

Workshop, Paris, 1 December 2020



# *OECD Pension Review: Czech Republic*

<http://oe.cd/pensions-cze-2020>



# OECD Pension Review: Czech Republic



- **Great collaboration with Ministry of Finance, Ministry of Labour and Social Affairs and various stakeholders**
- **Covers all components of the pension system**
- **This brief presentation has three parts:**
  - *Public pensions*
  - *Impacts of ageing on financial sustainability*
  - *Voluntary funded pension arrangements*



# Overall context for pensions in the Czech Republic



- **Fast population ageing – similar pace as OECD average**
- **Almost all current retirees benefit today from an earnings-related pension**
- **Average income of retirees is low in the Czech Republic, but old-age inequality is low**
- **Sharp increase in employment of 50+ since 2000 (before COVID)**
- **Employment rates fall sharply after age 60 and 30% of men receive pensions before the statutory retirement age**

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# Public pensions

## *OECD Pension Review: Czech Republic, Chapters 1 & 3*

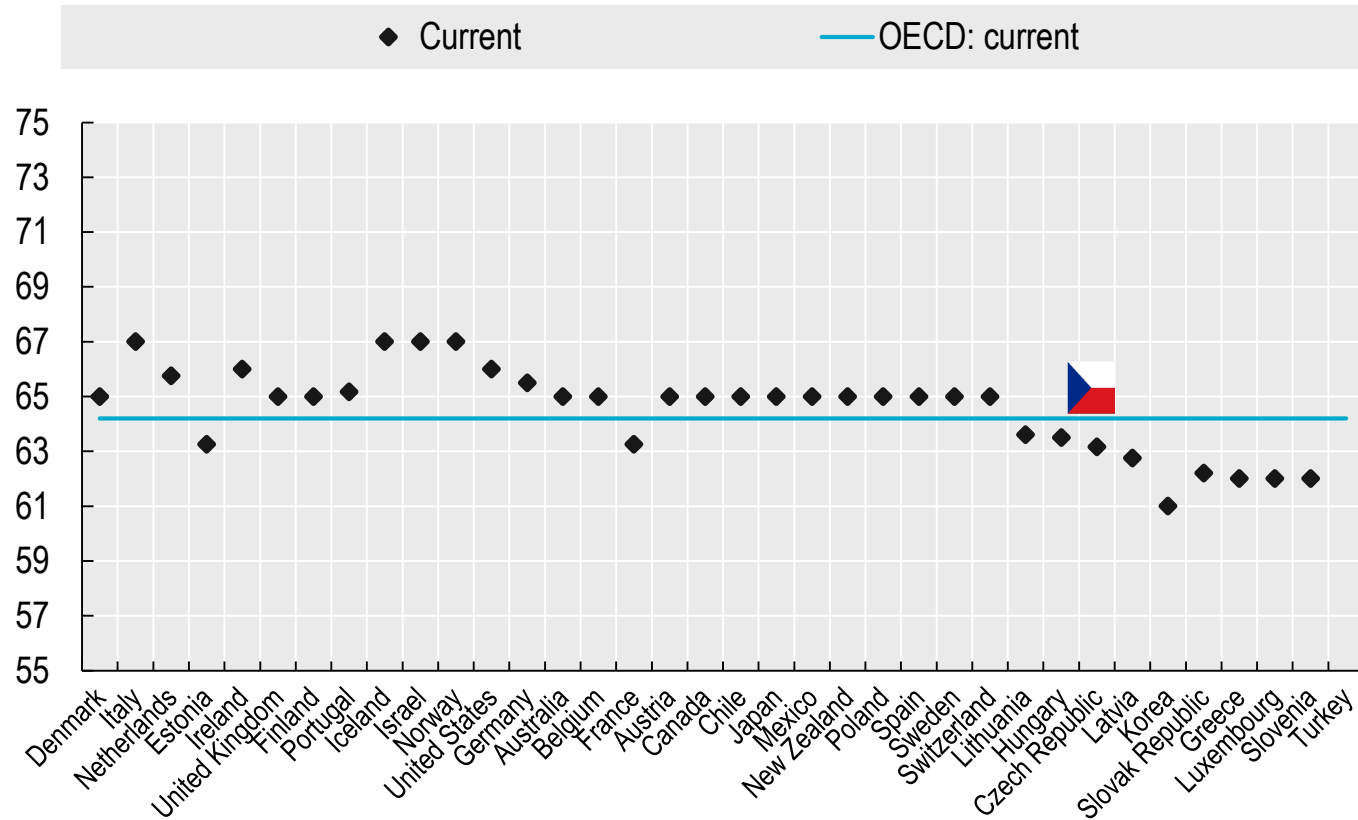
**Hervé Boulhol and Christian Geppert**

OECD, Directorate for Employment, Labour and Social Affairs



# The normal retirement age will remain about one year below the OECD average

Normal retirement age for men entering the labour market at age 22 with a full career

