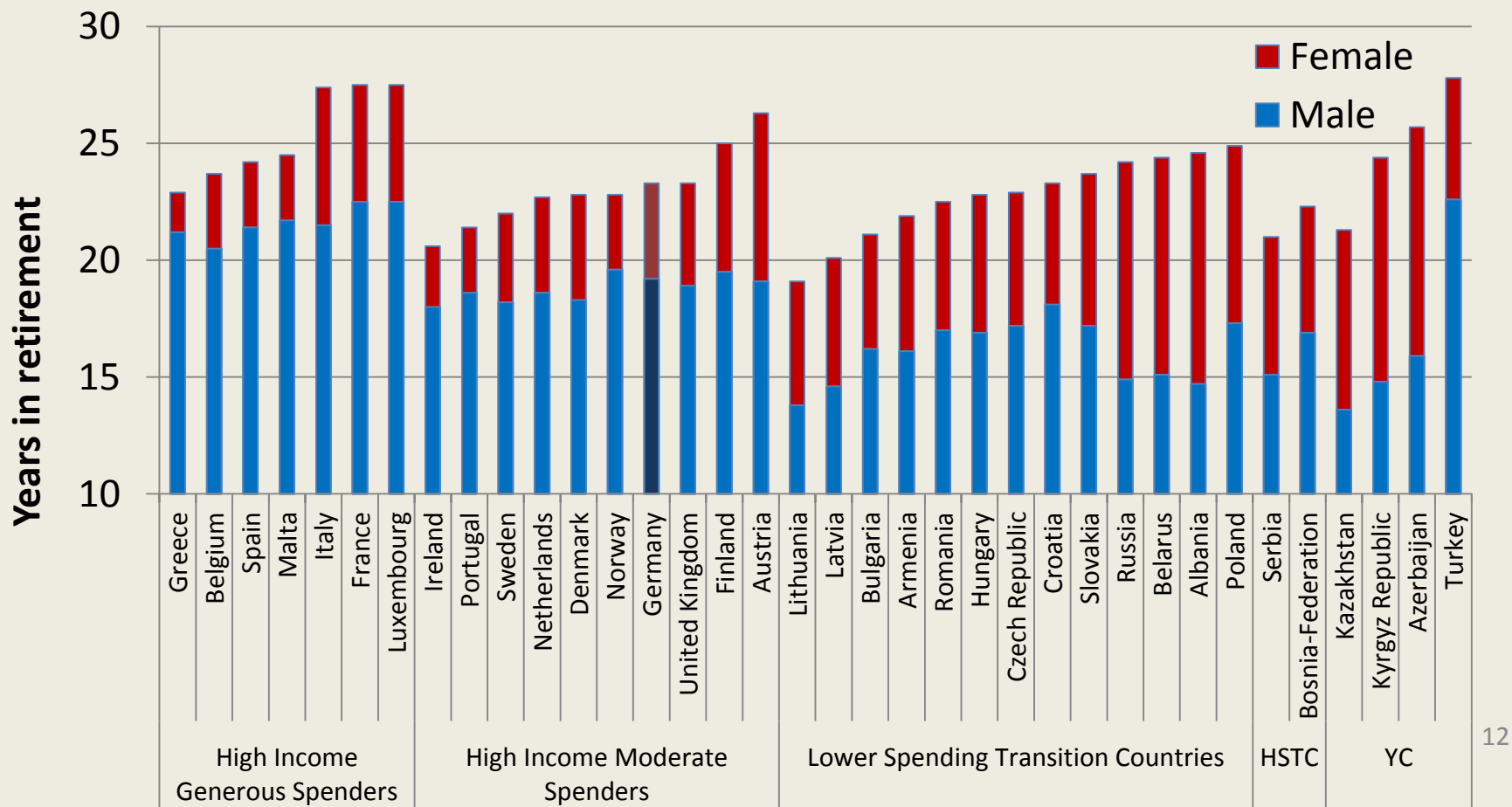
Change in Effective Retirement Age Compared to Change in Life Expectancy, Selected European Economies, 2001–2009



Source: Eurostat Statistics Database.

