

Adequacy and solidarity of public pensions in Estonia: how to set the aims and how to measure them?

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Core functions of old age pensions

- Income maintenance
 - prevent poverty in old age
 - secure everyone an income to allow copying and social participation
 - vertical redistribution
 - human rights perspective
- Income replacement
 - maintain living standards
 - reward previous contributions, provide work incentives
 - redistribution over lifetime
 - economic perspective

Desired qualities of pension systems

- Adequacy
 - Fulfilling social functions
- Sustainability
 - Financial affordability over time
- Adjustability
 - Resilience against demographic and economic risks

Need to balance the trade-offs

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Adequacy objectives

- Secure at least minimum, basic level of pensions to prevent and reduce old-age poverty
 - either universal flat-rate, contributory flat-rate or means-tested public pension
- Maintain (to a reasonable degree) previous standard of living upon retirement
 - either earnings-related public pensions or pre-funded private pensions

Adequacy ↔ eligibility

- Smaller pensions at a lower pension age or higher pensions at a higher pension age
- Estonia 2015
 - ~ 300 000 old age pensioners (23% of population)
 - average old age pension ~ 370 EUR

Trade-off between adequacy objectives

- If financial sustainability is challenged by economic strains and ageing, how much variation in pensions (read: income replacement function) can still be afforded to keep all retirees out of poverty?

How does solidarity factor into these equations?

- In the context of ageing, how to share the burden of demographic and economic risks across and within generations
 - who shall sacrifice and how much?
 - proportionally between different cohorts and income groups, or shall persons in more vulnerable situations sacrifice less?

Impact of migration

- Influencing the size of economically active population, but some influence also on benefit design
 - equitable transfer of pension rights (both acquired rights and insurance periods) less sophisticated with contributory earnings-related pensions/private pensions
 - non-contributory flat-rate/means-tested pensions potentially more strained

European legal standards

- Estonia is bound by the Revised European Social Charter and the European Code of Social Security setting some minimum social standards on the social security system, including public pension schemes

Revised European Social Charter (1996)

- Article 12 – the right to social security –
as interpreted by the European Committee of Social Rights:
 - social security system shall be collectively financed
 - *can not be fully replaced by private savings*
 - shall cover a significant percentage of the active population
 - the level of minimum benefit should not fall below the poverty threshold defined as 50% of median equivalised income
 - if the level of the benefit falls between 40% and 50% of median equivalised income, it may be completed with other benefits, including social assistance

Conclusions of the ECSR 2013

- The 50% of Eurostat median equivalised income amounted to 233 EUR in 2011
- The national pension was 128 EUR
- The Committee concludes that the situation in Estonia is not in conformity with Article 12§1 of the Charter on the grounds that:
 - the minimum level of national pension is manifestly inadequate

European Code of Social Security

- The rate of the benefit for the standard beneficiary shall be at least 40% of the total of the wage of an ordinary adult male labourer
- Standard beneficiary: Man with wife old pensionable age
- The net wage of an unskilled male industry worker 533,2 EUR in 2014
- The (net) pension after 30 years of insurance 283,83 EUR
- The national pension 148,98 EUR
- The rate of old age benefit for an ordinary adult male labourer after 30 years of insurance: 53,2%

Resolution of the Committee of Ministers 2014

- The Committee of Ministers notes that the national pension rate for old age and invalidity in 2013 amounted to only €140.81 per month (€134.10 in 2012), staying well below the absolute poverty line (€196 in 2012), while the pension of an unskilled male industry worker after 30 years of insurance amounted to €255.66 and therefore stayed below the relative poverty line.
- The Committee of Ministers, recalling that prevention and reduction of poverty is one of the main objectives of the Code, invites the Government of Estonia to demonstrate in its next report, on the basis of detailed statistics of social transfers for recent years, that Estonia expects to fulfill, to the maximum of available resources, its social responsibility to provide social benefits which permit maintaining the “family of the beneficiary in health and decency” at least above the absolute poverty line

Commentary

- While historically (including in Estonia) the primary aim of public old age pension schemes has been seen as income replacement through earnings-related pensions, the focus in the interpretation of the European standard-setting instruments has shifted towards prevention against old-age poverty along the human rights perspective
 - Recall the arguments from 1990s: *flat-rate living allowances are not pensions*
- Against European standard-setting instruments, Estonia faces problems as regards the minimum level of protection, not as regards the average level of protection

