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Fiscal and Pension Sustainability: Present and Future Issues in EU Countries

by Asghar Zaidi

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Introduction

This Brief examines the financial sustainability of public finances in EU states, and takes a forward glimpse at the likely evolution of pension incomes in EU countries, using projections made available by the European Commission during 2009. It also examines how the pension reform responses at national level to the challenges of financial sustainability have influenced the reshaping of pension systems in EU countries, producing a variety of pension systems that are less redistributive in some cases and more socially protective in others. These impact-of-pension-reforms results are derived from the simulations of pension income entitlements for future retirees, undertaken by OECD in 2009.

This briefing follows on from an earlier Policy Brief (Zaidi 2010), which stratified EU countries according to the poverty risks faced by its older populations (aged 65 or more) in 2008. *The highest poverty risk rates were observed in Latvia (51%), Cyprus (49%), Estonia (39%) and Bulgaria (34%), and the lowest in Hungary (4%), Luxembourg (5%) and the Czech Republic (7%).* These outcomes reflect both the influence of past pension policies and also the labour market and demographic experiences in working life of the specific cohort of current retirees. A question of parallel interest is how current generations of workers will fare in their incomes and poverty risks as and when they retire. This Brief focuses on this question, using the best knowledge currently available, in the form of projections and simulations on income entitlements of future retirees in EU countries. An essential context for these analyses of expected future pension incomes is the awareness of the public finance challenges that EU countries are facing, both now and in the future. And, to this we first turn to.

The financial and economic crisis, which first became apparent globally in the autumn of 2008, has impacted greatly on policy-makers' perspectives on the future directions of pension policy in EU countries. The introduction since then of substantial fiscal measures for stimulating the economy and

for stabilising financial markets has had the consequence that government borrowing in many EU countries has surpassed previous historic levels. The crisis has been global in its effect and unprecedented to the extent that it is not easy to ascertain how far the current signs of improvement in EU national economies can be equated with a sustainable recovery.

As the level of public debts surpasses previous historic levels, awareness of the need for credible austerity plans is gaining momentum.

In all events, fiscal austerity measures are forced back on the national policy agenda of many countries,[1] in which a strategy is sought to reduce, albeit slowly and cautiously, public spending and debts. Although inflation is currently not seen as a threat, tighter monetary policy is nonetheless on the menu. For example, some countries are withdrawing from 'quantitative easing' measures, introduced initially to increase the money supply and so reduce costs of domestic borrowing. The rate of recovery from the crisis is uncertain, as employment and output remain low – these factors in turn see the tax revenue base continuing to dwindle. The risk that Greece might default on its sovereign debt[2] (during February 2010) is a symptom of problems that many heavily indebted European countries (Portugal and Italy, and possibly Spain and Ireland, given their low prospects for economic growth), are currently facing, or will soon be facing.

The current adverse budgetary position combined with long-term demands on public resources generated by ageing of population are sources of fiscal challenges throughout the EU.

While these fiscal challenges are both clear and present, the policy issues created by ageing populations are relatively more latent and covert, and exert significant additional demands on future public budgets. Specifically, longevity gains, expected to be 7-8 years over the next 50 years, imply that age-specific expenditures (related to pensions and health and social care) will cover a greater duration of retirement and for an increasingly larger number of people. Falling fertility rates will lead to shrinking working age populations in many European countries, which will exert negative pressures on European countries' efforts to boost economic growth (especially if no significant improvements in employment rates and/or productivity are forthcoming).

There are serious concerns in the public discourse about how EU countries can attain fiscal sustainability while also maintaining the adequacy of pension incomes.

Altogether, it comes as no surprise that there are serious concerns nowadays in the public discourse about how European countries can maintain fiscal sustainability within public finances and social systems whilst still preserving the adequacy of social benefits. A squeeze in ageing-related expenditures, particularly on pensions, can be expected, so as to put public finances on a more stable and sustainable path. This pinpoints the dilemma between current fiscal issues and the future social sustainability issues that policy-makers face.

The real challenge lies in making suitable public policy choices, however unpopular they might be, and then generating public backing for reforms

The real challenge for EU policy-makers is to have the political foresight and courage to make the most appropriate, however unpopular, policy choices; balancing between the easing of the immediate pressures arising from the economic downturn and the longer term priorities for economic and social policies.

The more high-quality and independent data is admitted to this debate, the easier it becomes to persuade the public about the need for and the consequence of policy reforms.

by raising awareness. Note, for example, the policy dilemma currently faced by many European countries regarding labour market policies, a conflict between the immediate pressures arising from the economic downturn and the long-term perspective of offering sustainable economic and social policies. An attractive policy option to improve public finances, touted as a 'step in the right direction', is to increase the legal retirement age, and thus encourage older workers to extend their working careers. Such a reform increases the contribution base, while reducing the duration of retirement during which pension benefits are paid, and seems a natural and beneficial policy reform. However, as is the case in Spain, the current crisis has left many young people unemployed, and many argue that youth employment must be promoted, even at the expense of pushing older workers into early retirement. Any such proactive policy of forced early retirement, a misconception due largely to the 'lump of labour fallacy',[3] is not likely to solve longer-term issues, instead leading to further increases in public spending on pensions and accentuating challenges with respect to the sustainability of public finances in the future. The problem is therefore not simply current unsustainable public spending and rising debts, but a deeper political predicament of making the correct, if unpopular, policy choices in difficult economic circumstances.