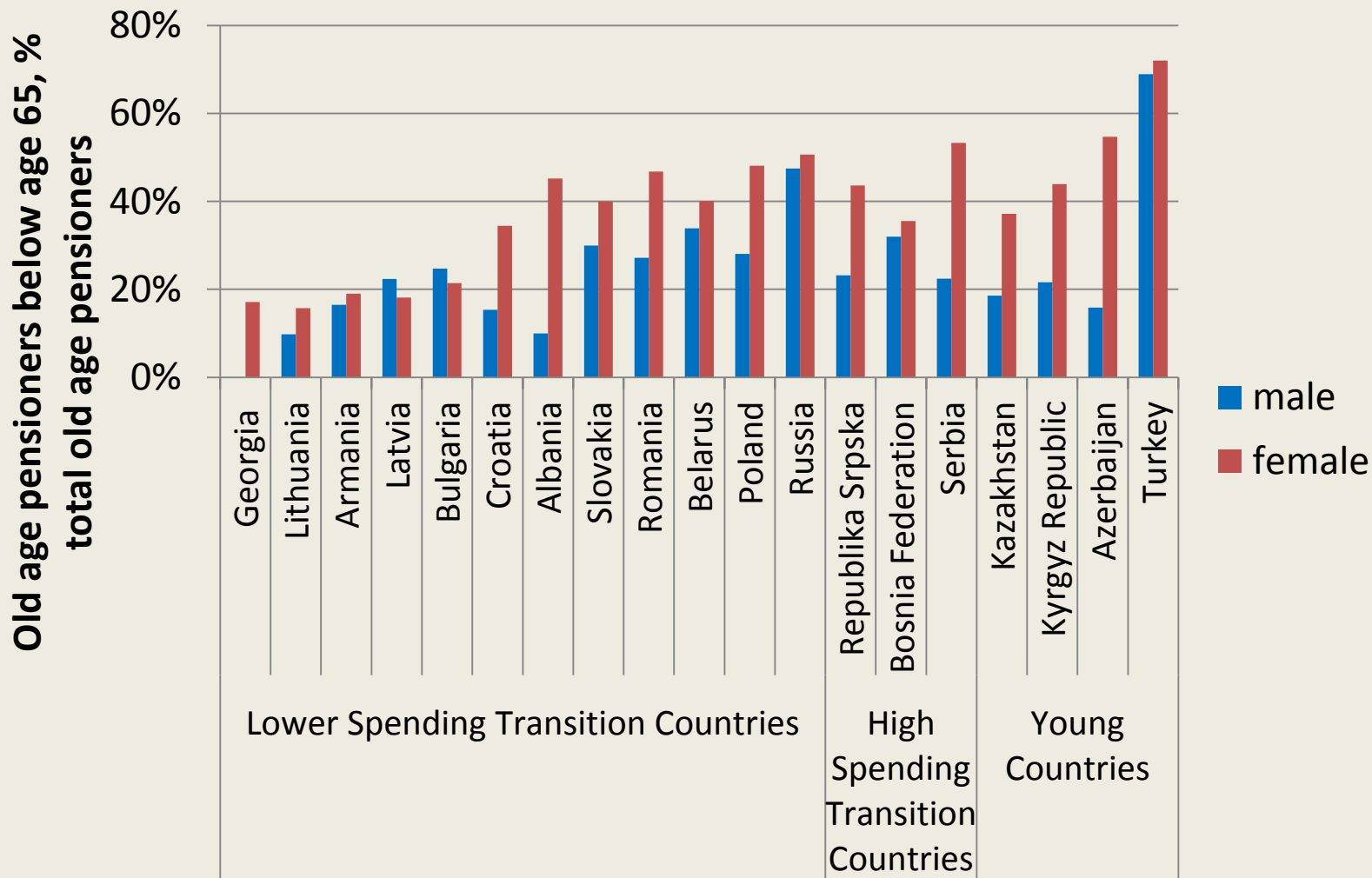


# Duration of retirement still remains far above 15 years



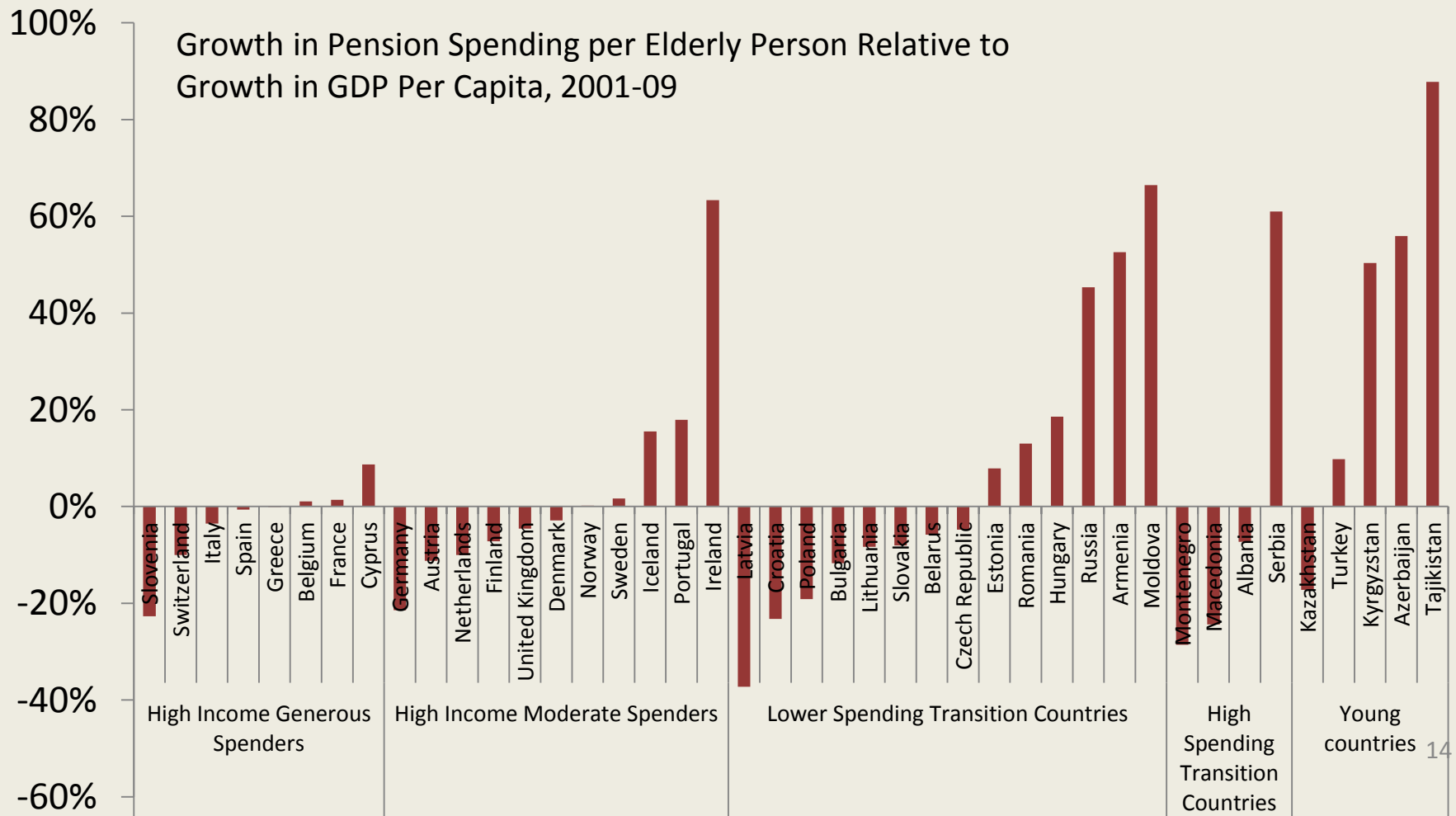


# Early retirement is still prevalent





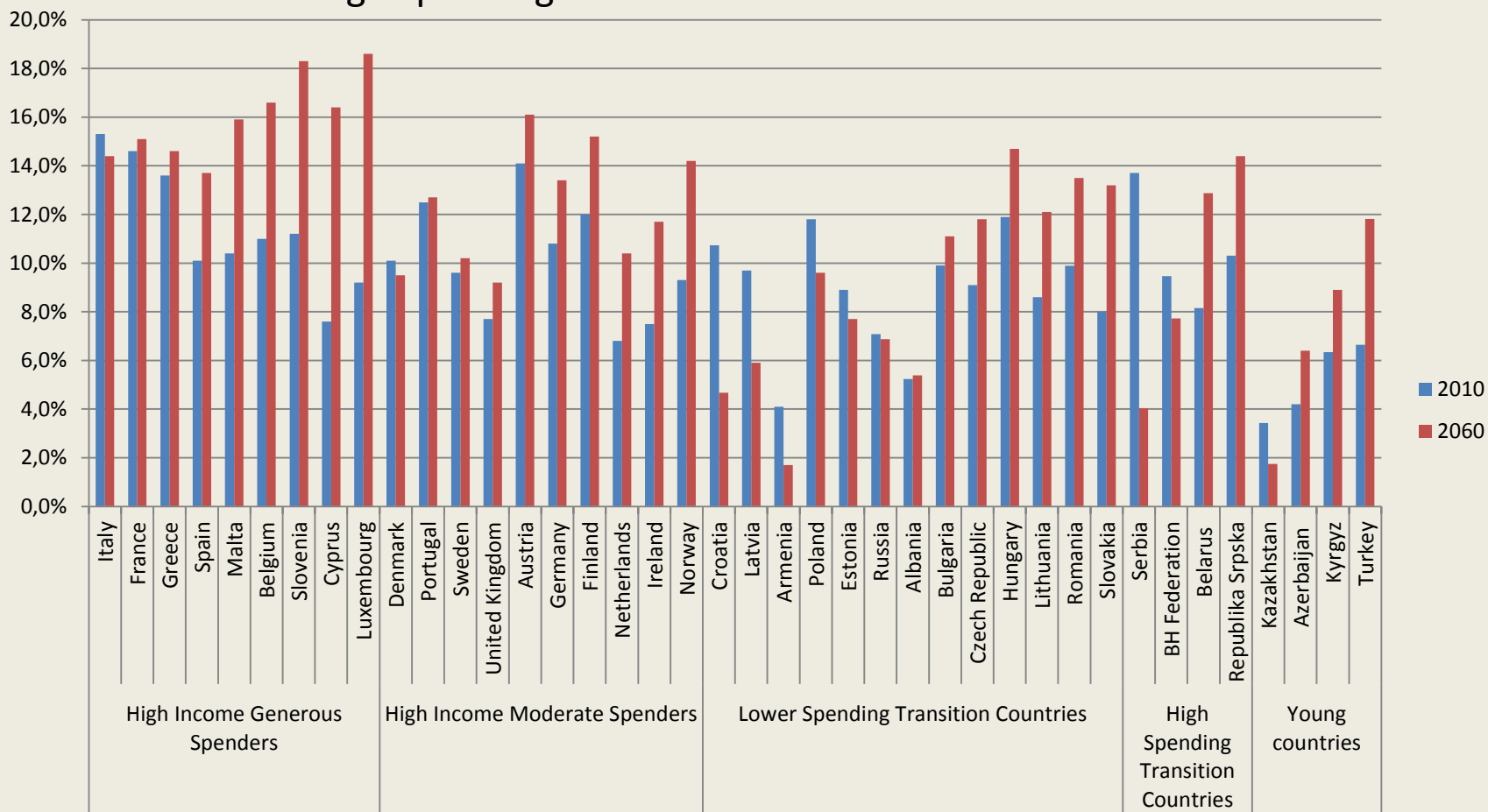
# No clear trend-line of reduced spending per pensioner





# Projected spending compared to spending as share of GDP in 2010

Average Spending in 2010 – 9.5% of GDP





# 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





# Mitigate incentives to unwind funded pension schemes

- Rely more heavily on tax financing of transition deficit
  - Earmarking revenues (i.e. VAT increases) with transition expenses might help
- Define reliable methodologies for calculating the implicit pension debt, and make these figures available to public
  - Increase awareness of government commitments that are not reported in the main variables of the Stability and Growth Pact
- In the absence of fiscal responsibility no pension system will be sustainable



# Transition to a more efficient industrial organization of the pension fund management industry

- Centralize business areas with scale economies
- Create competition in the portfolio management industry along a common default pension portfolio
  - » Use “optimal” portfolio as common default portfolio
  - » Consider lifecycle strategies (governance of the default)
  - » Consider how current generation benefits from the pension fund investments
- Collective schemes versus individual schemes



## Transition to a more efficient industrial organization of the pension fund management industry (2)

- Design payout structures that ensure proper risk allocation of investments and longevity risks
  - While variable income annuities are attractive instruments for benefit payments, they might be difficult to supervise and regulate.
- Risk averse policymakers may consider the introduction of guarantees on the value of the contributions,
  - Guarantees need to be properly priced
  - Guarantees need to be written by an independent party and not by the pension fund management companies