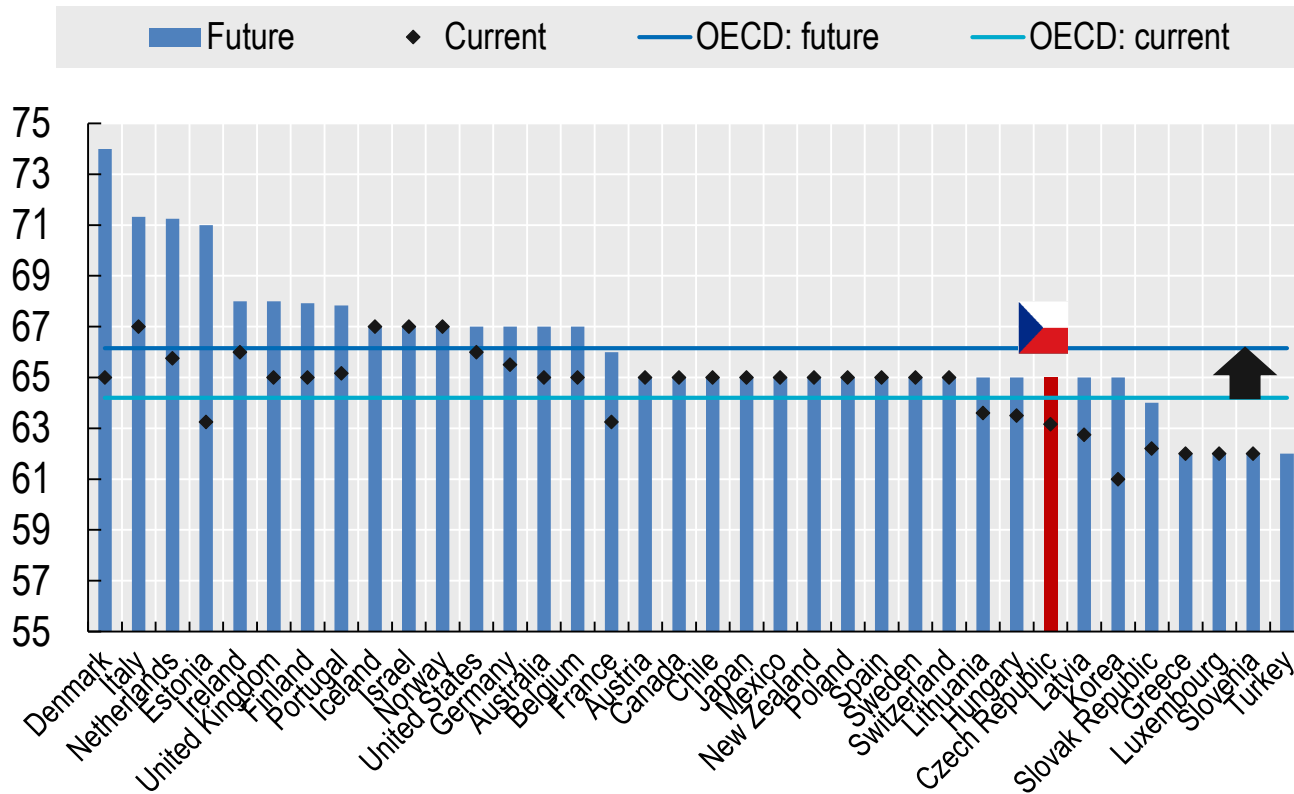


Source: Figure 1.14



# The normal retirement age will remain about one year below the OECD average

Normal retirement age for men entering the labour market at age 22 with a full career



Source: Figure 1.14

- Normal retirement ages are increasing in half of OECD countries, including in the Czech Republic
- The share of adult lifetime spent in retirement is projected to increase in the Czech Republic
- Early retirement age will remain at age 60 years while the *current* OECD average is already 61.2 years