This Brief is laid out as follows. It provides some context by highlighting further the fiscal sustainability challenges faced by EU countries. Then, it analyses the development of pension incomes in EU countries in the future which is the main theme of this Policy Brief. Synthesizing discussion and conclusions are given at the end.

Context: Fiscal sustainability challenges faced by EU countries

Fiscal sustainability is the long-term ability of the government to meet the financial obligations linked with its current and future expenditures and debts. A failure in this respect, where a country is not able to finance its immediate expenditures including debt servicing, will lead to insolvency. Greece is currently seeking external support to avoid defaulting on its debts, and Portugal and Spain are also at high risk of following this downward trend. Without a significant boost in economic growth, other European countries also run a similar risk and the need is to find a credible fiscal consolidation plan. Given that the recovery may be faltering, the deficit reduction will have to come from spending cuts, and finding some balance which avoids items impacting negatively on society's more vulnerable groups, while avoiding tax increases that could damage employment and investment.

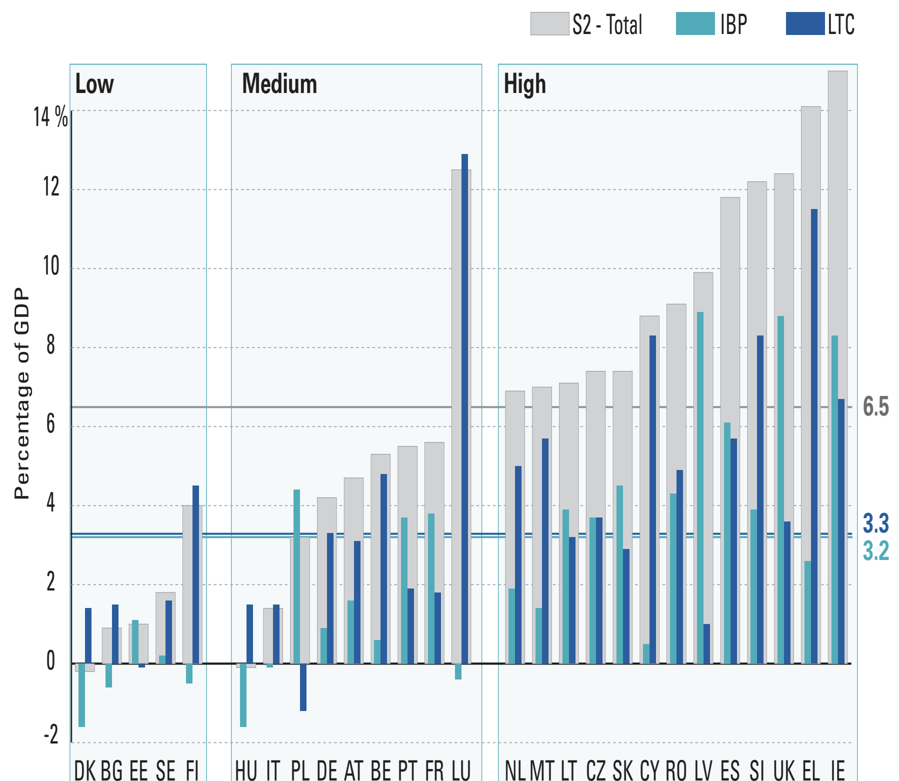
Ireland, Greece, the United Kingdom, Slovenia and Spain face serious challenges as their financial sustainability gap is in excess of 10% of GDP. Latvia, Romania and Cyprus are not far behind, at just below 10%.

Given that the recovery from the current economic downturn seems to be faltering, it is important that any spending cuts or tax increases do not impact negatively on society's more vulnerable groups.

In quantifying fiscal sustainability risks, the principal indicator is the fiscal sustainability gap S2, as provided in the 2009 Sustainability Report of the Economic Policy Committee. This indicator measures the gap (in terms of % of GDP) that must be closed to ensure that the government is able to finance all public obligations in the infinite future. The S2 indicator can be better understood by an analysis of its two key components: the *Initial Budgetary Position* (IBP), which is in deficit in many countries, largely due to economic downturn experienced during 2008-2009, and the *Long Term Changes* (LTC) of the future related to demographic changes and related expenditures on pensions, healthcare and long-term care. Note that the sustainability gap results presented here incorporate the initial impact of the crisis in the IBP only, but for the LTC they still rely on the employment and GDP growth assumptions of the pre-crisis period.

Figure 1 shows the wide variations across countries with respect to the fiscal sustainability gap. Countries are divided into categories of high, medium and low risk, with as many as 13 EU countries being considered high risk countries. Among them, Ireland, Greece, the United Kingdom, Slovenia and Spain have serious challenges ahead, as their sustainability gap is in excess of 10% of GDP. Latvia, Romania and Cyprus are not far behind, at just below 10%.