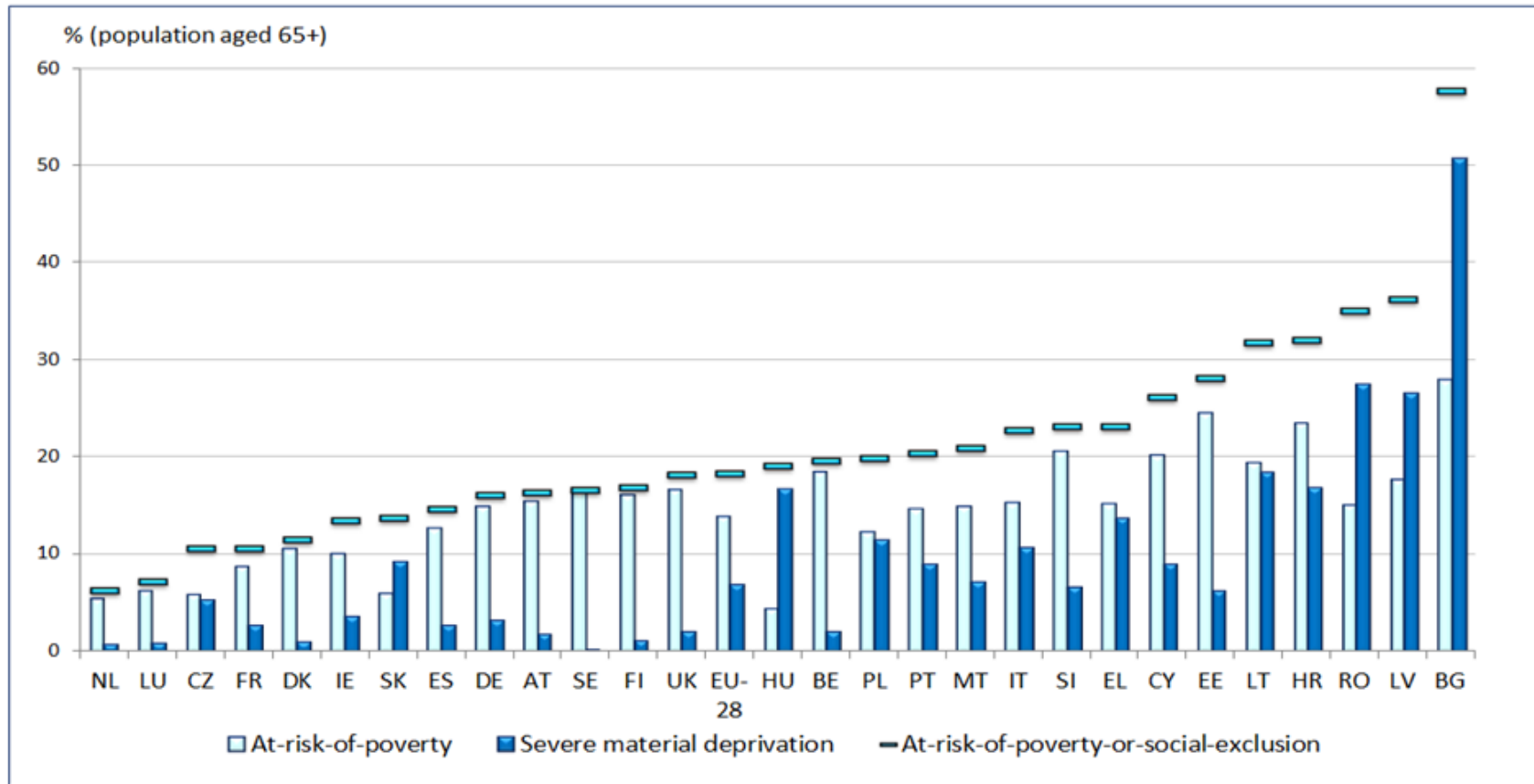
Indicators of adequacy

- The average replacement rate (average old age pension to average wage) is the most commonly used indicator to describe adequacy of the pension system in Estonia
- Pros:
 - gives a broad indication of the level of generosity of the system
 - relatively simple to calculate and update
- Cons:
 - describes only the degree of income replacement
 - illustrates the average case
 - gives no indication about poverty alleviation capacity, variation in individual replacement rates and pension inequalities

EU pension adequacy indicators

- At-risk-of-poverty rate 65+
- Severe material deprivation
- Intensity of poverty
 - alternative poverty thresholds (40 %, 50 %, 70%)
- Relative incomes of older people
 - relative median income ratio
 - income quintile ratio
- Replacement rates
 - theoretical replacement rates
 - aggregate replacement ratio
 - benefit ratio
 - gross average replacement rate
- Gender pension gap