## OECD Recommendations:

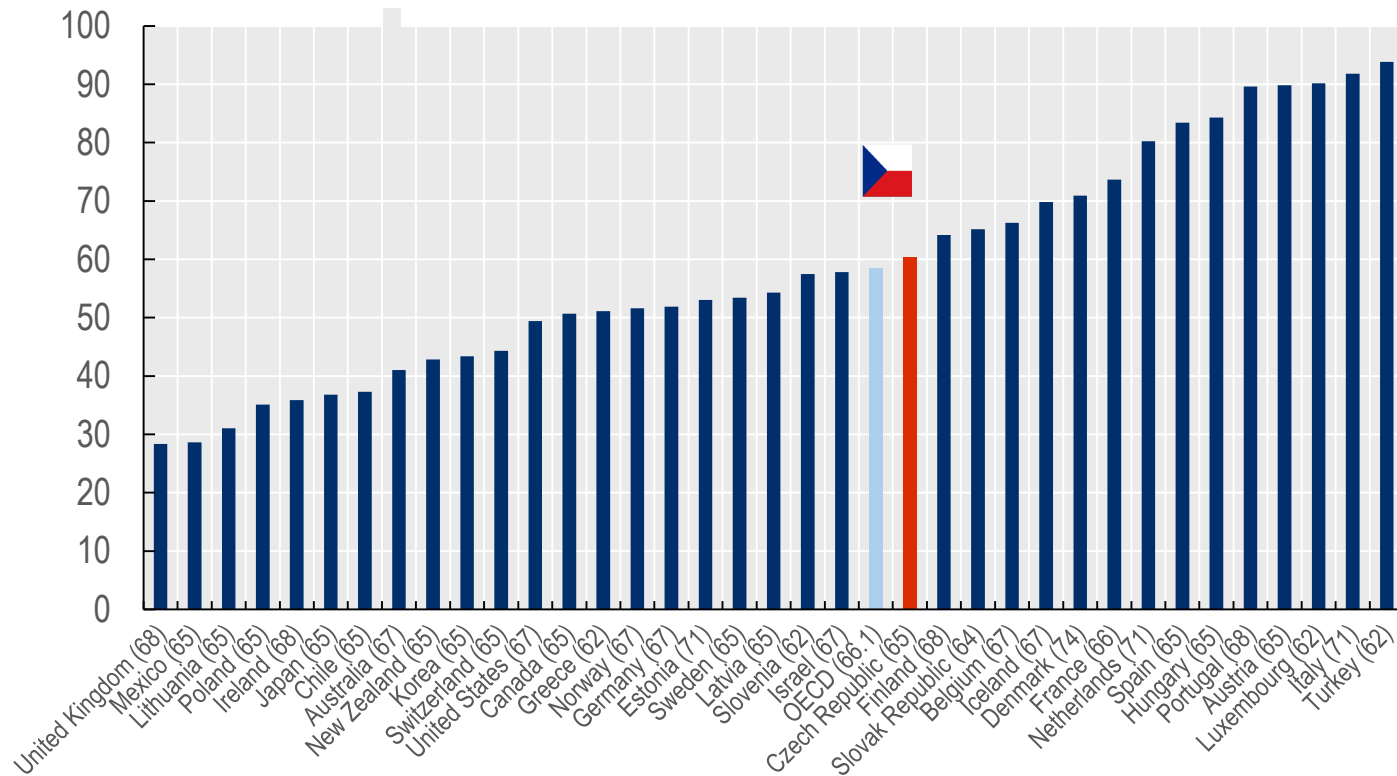
- Implement the legislated increase until 2037
- Link to gains in life expectancy after that
- Raise the minimum retirement age and adjust it to life expectancy as well

See later and Chapter 2 for more detail and additional measures to improve financial sustainability