Figure 1: Sustainability gap indicators S2 and its two components – Initial Budgetary Position (IBP) and Long Term Changes (LTC)



Source: Sustainability Report 2009, pp. 35

At the EU27 level, the contribution of two components of S2 is almost the same: 3.2% for the IBP and 3.3% for the LTC. Countries also differ remarkably in terms of contribution of the IBP and the LTC. Within the high risk countries, the contribution of the LTC is particularly high in Greece, Slovenia, Cyprus, Malta and the Netherlands and the contribution of the IBP is large in the United Kingdom, Latvia and Slovakia. Within the group of medium and low risk countries, Luxembourg and Finland and also Belgium and Germany stand out for a larger contribution of the LTC. As for the IBP contribution, Poland is most notable, but also France and Portugal.

The question is how policy-makers ought to be responding to these challenges? At the generic level, one can identify certain moves in the family, labour market and pension policies. Within the broad realm of family policies, countries need to (continue to) provide incentives towards higher fertility rates, thus contributing towards slowing down trends of shrinking working age populations. The policy drives within the remit of labour market policies will be to enhance the employment rate of the working age population, especially for those who had been typically low employment groups (e.g. mothers with young children, older workers, and disabled persons with reduced capabilities).

Future pension policy will feature strong incentives towards continued employment and longer working careers, improved public pension coverage for working age populations, and the provision of suitable ways to enhance private personal savings. A more realistic revision of pension benefits, with guaranteed minimum provisions, to improve affordability of public pension schemes, may also be necessary.

Pension policy will need to complement any family and labour market policy moves, with incentives towards employment and longer working careers needing to be strengthened, allied to an improvement in the coverage of public pension schemes for working age populations, the provision of suitable low-cost mechanisms to encourage private personal savings and, where possible, a more realistic revision of pension benefit provisions to improve affordability of public pension schemes. All these issues merit special attention, and this Policy Brief provides a glimpse into how pension income generosity will be changing in the future within the EU countries.

Recent pension reforms in EU countries have been shaped by the following structural measures:

- tightening eligibility conditions (particularly for early retirement and disability pension schemes);
- scaling down the level of public pension benefits and their growth (in relation to wages); and
- moving towards increasing the official retirement age.

A direct consequence of these reforms is the expectation that people will extend their working careers while also seeking to generate greater private personal savings. Such behavioural responses can only be ex-

The need for pension literacy is not limited to policy-makers: the traditional patterns of life course for all people – the duration of working and retirement lives, diversity in saving mechanisms for retirement and their associated risks – have been irrevocably affected by life expectancy gains. In the absence of rational responses by workers of longer working careers and greater private pension savings, there is a risk that their pension incomes will be unsustainably low.

pected if workers become well-informed of their future prospects and also willing to adopt a forward-looking perspective. Without such pension literacy and the subsequent behavioural responses, it is feared that future retirees in many countries will be facing a cut in their pension incomes. Such social concerns, i.e. future generations of older persons ending up more often poor than the rest of the population, will put future governments in these countries under severe political pressure to introduce further reforms to increase pension levels and improve the standard of living of pensioners, after all people aged 65 or more are expected to be in majority in many EU countries, making them a powerful electoral force. Such concerns, to be referred to as pension income sustainability challenges, form the basis of the rest of this Policy Brief.

Pension income sustainability challenges

Pension policy remit includes provision of adequate levels of retirement incomes so as to ensure that people do not end up living in poverty in their old age. As shown in the earlier Brief (Zaidi 2010), during 2008 eight EU countries were already identified as facing the challenge of a disproportionately high poverty risk among the elderly population. The analysis undertaken below highlights how the current generations of workers are expected to fare with respect to their incomes and poverty risks when they will be retiring.

On the basis of information available, three possible ways can be adopted to examine the evolution of pension incomes in EU countries:

- To examine changes in the benefit ratio that measures the generosity of average public pension benefits in relation to the average wage; the period under consideration is between 2007 and 2060.
- To analyse the changes expected in the average first pension as a proportion of the average wage; for the same period as used for the analysis of the benefit ratio.
- To discuss what impact pension reforms are likely to have on pension income replacement for low, average and above average wage workers. These analyses, for those workers who enter into employment during 2006, show the cumulative effect of reforms that happened over the past 10-15 years for stylised cases of workers who spent their full career working.

These three analysis streams provide insight into how pension incomes for future retirees are going to be affected. Note here that these results were compiled before the onset of the crisis, so they require some further adjustments in the projections of future pension spending as well as forecasts of GDP and employment.