At risk of poverty and severe material deprivation, population 65+, 2013

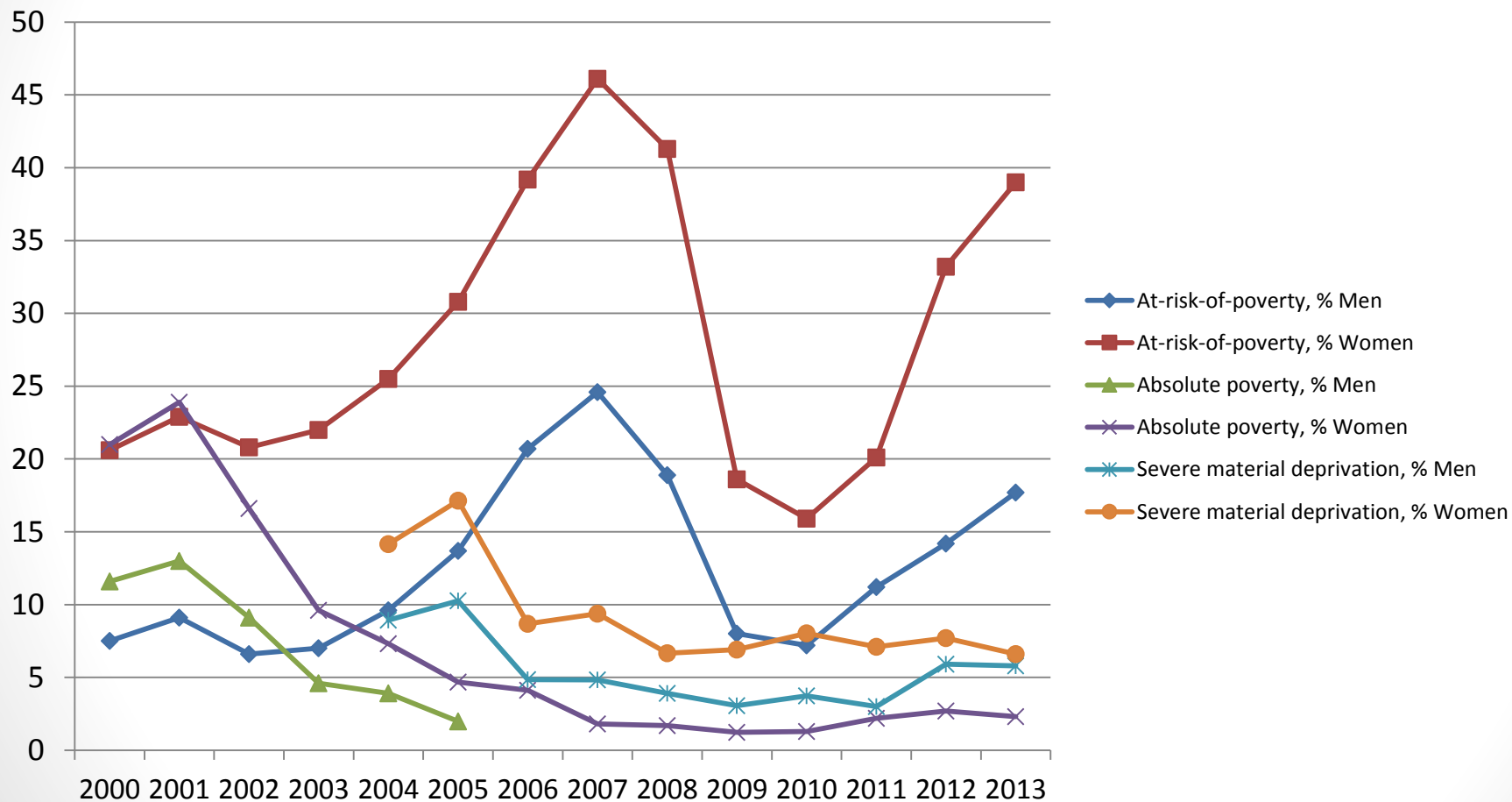


Source: Eurostat

Severe material deprivation

- The proportion of people living in households that cannot afford at least **four** of the following nine items:
- mortgage or rent payments, utility bills, hire purchase instalments or other loan payments;
- one week's holiday away from home;
- a meal with meat, chicken, fish or vegetarian equivalent every second day;
- unexpected financial expenses;
- a telephone (including mobile telephone);
- a colour TV;
- a washing machine;
- a car; and
- heating to keep the home sufficiently warm.