# The role of voluntary pension schemes

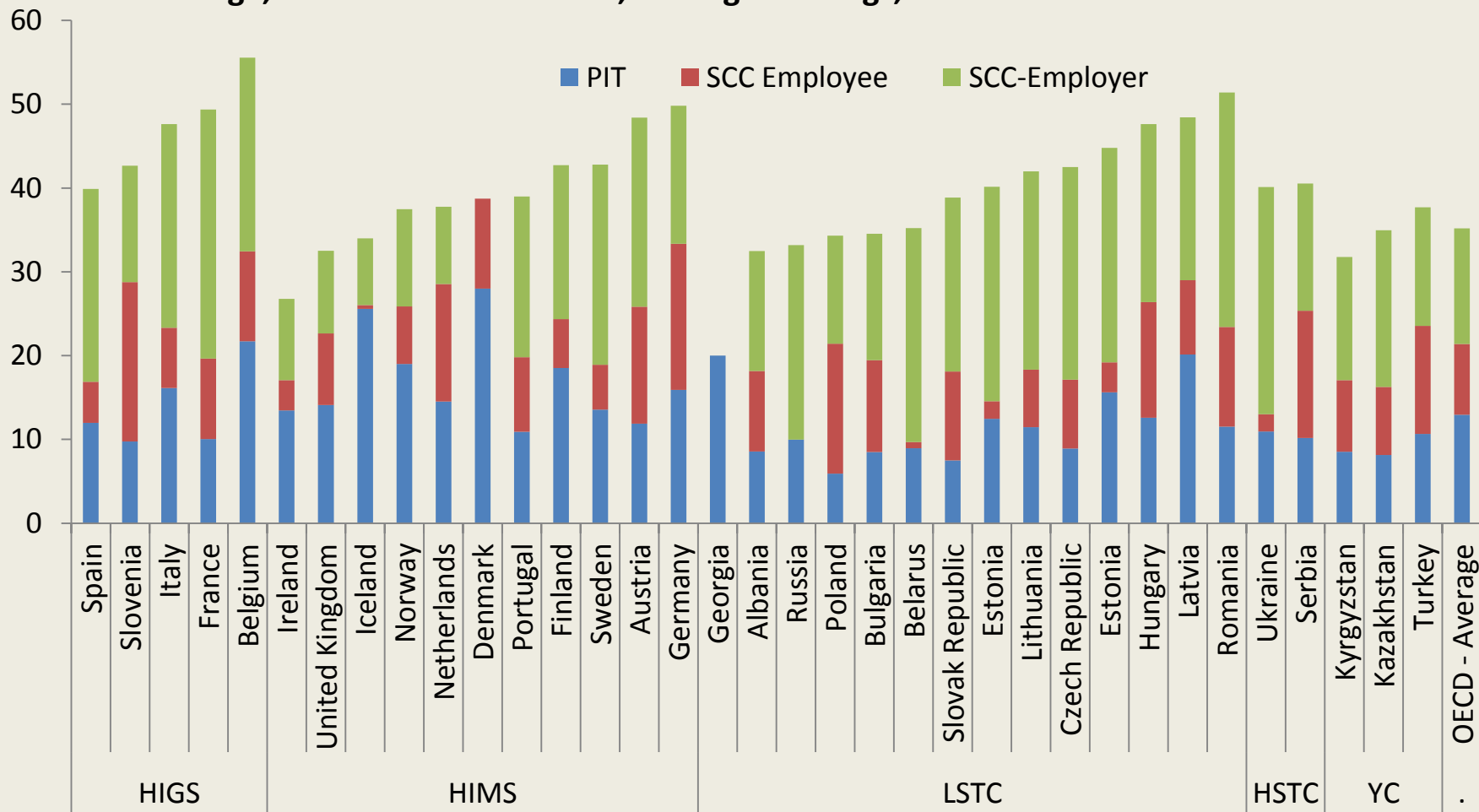
- No substantial differences in coverage between auto-enrollment (opt out) and mandatory systems
- Opt out schemes can be instrumental for incentivizing additional retirement savings
  - » Non discrimination test to ensure broad participation of workers
  - » 2+2+2 (or so) to increase contribution (careful with the default option)



# Most countries already have a high tax burden on labor

- Labor taxes (SSC+Personal income tax) account for about 30 percent of Labor Costs => **Further increase constrained by pressures of international competitiveness**