Benefit ratio

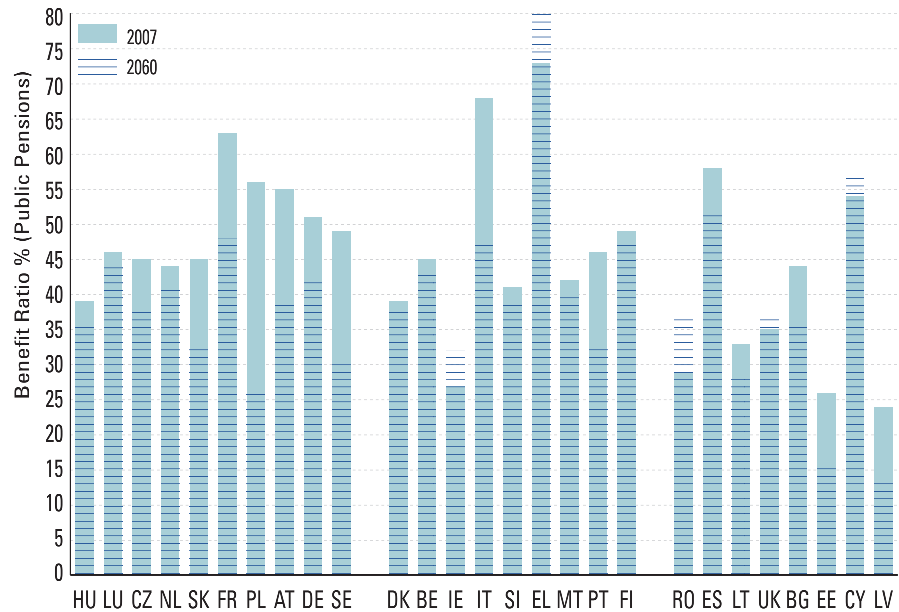
The benefit ratio effect indicates the development of the relative value of the average pension (public pension spending divided by number of pensioners) with respect to the average wage (approximated by the GDP per hours worked). All other things remaining constant, a decline in the benefit ratio will show a fall in the generosity of public pensions, while reducing the impact of an ageing population on public finances, and vice versa.[4]

The recently completed assessment of ageing related public expenditures by the European Commission suggests that the projected benefit ratio will be declining in the majority of EU countries, over the period 2007-2060 (Economic Policy Committee, 2009a, pp. 111). These results are presented in Figure 2, which ranks countries from right to left according to the decreasing level of at-risk-of-poverty rate during 2008 (as shown in Zaidi 2010, Figure 1). Key results can be identified as follows:

In Estonia, Poland, Sweden, Austria, France and Portugal, the average pensions of future retirees will fall (relative to average wages), leaving their citizens facing pension sustainability risks. Curiously, none of these countries have high-risk fiscal sustainability issues, and most have implemented pension reforms recently.

- In countries with a high at-risk-of-poverty rate during 2008, the magnitude of the decline in the benefit ratio is quite strong for Estonia and Latvia. However, in both countries, the expected decline will be offset by the new private pensions, although a decline of about 18% is still expected in Estonia. Thus, Estonia is expected to be facing a risk of continuing to be a high poverty risk country for its older population in the future.
- In countries with a low at-risk-of-poverty rate during 2008, the decline in the benefit ratio is quite strong for Poland (-54%), Sweden (-39%), Austria (-30%), Slovakia (-27%) and France (-25%). With the exception of Slovakia, the decline in public pension generosity will not be offset by other mandatory pension schemes because the fall in the benefit ratio will still be more than 20%. Thus, in the absence of any counteracting policy changes, future retirees in Poland, Sweden, Austria and France run the risk of being more often poor than is the case now.
- In the middle group, Portugal could be identified as the country where the poverty risk for the elderly population is expected to be higher in the future, because of its falling benefit ratio. In Italy, on the other hand, the benefit ratio remains among the highest in 2060, despite the fall observed during the period 2007-2060.
- Greece is in a league of its own, as it remains the country with by far the highest benefit ratio, despite a fall during the period in question. Spain and Cyprus are also countries that will continue to have a high benefit ratio in the future. It can be expected that further reforms, mainly to restrict public spending in these countries, will increase the risk that future retirees will see a cut in their pension receipt.

Figure 2:
Public pension benefit ratio over the period 2008 to 2060 across EU countries



Note:
The 'Public pension benefit ratio' is calculated as the ratio between the average pension benefit and the economy-wide average wage.
Source:
The 2009 Ageing Report, pp. 111

Gross replacement of earnings

The lower the first pension, the greater is the risk that future retirees will end up in poverty.

Change in the Gross Replacement Rate (GRR) is another useful indicator of incomes of future retirees. GRR is the measure of the average first pension as a share of the economy-wide average wage. The lower the first pension benefit, with reliance on price (as opposed to wage) indexation, the higher the likelihood that the pension benefit will not be adequate in old age.

The effect on private pensions of recent crises may also bring Estonia and Latvia, and possibly Lithuania, into this high risk group.

The GRR results analysed below are available for 2007 and 2060, but only for about half of all EU Member States (Economic Policy Committee, 2009a, pp. 111). As shown in Table 1, the generosity of the first pension from public pension schemes is set to decline in a number of countries (ranging from a massive 43% in Estonia, 37% in Sweden and 33% in Latvia to only 7% in Belgium and 3% in Portugal). As many as eight countries observed a decline in the GRR that is in excess of 10%, and for two other countries the changes are moderate. The other polar positions are taken up by Romania (an increase of 20%) and Luxembourg and Greece (an increase of 17% and 10%, respectively). Greece offers an exceptional situation: it has the highest GRR (61%) among the European countries during 2007, and yet it is likely to observe a further rise of about 10% during 2007-2060 (to 67%).