Poverty indicators for 65+ in Estonia



Relative income position

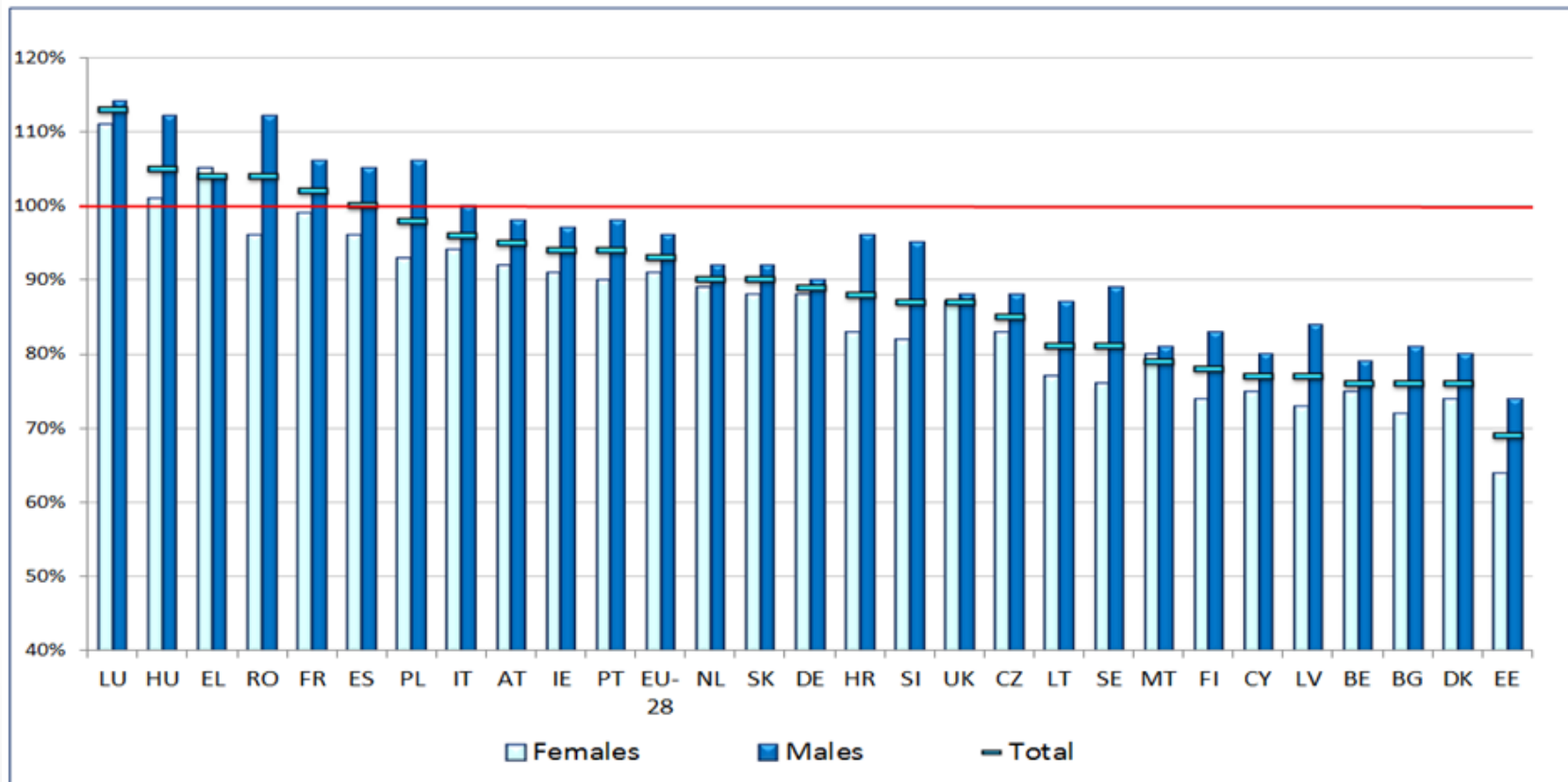
- **Relative median income ratio**

- the ratio of the median equivalised disposable income of persons aged 65 or more compared to the median equivalised disposable income of persons in the age group 0 to 64
 - includes all sources of income (not just pensions)
- the indicator measures the relative income position of the elderly – the overall income situation of older people relative to the income of the younger age group

