

## Executive summary

This edition of *Pensions at a Glance* discusses the impact of COVID-19 on pensions and reviews the pension measures legislated in OECD countries between September 2019 and September 2021. As in past editions, a comprehensive selection of pension policy indicators is included for OECD and G20 countries. Moreover, this edition provides an in-depth analysis of automatic adjustment mechanisms in pension systems.

### Limited impact of COVID-19 on pensions while ageing pressure might come back to the forefront

The past two years have been marked by the COVID-19 pandemic, which has taken a heavy toll especially among the older population. However, the income of current pensioners has been well protected. As exceptional policies supported incomes and cushioned the impact on labour markets, future pensions are not likely to be much affected in most OECD countries.

OECD countries have put concerns about public finance between parentheses, and shortfalls in pension contributions were largely covered by transfers from state budgets. But the long-term financial pressure from ageing persists. Although life expectancy gains in old age have slowed somewhat since 2010, the pace of ageing will be fast over the next two decades. The size of the working-age population is projected to fall by more than one-quarter by 2060 in most Southern, Central and Eastern European countries as well as in Japan and Korea.

### Substantial measures, including strengthening first-tier pensions and extending early retirement

Many countries significantly reformed earnings-related pension benefits: Mexico substantially increased contributions, boosting future pensions; Estonia made contributions to private pensions voluntary and allowed to withdraw pension assets; and, Greece will replace pay-as-you-go auxiliary pensions with a funded defined contribution scheme. Measures boosting earnings-related pensions were also implemented in Hungary, Poland and Slovenia.

One clear recent trend has been to increase income protection for individuals who have recorded low earnings during their career, as in Chile, Germany, Latvia and Mexico.

Mandatory schemes provide an average future net replacement rate of 62% to full-career average-wage workers, ranging from less than 40% in Chile, Estonia, Ireland, Japan, Korea, Lithuania and Poland to 90% or more in Hungary, Portugal and Turkey. For workers earning half the average wage, net replacement rates are 12 percentage points higher on average.

Action on retirement ages was limited. Sweden increased the minimum retirement age for public earnings-related pensions, and plans a future link to life expectancy; the Netherlands postponed the planned increase while reducing the pace of the future link to life expectancy; and Ireland repealed the planned increase from 66 to 68 years. Denmark, Ireland, Italy and Lithuania have extended early retirement options. Among non-OECD G20 countries, Brazil has introduced minimum retirement ages and adjusted benefit calculation.

Based on legislated measures, the normal retirement age will increase by about two years in the OECD on average by the mid-2060s. The future normal retirement age is 69 years or more in Denmark, Estonia, Italy and the Netherlands, with links to life expectancy, while Colombia, Luxembourg and Slovenia will let men retire at 62. Women will maintain a lower normal retirement age than men in Colombia, Hungary, Israel, Poland and Switzerland.

### **Automatic adjustment mechanisms are crucial to help deal with the impact of ageing**

Automatic adjustment mechanisms (AAMs) refer to predefined rules that automatically change pension parameters or benefits based on the evolution of a demographic, economic or financial indicator. AAMs protect pensions from uncertainties and are less erratic, more transparent and more equitable across generations than discretionary changes. Initially introduced to uphold pension adequacy through wage or price indexation, AAMs are increasingly used to maintain financial sustainability.

AAMs should be sustained politically over time, also when governments change, to achieve their medium- to long-term objectives. Wide political support for their introduction and a mechanism design that avoids harsh adjustments can contribute to that. As with discretionary changes, AAMs have distributional consequences: whether to make adjustments to pensions, contributions or retirement ages is fundamentally the subject of democratic debate. Even with AAMs, policy makers maintain full control over pensions and can intervene if they deem the triggered adjustments undesirable. At the same time, AAMs reduce the need for frequent pension reforms.

Some AAMs introduced at a time of crisis to restore financial sustainability might be questioned once the economy recovers. Hence, AAMs are not a substitute for bold discretionary measures in a financially unbalanced pension system: it is therefore important to distinguish changes that should take place in any case from those that are conditional to the evolution of circumstances.

Increases in life expectancy should at least partially be offset by increasing statutory retirement ages, as this protects both adequacy and financial sustainability. A supplementary correction is likely needed to adjust for changes in the size of the contributing population, as well as a balancing mechanism ensuring financial balance over time.

About two-thirds of OECD countries employ some form of AAM. Six have notional defined contribution schemes with built-in adjustments. Seven countries adjust pension qualifying conditions to life expectancy, and six adjust benefits to changes in life expectancy, demographic ratios or the wage bill. Finally, seven countries have a balancing mechanism. In funded defined contribution schemes, trends in life expectancy do not affect pension finances.

Sweden and Finland have the most far-reaching AAMs. Sweden combines the automatic adjustment of benefits to life expectancy with a balancing mechanism ensuring solvency. Finland adjust both benefits levels and retirement ages to life expectancy, supplemented by a balancing mechanism adjusting contribution rates if needed. Moreover, both Estonia and Italy account for changes in total contributions and GDP, respectively, while linking the statutory retirement age to life expectancy. The German balancing mechanism adjusts both pensions and contribution rates to demographics. Backstop mechanisms in the Canada Pension Plan ensure financial balance while explicitly prioritising a political solution in case of a deficit: the automatic balancing mechanism is triggered if there is no agreement on alternative interventions.

Overall, automatic adjustment mechanisms have the advantage of defining the direction pension systems should be heading for; deviating from that path will at least require explanations and make the trade-offs visible.





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