Table 1:
Gross Average Replacement Rate (in %) for selected EU countries and trends between 2007-2060

	Public pensions only			Public + Private pensions		
	2007	2060	% change	2007	2060	% change
Belgium	45	42	-7%			
Czech Republic	33	27	-18%	33	27	-18%
Denmark	33	33	0%	71	84	18%
Estonia	28	16	-43%	28	31	11%
Greece	61	67	10%			
Italy	67	49	-27%			
Latvia	33	22	-33%	33	33	0%
Lithuania	32	29	-9%	32	37	16%
Luxembourg	53	62	17%			
Hungary	49	38	-22%	49	43	-12%
Austria	49	38	-22%			
Portugal	58	56	-3%			
Romania	36	44	22%	36	49	36%
Sweden	49	31	-37%			

Note:
The 'Gross Average Replacement Rate' is calculated as the average first pension as a share of the economy-wide average wage.
Source:
The 2009 Ageing Report, pp. 111.

These changes in the GRR suggest that the average first public pension will be lower in very many EU countries, partly reflecting the impact of life expectancy gains introduced in the calculation of pension benefits.

Sweden, Italy, Austria, the Czech Republic and Hungary show a considerable decline in the value of first pensions during the period between 2007 and 2060 raising pension sustainability concerns in these countries.

However, as mentioned above, other sources of pension income can make up for the lower initial pension from public schemes. This is certainly true in three Baltic States, where income from private pension schemes is expected to more than offset all falls in public pensions. However, even when the private pensions are also accounted for, the GRR is projected to fall in the Czech Republic and Hungary (out of seven countries providing results for private pensions). There are concerns that the recent financial and economic crisis have dented greatly returns from the private savings, and thus the offsetting factor might not be as strong as projected by the European Commission's Economic Policy Committee.

There are other factors that will also come into play. For example, it can be expected that in view of a falling replacement rate there will be a tendency to extend working lives and enhance future retirement incomes. Nonetheless, the combination of falling first pensions from public schemes and the lower returns from the private pension schemes, alongside the phenomenon of the public pension indexation only in line with prices, is a bad omen for poverty risks among future retirees.

Impact of pension reforms on future pension incomes

Another informative way to analyse future changes in pension systems is to compare the Net Replacement Ratio (NRR) before and after pension

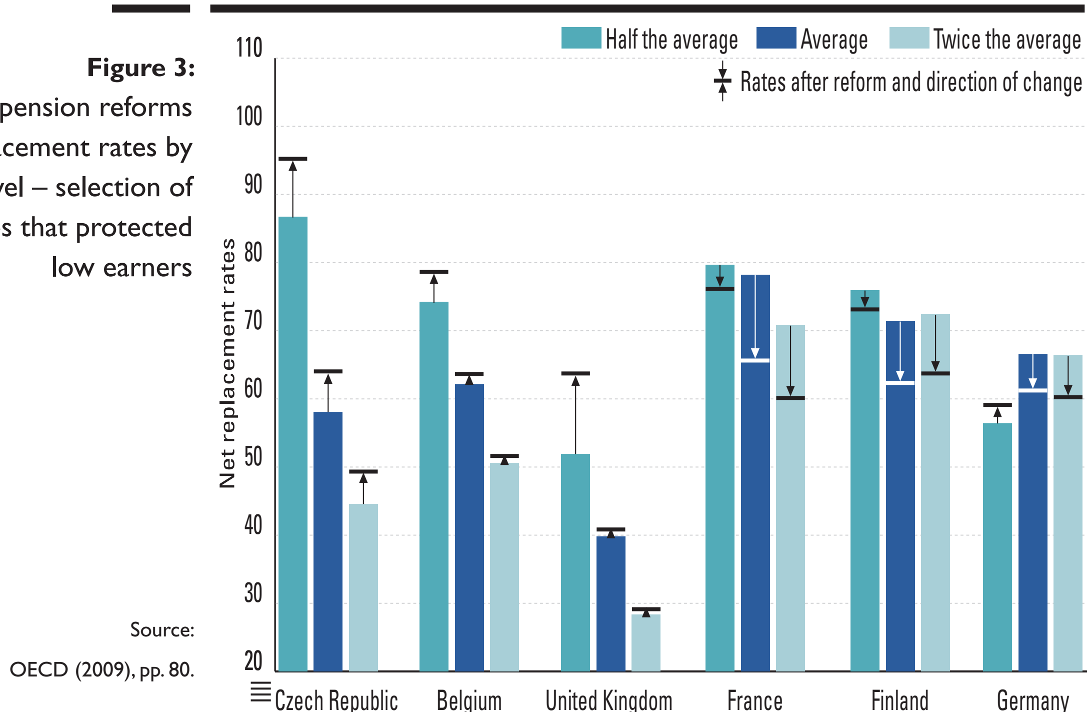
reforms. These results are extracted from 'Pensions at a Glance' (OECD, 2009: chapter 2) and they use a somewhat different set of assumptions than those used by the European Commission in Table 1. Results for 12 EU countries are included in Table A.1 (Annex A1) and they simulate the impact of reforms for those workers who entered the labour market in 2006. They compare the situation for a person who spent a full career under the reformed pension system with the benefits that would have been received had the system not been changed.