- **Income quintile ratio (S80/S20)**

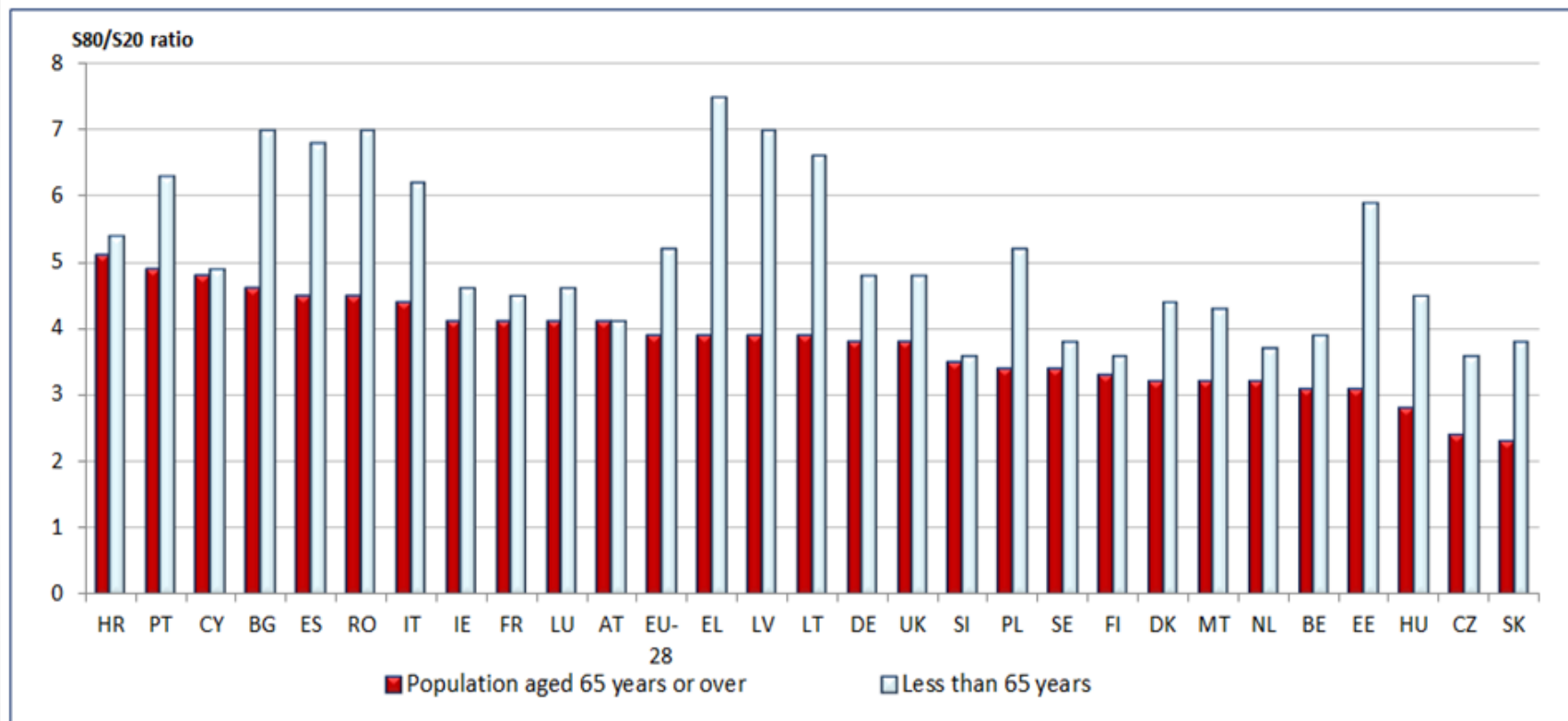
- the ratio of the total income received by the 20 percent of the elderly population with the highest income (the top quintile) to the total income received by the 20 percent of the elderly population with the lowest income (the lowest quintile)

Relative median income ratio, total and by gender, 2013



Source: Eurostat

Income quintile ratio (S80/S20), by age group, 2013



Source: Eurostat

Replacement rates

- **Aggregate Replacement Ratio (ARR)**

- the ratio of (i) the median individual gross pension of people aged 65-74 to (ii) the median individual gross earnings of people aged 50-59
 - based on income data from EU-SILC
 - individual gross income data
- ARR reflects the overall adequacy of pensions in the transition from work to retirement