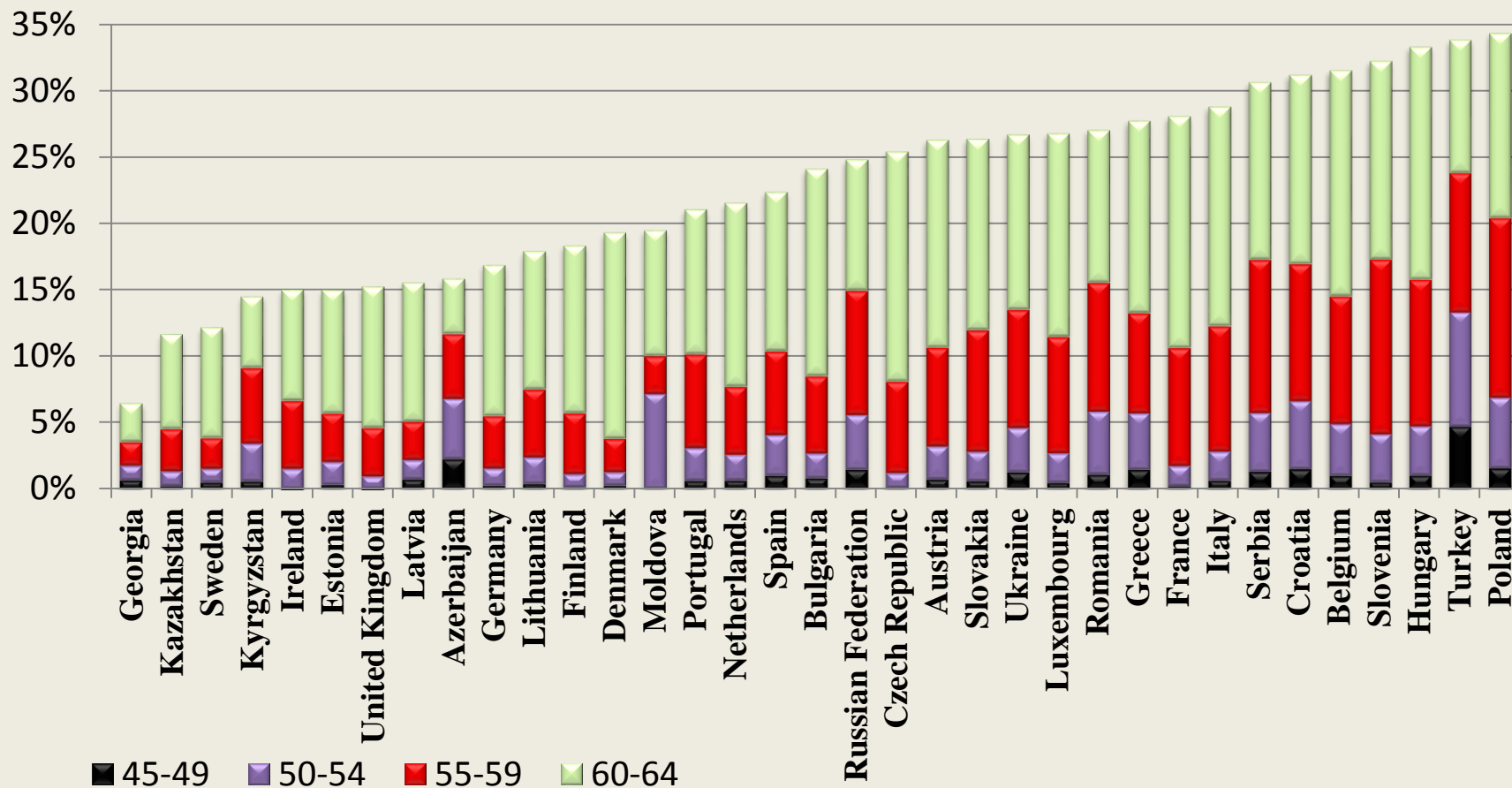
### Tax Wedge, % of Gross Labor Costs, Average Earnings, 2011





# Significant room for tapping on the potential for more “active aging”

Potential to increase Labor Force among 45-64 year olds





# Support policies for more Active Aging

*Older workers do face barriers when looking for work and to remain productive at work, that can be addressed through:*

- ***Workplace adaptations*** – Encouraging firms to adapt the workplace to fit older workers' needs (BMW, CVS)
- ***Smart tax/labor regulations and social benefits design*** – Making them compatible with longer working lives by avoiding incentive “traps” (e.g, seniority wage premia), enabling flexible work, gradual retirement, and addressing barriers (e.g, childcare)
- ***Training fit to labor market needs and to aging brains*** – Engaging employers to provide more age-sensitive labor training and tap on benefits of age-diverse teams.