Recent pension reforms have wrought structural changes in EU pension systems: the United Kingdom, Belgium, Germany, France and Finland have protected low earners; in Poland, Hungary and Slovakia, the link between earnings and contributions have been strengthened; and Portugal, Italy and Austria have resulted in across-the-board cuts in pension benefits.

The results shown are reported in terms of net replacement rates: that is, the value of the pension in retirement, after taxes, compared with the level of earnings when working, after taxes and contributions. For each country, the first row shows the position of low earners: workers earning 50% of the economy-wide average each year of their entire working life. The second row shows the net replacement rates for average earners and the third row for above average earners (workers earning 150% of the average).

Depending on the effect of the pension reforms on the retirement income of workers at different earnings levels, countries can be divided into three groups: countries with reforms that protected low earners, countries with reforms that strengthened the link between earnings and contributions, and countries with reforms that resulted in across-the-board cuts in benefits.

Figure 3:
Impact of pension reforms on net replacement rates by earnings level – selection of countries that protected low earners



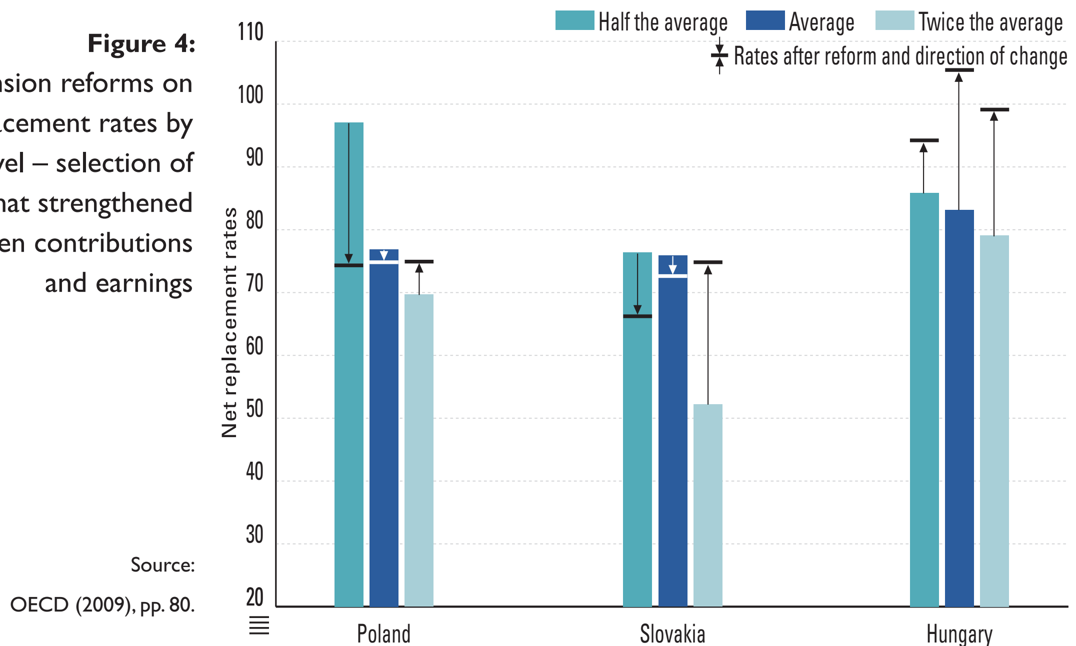
Source: OECD (2009), pp. 80.

Results for those six countries whose pension reforms have been more protective of low earners can be seen in Figure 3. The findings can be summarized as follows:

- In the United Kingdom and Belgium, pension reforms are likely to leave the pension entitlements of average and above-average earners unchanged, but they will increase the benefits for low earners (by nearly 23% for the United Kingdom, and 6% for Belgium). Results for the Czech Republic are similar, although the differences across workers with different earnings are less noteworthy.
- In France and Finland, the reforms will be resulting in a decrease in pension entitlements across the board, but the decrease in the benefits for low earners is less than that for workers with average and above-average levels of earnings.
- Germany offers the unique prospect of observing a rise in the pension entitlements for low earners to be accompanied by a decline for workers who have average and above-average earnings.

Results for three other EU countries, Poland, Slovakia and Hungary, show that pension reforms are likely to strengthen the link between pensions in retirement and earnings when working (see Figure 4). Such reforms are justified on the grounds that the reformed system will be fairer than a redistributive system and that it would reduce work disincentive distortions in the labour market.

Figure 4:
Impact of pension reforms on net replacement rates by earnings level – selection of countries that strengthened link between contributions and earnings