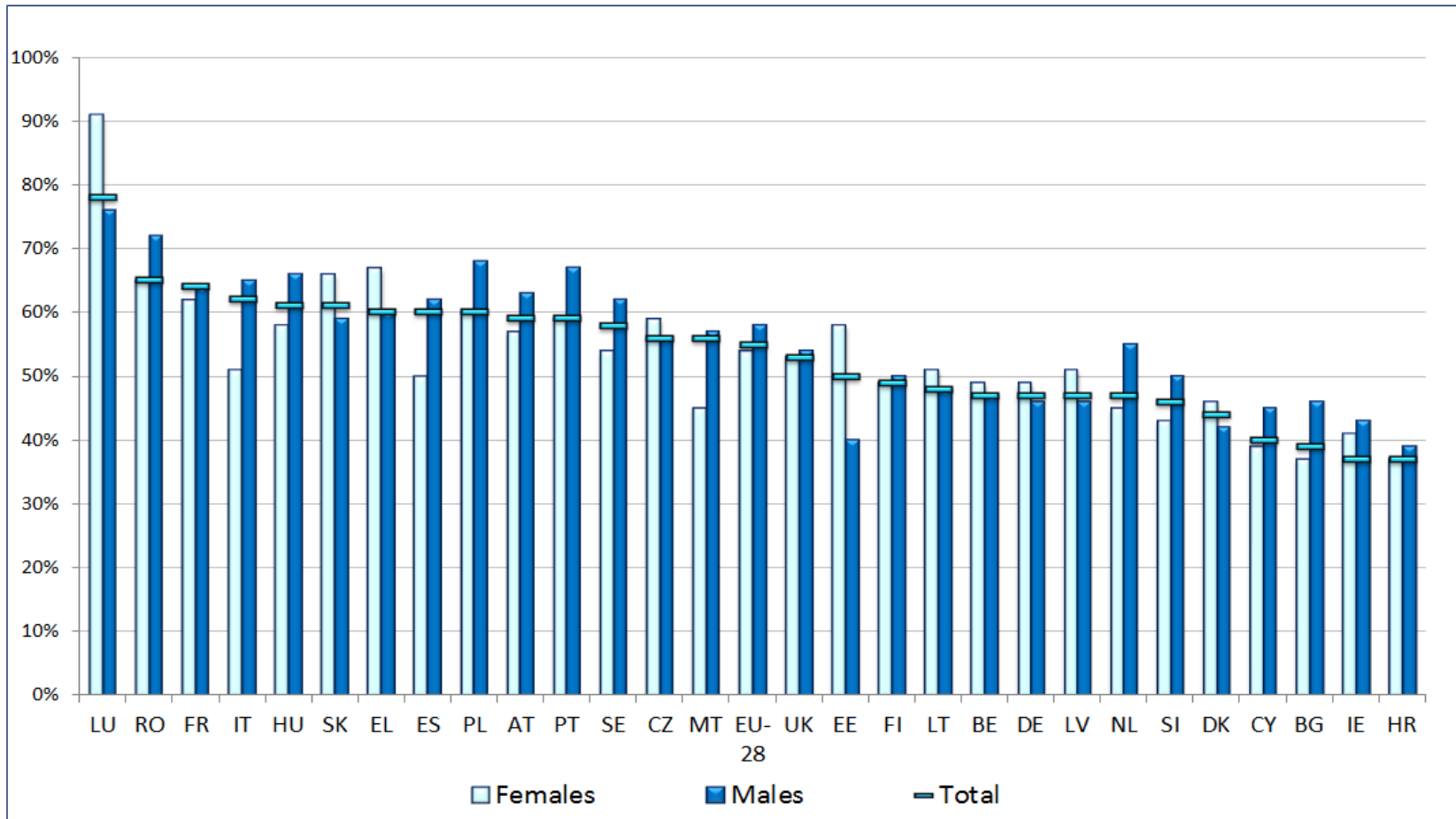
- **Benefit Ratio (BR)**

- defined as the average pension benefit relative to the economy-wide average wage
 - the average pension calculated as the ratio of public pension spending relative to the number of pensioners
 - the average wage is proxied by the change in the GDP per hours worked
- BR is intended to provide an estimate of the overall generosity of pension systems

Replacement rates

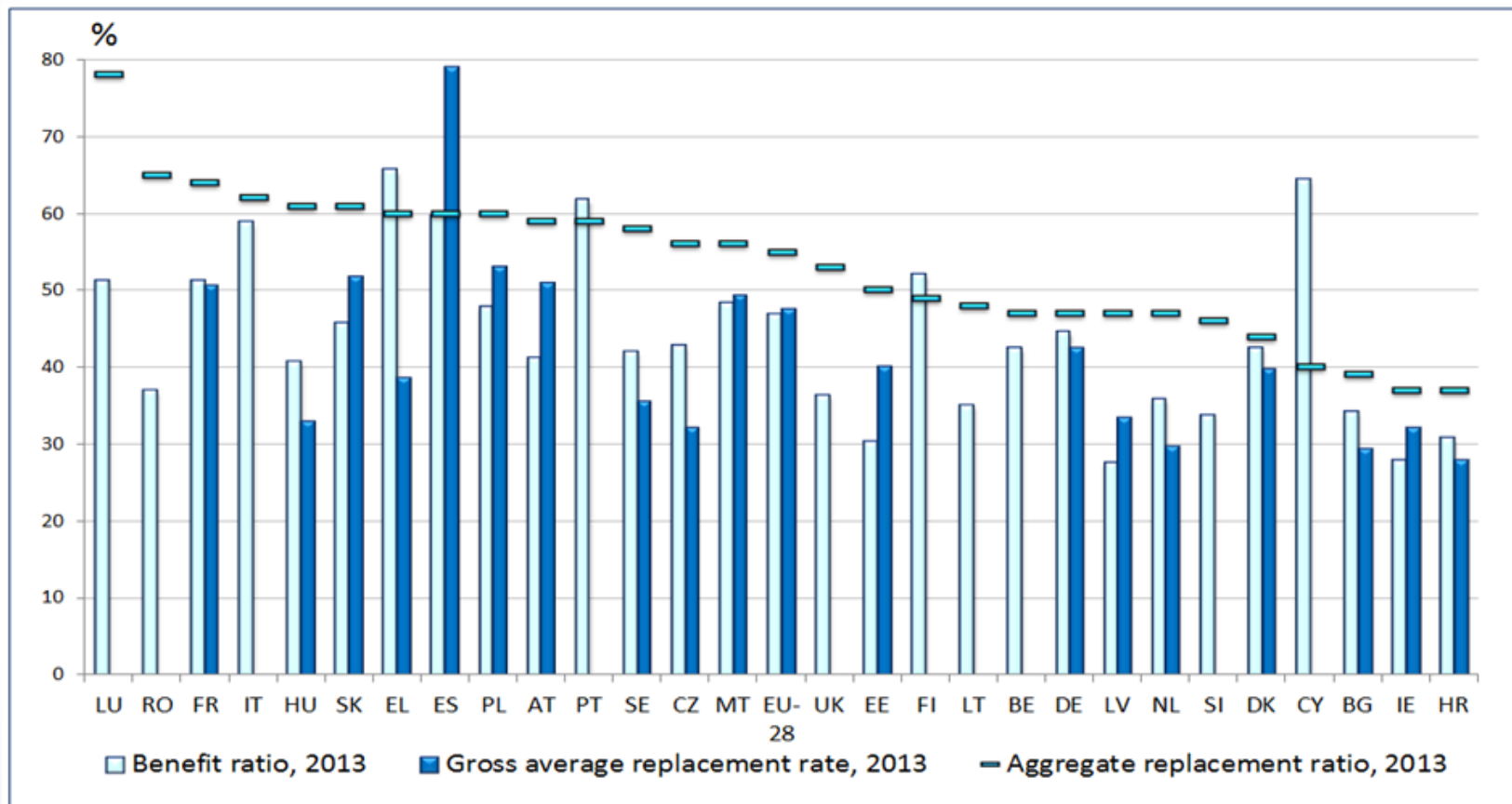
- **Gross Average Replacement Rate (GARR)**
 - calculated as the average first pension relative to the economy-wide average wage at retirement
 - a proxy for the change in the standard of living at the moment of transition from work to retirement
- **Theoretical Replacement Rates (TRR)**
 - the level of pension income in the first year after retirement, measured as a percentage of individual earnings at the moment of retirement
 - case study based calculations for an assumed hypothetical worker, including all schemes that are mandatory, typical or have a wide coverage
 - a proxy for the change in the standard of living at the moment of transition from work to retirement
 - both net TRR and gross TRR are calculated