# Net replacement rates for full-career workers are similar to the OECD average at the average-wage level

Future net replacement rate at the average-wage level, %



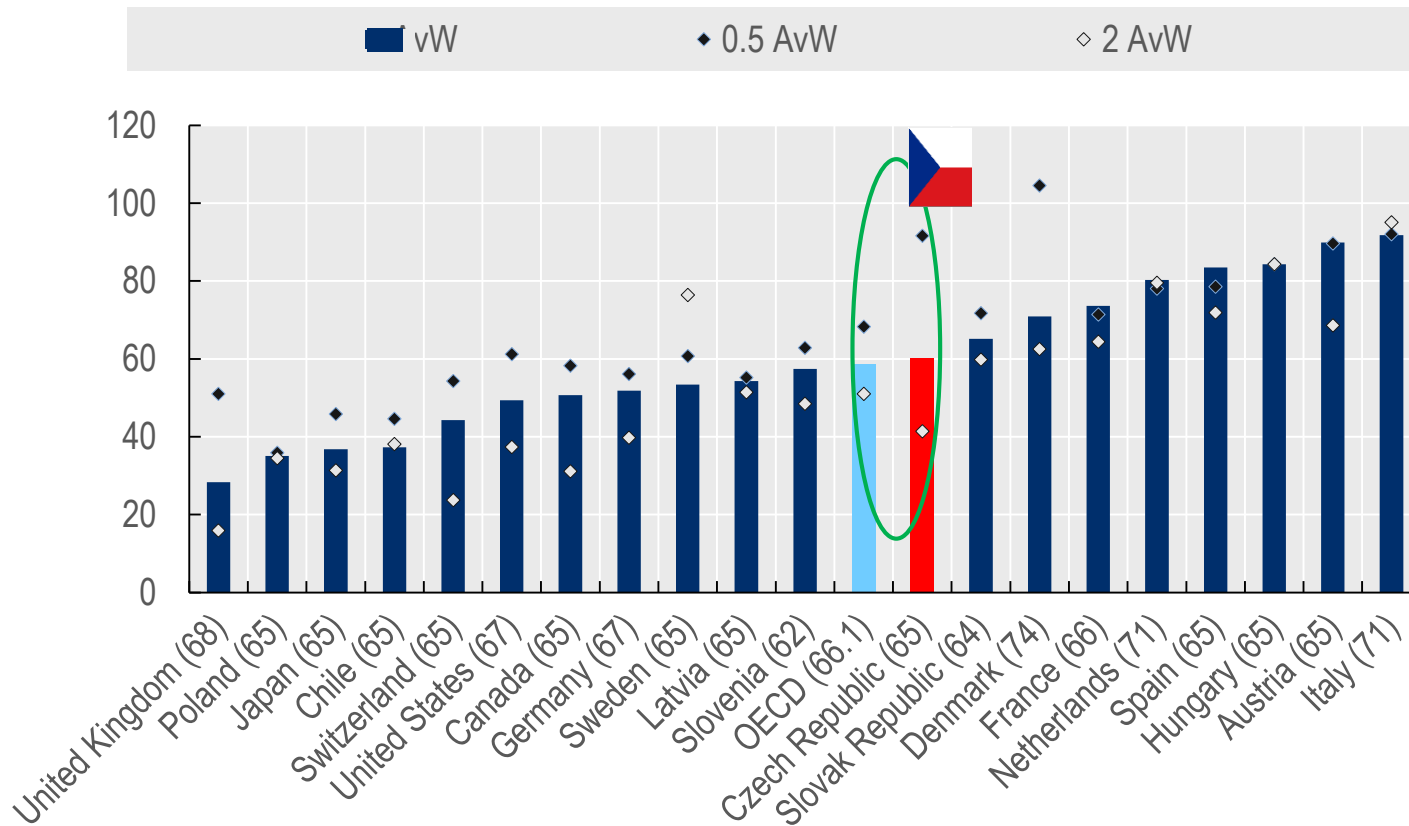
Note: Future normal retirement age in brackets. The calculations show the pension benefits of a worker who enters the labour market in 2018 at age 22 and retires after a full career.

Source: Figure 1.16



# Strong progressivity in Czech public pensions

Future net replacement rate, by earning level, %



- **Progressivity level is a normative, political choice**
- **Low replacement rates for high earners: low returns on high contributions**
- **Current schedule is the result of complex rules to compute benefits**
- **Same level of progressivity can be achieved in a more simplified way**

Note: Future normal retirement age in brackets. The calculations show the pension benefits of a worker who enters the labour market in 2018 at age 22 and retires after a full career.