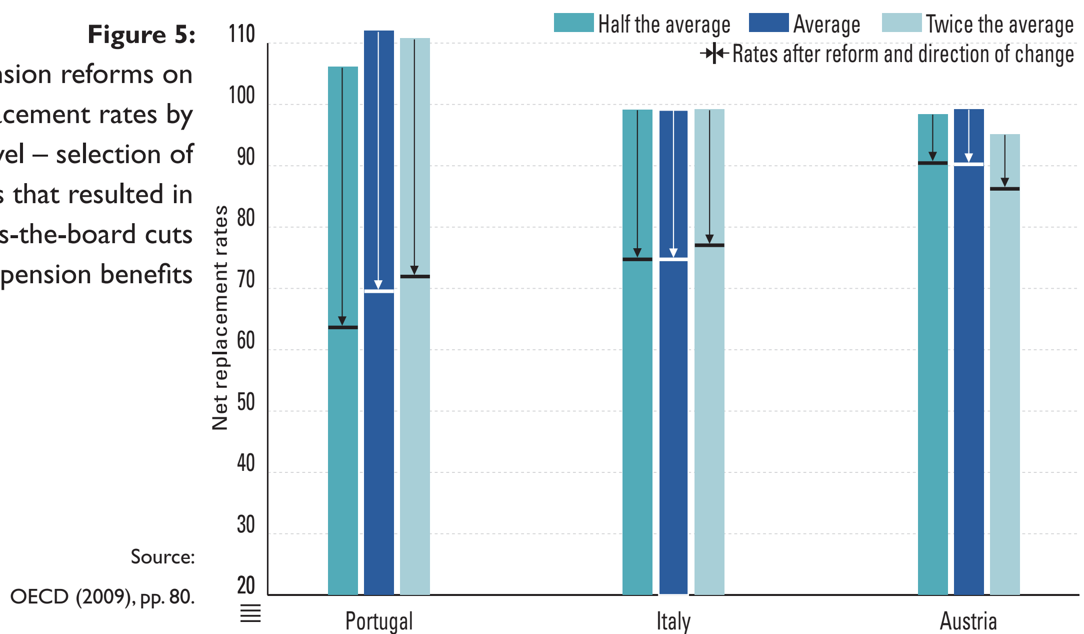


Source:
OECD (2009), pp. 80.

In Poland, there is a strong decline in the pension entitlement of those who are low earners: -22%. In contrast, the pension entitlement is expected to fall only slightly for average earners and there might even be a rise for high earners (+8%). The reform impact in Slovakia is along the same lines as observed for Poland, but the decline in the pension entitlements for low earners is smaller (-13%) and the rise observed for high earners is considerably higher (+22.7%).

The impact of pension reforms in Hungary offers similar patterns as in the United Kingdom and Belgium: the reforms will be resulting in a rise in pension entitlements across the board. However, in Hungary, the rise in the pension entitlement for low earners is much less than that observed for workers with higher earnings.

Figure 5: Impact of pension reforms on net replacement rates by earnings level – selection of countries that resulted in across-the-board cuts in pension benefits



Source: OECD (2009), pp. 80.

The last set of countries falls in the category in which reforms will result in a similar impact on benefits for both low, average and above-average earners (see Figure 5). These countries observe across-the-board cuts in pension benefits. Portugal is likely to observe the highest decline in net replacement rates, followed by Italy and Austria. Despite these across-the-board cuts, all these countries will continue to offer an impressively high net replacement rate.

Conclusions

The challenges to fiscal sustainability that EU countries face are well documented, and the focus is justifiably on addressing them. But, the impact of policy reforms now on the future for pension systems and incomes of future retirees is less clearly delineated. This Policy Brief has addressed this issue. Equally, the need for sustained policy remedies to the current economic crises is widely recognised. At the same time, the effects of actions taken now on the nature of future fiscal and social challenges arising is masked. This Brief emphasizes for policy-makers the need to be aware of the impacts of decisions on fiscal policy issues upon the pension structures and income arrangements for future pensioners.

Policy decisions need to strike the delicate balance between current recovery strategies and future sustainability of public finances and pensions. Clear and bold social policy choices are required from national governments, to devise a credible strategy to reduce public debt, but without compromising on the important aspects of current and future welfare systems – particularly those designed to protect the older generations. The temptation to sacrifice some element of future pension benefits to buy popularity with current generations, and/or to continue to implement stimulus spending strategies for a recovery from current crisis, is ever present, and however natural, it needs to be resisted in the absence of demonstration of actual need.

The next few years will undoubtedly be a crucial time as EU national governments look for the 'magic formula' in the shape of proactive economic policies which not only strengthen their recovery from the crisis, but also help steer clear of the dangers of national insolvency. At the same time, one critical requirement is to avoid the damage to future generations that would be the result of failure to attend to issues of pension sustainability. To balance the needs of youth and older people, both current and future, warrants a fresh focus on current fiscal policies and future pension policy imperatives. Fiscal solutions to the current crisis need to ensure that the avoidance of current fiscal catastrophes does not simply lay the groundwork for future, perhaps bigger, social crises. Achieving this balance requires not only the political will to make tough policy decisions, but also the ability to persuade the public that its own interest requires it to make some current sacrifice to ensure future stability in areas such as pensions.

The fiscal and pension issues discussed in this Brief can be summarised as follows:

- **Financial sustainability challenges.** The S2 indicator of the Economic Policy Committee puts 13 EU countries among the high risk countries,

in particular, Ireland, Greece, the United Kingdom, Slovenia and Spain are most seriously at risk with sustainability gaps in excess of 10% of GDP. Latvia, Romania and Cyprus, with rates below 10%, follow close behind.