Aggregate replacement ratio total and by gender, 2013



Source: Eurostat

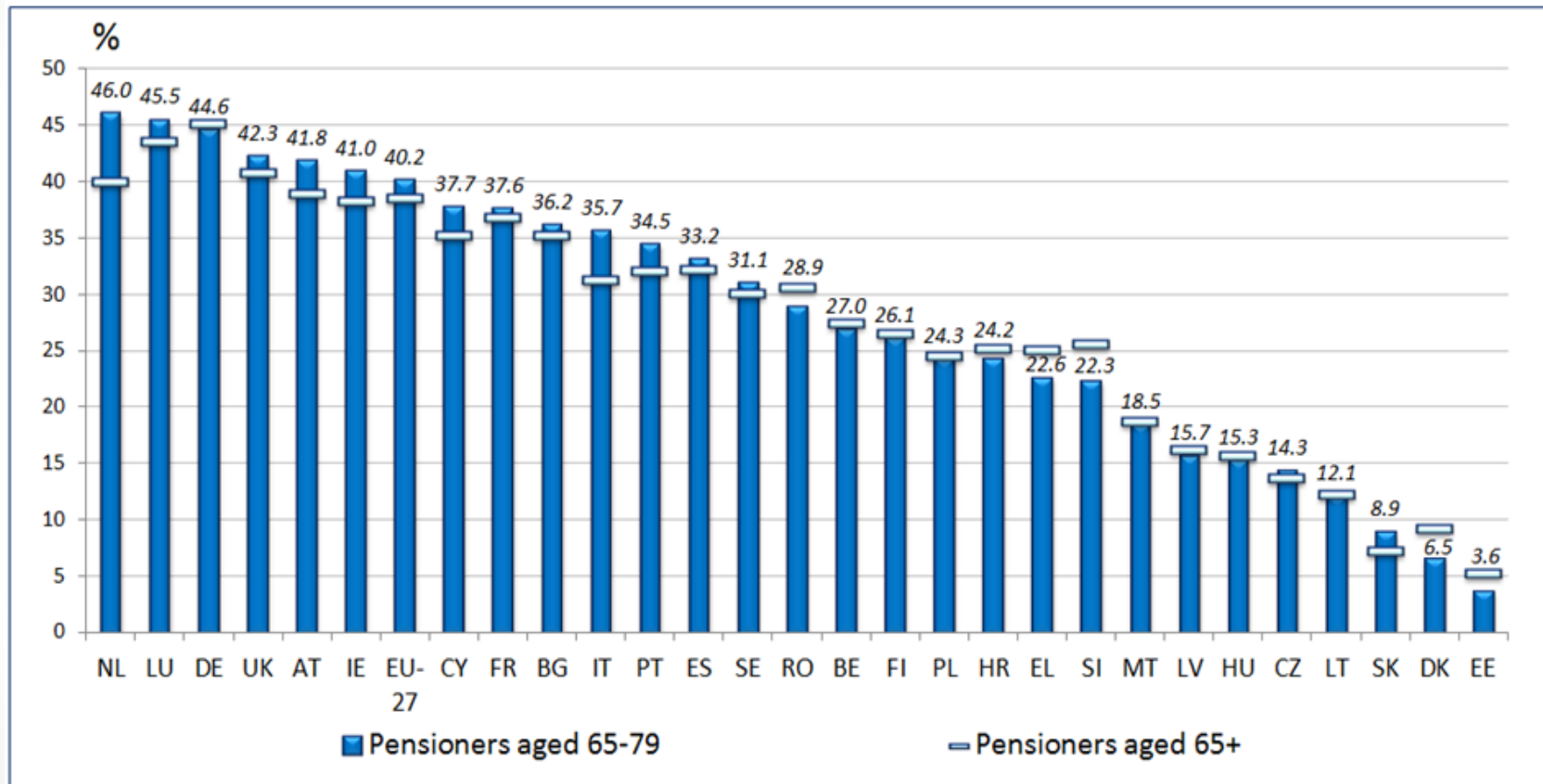
Benefit Ratio, Gross average replacement rate and Aggregate replacement ratio, 2013