Source: Figure 1.16

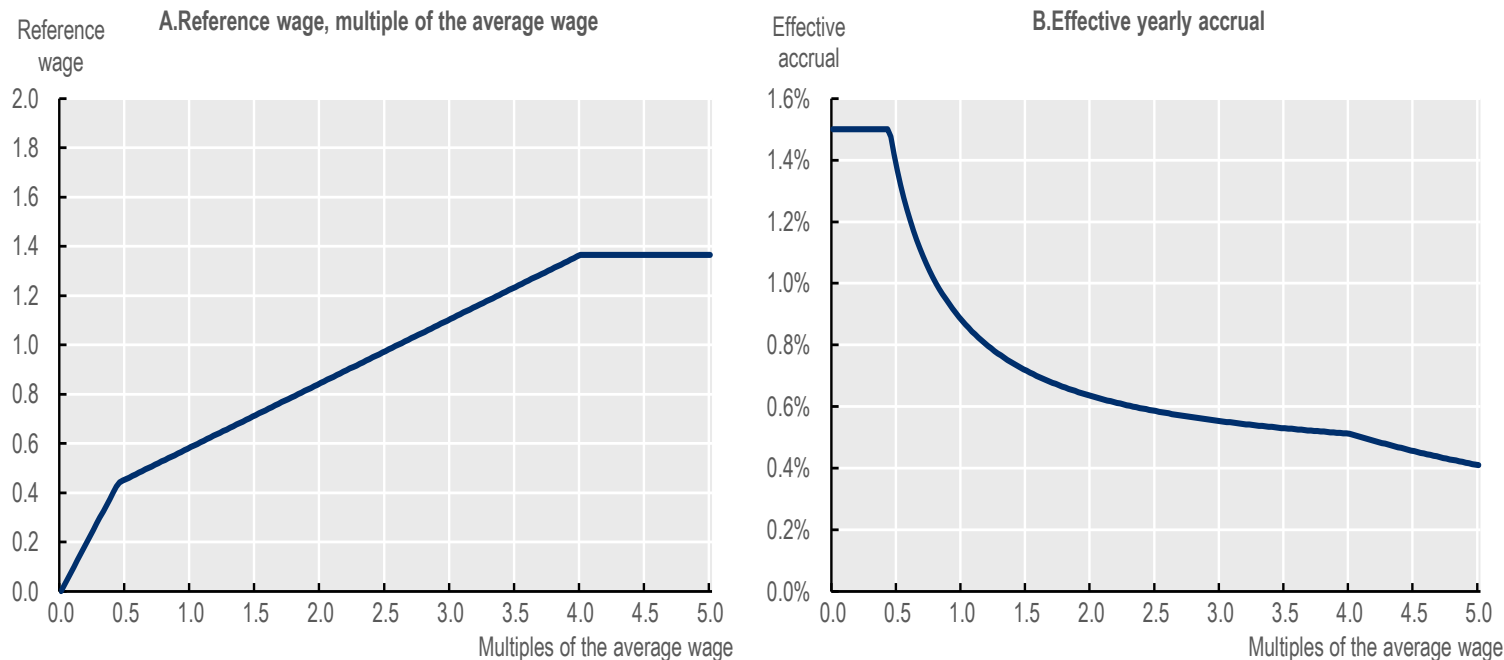




# Need to simplify pension calculation rules

- Complexity arises from the rules to compute the reference wage : sharply non-linear weights granted to lifetime wages are an exception internationally

Figure 1.10. Reference wage and effective accrual  
by average wage over the career



Source: Czech Ministry of Labour and Social Affairs and OECD calculations.



# Need to simplify pension calculation rules

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- **Complexity of calculating pension rights arises from the rules to compute the reference wage, which is crucial : sharply non-linear weights granted to lifetime wages are an exception**
- **Lack of transparency in understanding entitlements when they are supposed to accrue: whole career is accounted for to compute pension entitlements, but entitlements accrued in a given year depend on the career before and the remaining part of the career**
- **This complexity prevents contributors from understanding pension entitlements and anticipating their income in old age**
- **It also weakens the management of the system by making it difficult and more uncertain to project pension flows**
- **Some non contributed periods generate no entitlements AND lower already accrued and future entitlements (through lowering the reference wage) : this implies a double penalty, potentially leading to a large impact of unemployment periods on pensions**