- **Pension sustainability concerns: pensions vs wages.** Current projection maps for public pensions and wages in the period 2007-2060 suggest the future pensioners of Estonia, Poland, Sweden, Austria, France and Portugal are at high risk of lower relative pensions. It is instructive to note that none of these countries feature as having high-risk fiscal sustainability issues, and they have featured large pension reforms during the past decade.
- **Pension sustainability concerns: first pension indicator.** Six countries show a considerable decline in the value of first pensions during the period between 2007 and 2060: Sweden, Italy, Austria, and the Czech Republic and Hungary. The effect of recent financial and economic crises on returns from private savings suggests Estonia and Latvia, and possibly Lithuania, will be added to this list. This lower first pension in these countries, allied with price indexation, is an indication that future retirees in these countries run the strong risk of being more often in poverty.
- **Structural changes in pension systems due to pension reforms.** A clear line of evidence points to changes in pension systems with respect to the element of redistribution and/or linkage of contribution history to pension entitlements. Pension reforms in some countries have protected low earners – in the United Kingdom, Belgium, Germany, France and Finland. In other countries, the link between earnings and contributions have been strengthened – Poland, Hungary and Slovakia. Finally, pension reforms have resulted in across-the-board cuts in pension benefits Portugal, Italy and Austria.

Though the results painted here may look bleak, it needs to be emphasised that the picture that emerges errs, if at all, on the 'optimistic' side. This is because the bulk of the raw data analysed here was collected prior to the onset of the current economic crisis, and it is interesting to speculate on what the revised projections would be, when adjusted in line with the economic realities – in terms of government debt and (un) employment projections – that are emerging from the crisis. The crisis in the sustainability of public finance itself highlights the need to further refine the quality and the independence of the evidence base from which decisions are made: the more high-quality evidence is admitted to this debate as the accepted starting point for discussion on what to do next, the easier it becomes to formulate policy responses and persuade the public about the need for, and the consequences of change.

Notes

1 For example, in the United Kingdom, leading economists, including a former chief economist of the IMF and a former deputy Governor of the Bank of England, warn that failure to cut the 'structural' budget deficit within the lifetime of the next parliament could trigger a loss of confidence, push up interest rates, undermine the pound and threaten the recovery from the recession (*Sunday Times*, 14 February 2010).

2 The term usually refers to bonds issued by the national government in foreign currencies; thus the total amount owed to the holders of the sovereign bonds is called national sovereign debt.

3 See Kapteyn et al. (2004) for more discussion on this issue.

4 One important other factor would be whether the targeting of the public spending may have changed during the period in question, and this aspect is also analysed in this Brief.

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Annex A1: Statistical tables

Table A.1: Impact of pension reforms on net replacement rates by earnings level, stylised estimates from OECD for full career workers, 2009

Countries	Earnings level	Before	After	%age point difference	Change (%)
Reforms that protected low earners					
Germany	Half the average	56.4	59.2	2.8	5%
	Average	66.6	61.3	-5.3	-8%
	Twice the average	66.4	60.3	-6.1	-9%
France	Half the average	79.7	76.2	-3.5	-4%
	Average	78.2	65.7	-12.5	-16%
	Twice the average	70.8	60.2	-10.6	-15%
Finland	Half the average	75.9	73.2	-2.7	-4%
	Average	71.4	62.4	-9.0	-13%
	Twice the average	72.4	63.8	-8.6	-12%
UK	Half the average	51.9	63.8	11.9	23%
	Average	39.8	40.9	1.1	3%
	Twice the average	28.3	29.2	0.9	3%
Belgium	Half the average	74.2	78.7	4.5	6%
	Average	62.1	63.7	1.6	3%
	Twice the average	50.6	51.7	1.1	2%
Czech Repub.	Half the average	86.7	95.3	8.6	10%
	Average	58.1	64.1	6.0	10%
	Twice the average	44.6	49.4	4.8	11%
Reforms that strengthened the link between contributions and earnings					
Poland	Half the average	97.1	74.4	-22.7	-23%
	Average	76.9	74.9	-2.0	-3%
	Twice the average	69.7	75.0	5.3	8%
Slovakia	Half the average	76.4	66.3	-10.1	-13%
	Average	75.9	72.7	-3.2	-4%
	Twice the average	52.2	74.9	22.7	43%
Hungary	Half the average	85.9	94.3	8.4	10%
	Average	83.2	105.5	22.3	27%
	Twice the average	79.1	99.2	20.1	25%
Across-the-board cuts in benefits					
Austria	Half the average	98.4	90.5	-7.9	-8%
	Average	99.2	90.3	-8.9	-9%
	Twice the average	95.1	86.3	-8.8	-9%
Italy	Half the average	99.1	74.8	-24.3	-25%
	Average	99.1	74.8	-24.3	-25%
	Twice the average	99.2	77.1	-22.1	-22%
Portugal	Half the average	106.1	63.7	-42.4	-40%
	Average	112.0	69.6	-42.4	-38%
	Twice the average	110.8	72.0	-38.8	-35%

Source: OECD 2009, pp.80

About the European Centre for Social Welfare Policy and Research

The European Centre is a UN-affiliated intergovernmental organization concerned with all aspects of social welfare policy and research.

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- An international centre of applied social science and comparative empirical research on social policy and welfare
- An information and knowledge centre providing social science-supported social policy intelligence through a think-net
- A platform initiating future-oriented public policy debates on social welfare issues within the UN-European Region

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