# Workplace Adaptations: BMW 2017 production line pilot in Bavaria



## Helping Older Workers be as Productive as Younger Staff

**Initial condition:** Aging assembly line workforce

**Result** 7% productivity improvement in one year, equaling the productivity of lines staffed by younger workers

**How?** Pilot assembly line with design and equipment changes and changes in work practices

- 70 changes to workplace equipment reduced physical strain and the chances of error
- Job rotation across workstations during a shift in order to balance the load on workers' bodies
- Physiotherapist developed strength and stretching exercises for workers to do every day

**Cost-effective:** US\$40,000





## Training aging brains: Workforce training can work for adults

- Recent rigorous evaluations in the US: Wide range of public and private training strategies produce significant returns to investments
  - Estimated returns up to 10-26% (vs. 6-10% average rate of return on stocks)
- Growing number of studies show training impacts typically turn positive in 2nd or 3rd years
  - “Lock-in effects” in first year generate initial negative impacts
- Most promising programs are fit to how adults learn - integrate basic skills instruction into a specific occupation or set of occupations, use modular approach with recognition of prior learning



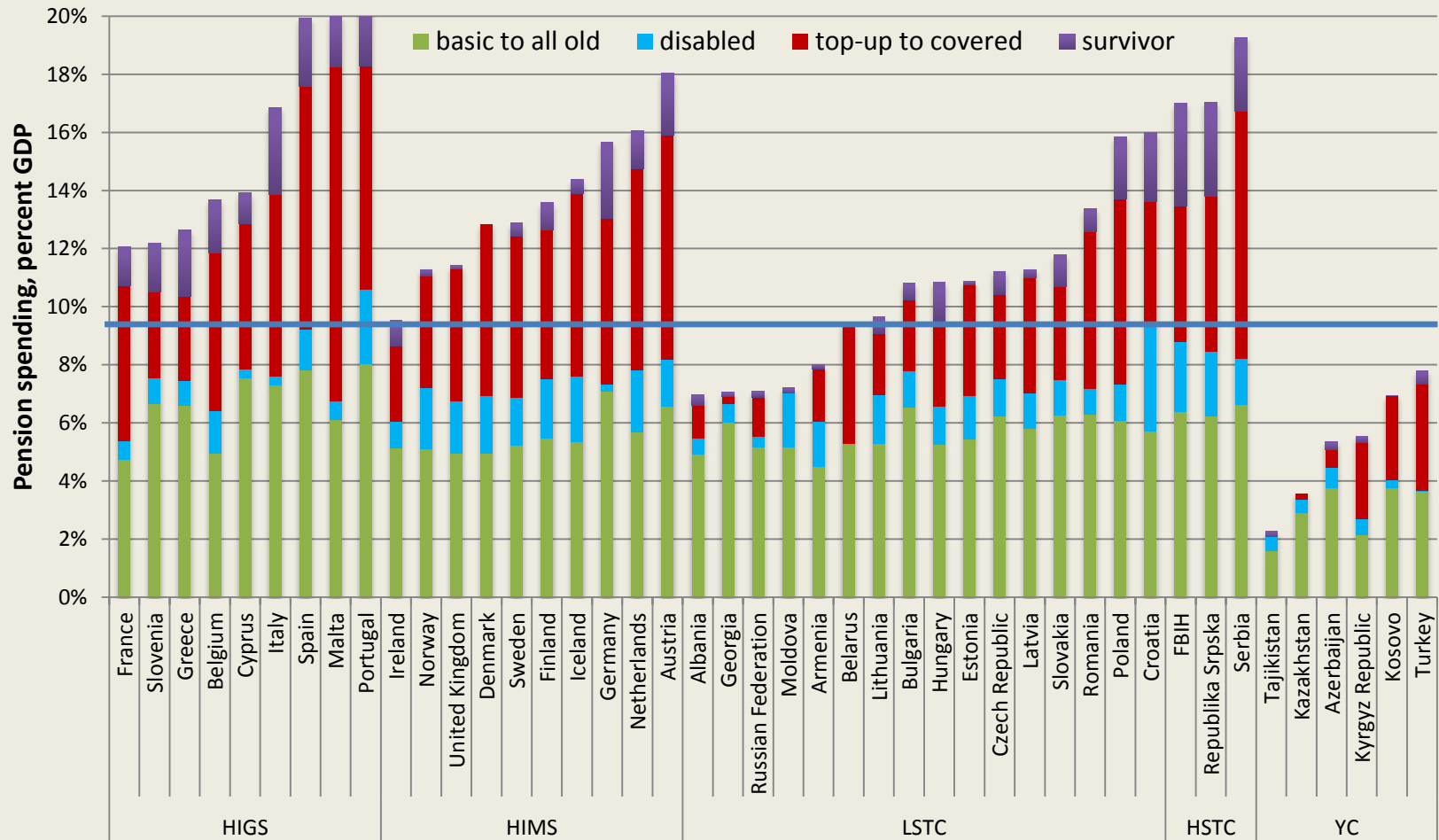


# Given the demographic challenges, is pension spending efficient?

- 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

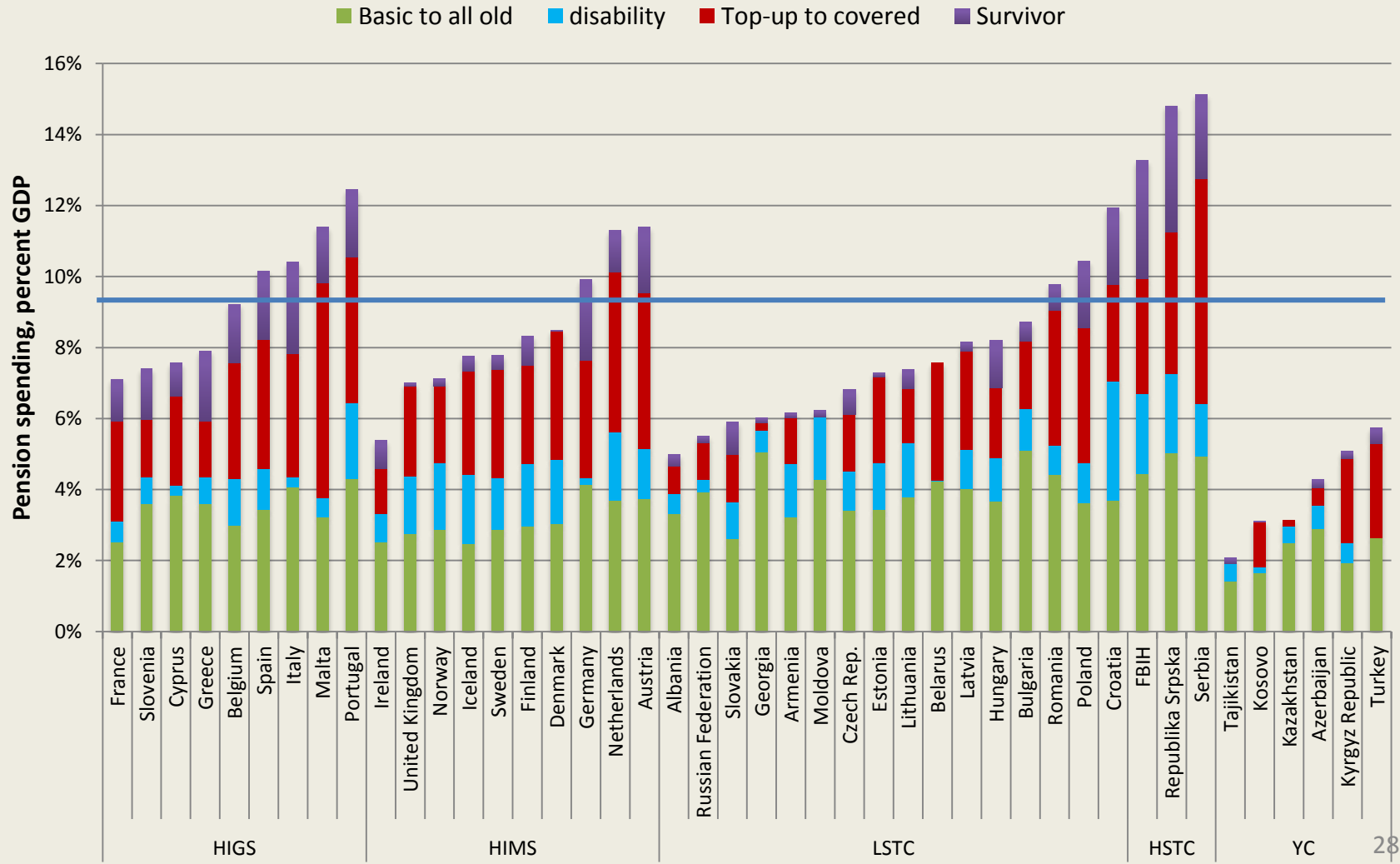


# An Example Of Prioritizing Pension Spending and Costing It Out If Effective Retirement Age Is 65 with Prime Age Labor Force Participation Until Age 64 - 2050





# Same Priorities As Before But With Retirement Age Where Life Expectancy Equals 15 Years and Prime Age Labor Force Participation Until Then - 2050





# 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