# OECD Recommendations to simplify the benefit formula

*while maintaining the reference to wages through the whole career*

- Calculate earnings-related entitlements using a constant effective accrual rate across earnings levels (up to a ceiling). Adjust then the basic pension level to achieve redistribution objectives
- At least, remove the double penalty related to the impact of non-validated periods on pensions
- Each insured individual would know the acquired entitlements in every period, which would be easily calculated
- Proposals by the Fair Pension Commission in January 2020 (triple the basic pension level and constant effective accrual rate of 0.39%) would greatly simplify and go a long way in mimicking the current pension formula (see Figure 1.30) at retirement

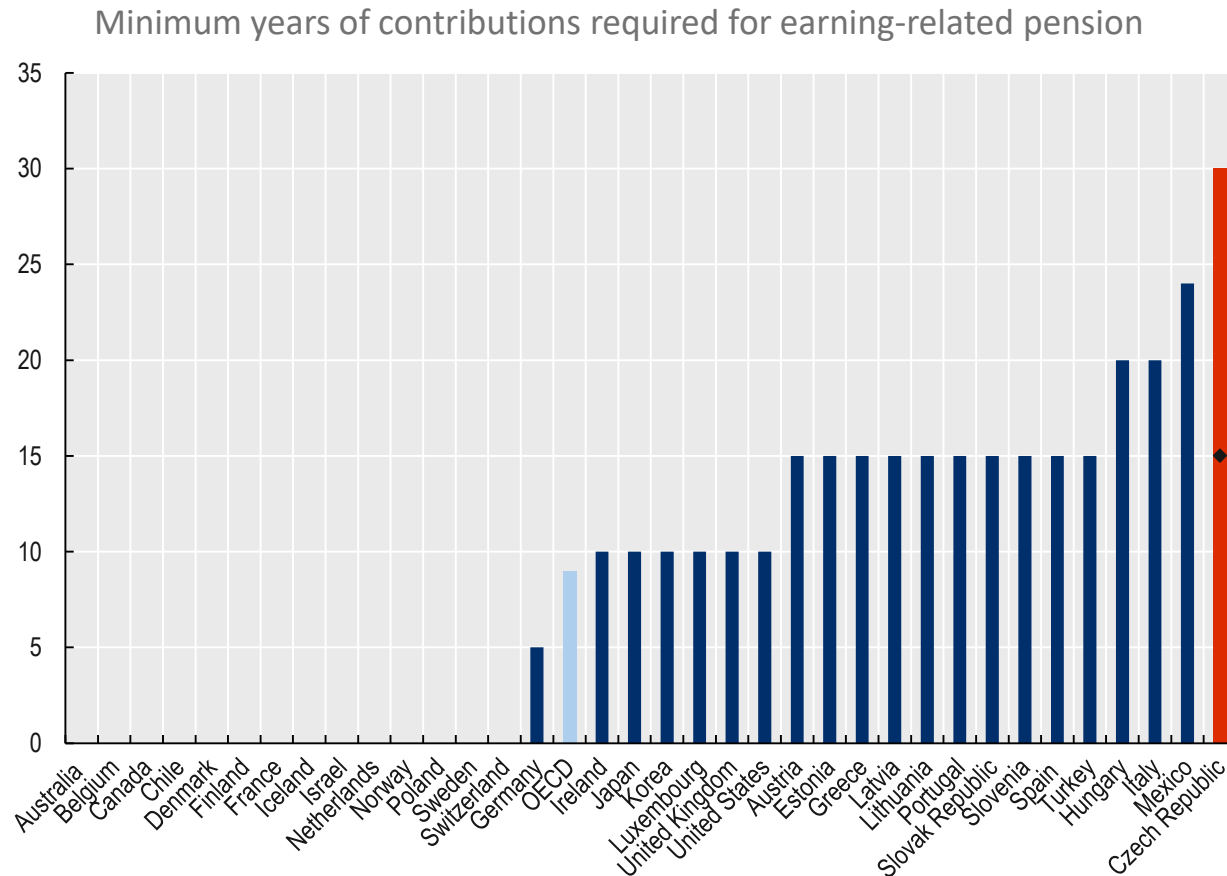
There might be some significant impact during retirement due to indexation

Alternative: convert pension in CZK at retirement and follow the indexation rule

- The Commission proposals imply a high level of basic pension and a low level of accruals in international comparison, consistent with maintaining high progressivity
- With constant spending, progressivity can be increased (reduced) through a higher (lower) basic pension and a lower (higher) constant accrual rate