Source: Eurostat

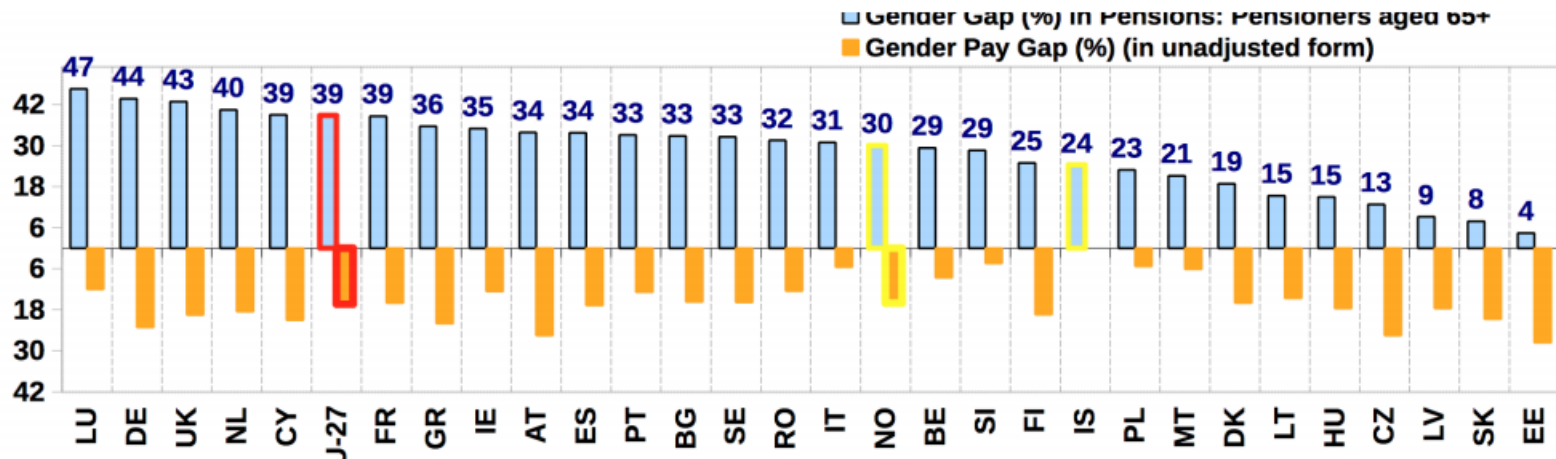
Member State	Net Theoretical Replacement Rates (2013)					
	Base Case I		Base Case II		Increase in SPA	
	age 25 to 65		40 years to SPA		age 25 to SPA	
	men *	women *	men *	women *	men *	women *
BE	78.6		78.6		78.6	
BG	62.3	69.3	57.3		55.3	51.1
CZ	62.2	72.1	55.6		52.2	48.9
DK	68.4		68.4		68.4	
DE	57.0		57.3		57.6	
EE	61.9	77.1	50.9	63.4	49.2	61.0
IE	83.1		83.1		83.1	
EL	n.a.		n.a.		n.a.	
ES	96.2		96.2		96.2	
FR	80.2		80.2		80.2	
HR	55.5	59.7	55.5		55.5	49.6
IT	80.2		80.3	80.0	83.9	75.7
CY	58.0		58.0		58.0	
LV	71.9		65.0		61.1	
LT	61.6	70.0	52.6	52.4	49.9	47.3
LU	105.4		102.5		93.5	
HU	100.8		85.4		80.6	
MT	79.0		79.0		79.0	
NL	114.0		114.0		114.0	
AT	85.1	93.7	85.1		85.1	77.1
PL	74.2		74.2	73.1	75.5	66.6
PT	92.3		92.3		92.3	
RO	73.1	62.1	73.1	62.1	71.3	59.5
SI	57.3	60.3	57.3	60.3	55.4	55.9
SK	76.0	77.9	64.4		59.6	58.8
FI	69.5		69.5		69.5	
SE	69.3		69.3		69.3	
UK	83.4	88.0	83.4	73.4	83.4	71.4

Gender Gap in Pensions (%), 2012



Source: Eurostat

Gender Gap in Pensions versus Gender Pay Gap



EU-SILC 2010 data

Source: Bettio et al 2013. *The Gender Gap in Pensions in the EU*