# Eligibility: Very high minimum number of years required



- **Czech Republic is outlier: 30 years of contributions (or 35 validated years) at statutory retirement age, 15 (20) years five years later**
  - **Few older people do not reach the threshold today**
  - **Yet, risk of having to retire very late to access a small pension or to have contributed for nothing is rising**
  - **No more validation of education periods**
  - **Effect of full employment in Czechoslovakia is vanishing**
  - **Labour market risks might have increased**
- (see Chapters 2 and 3 for more details)

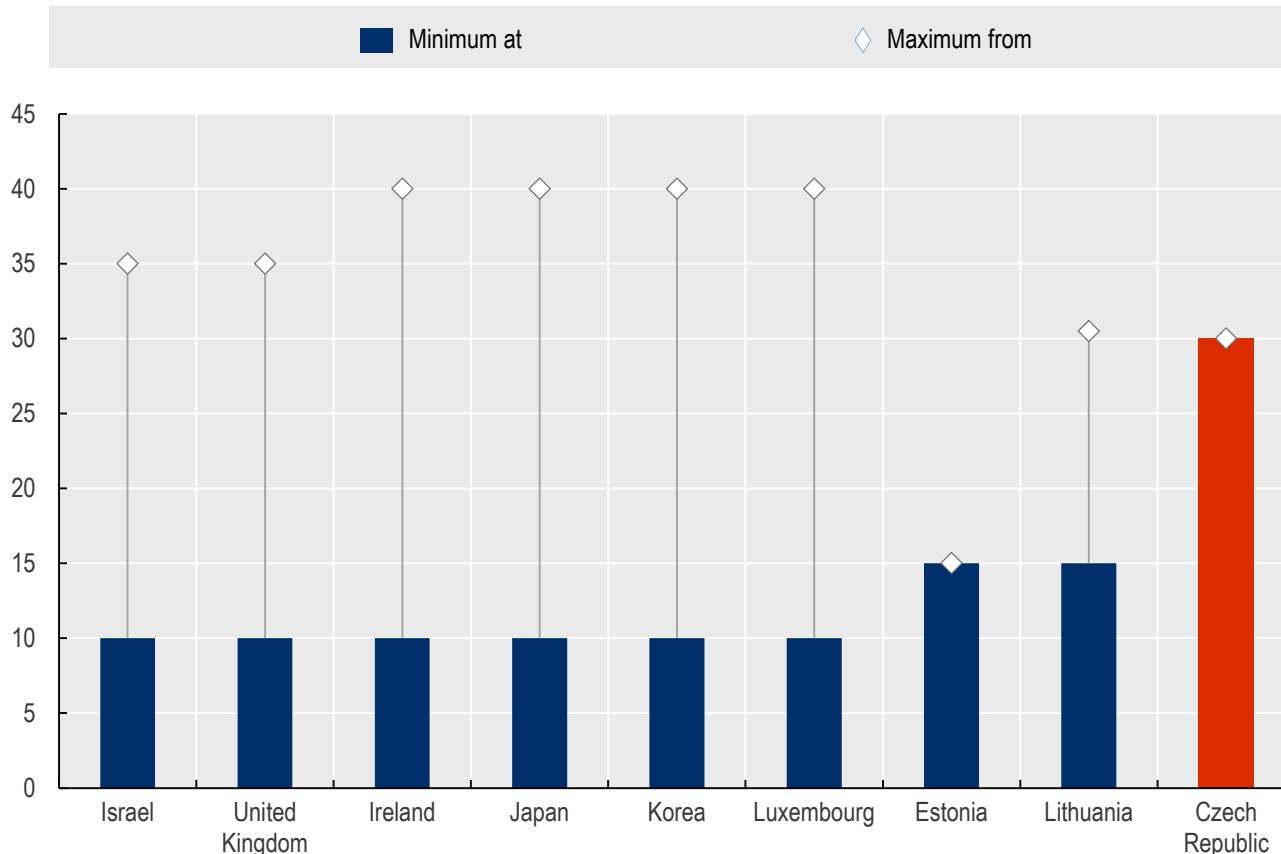
### **OECD Recommendation:**

- **Drastically reduce the minimum number of contribution years required to be eligible for old-age pension receipt**



# Basic pension level: No increase with number of contribution years

Contributory basic pensions: Numbers of contribution years required to receive the minimum respectively maximum benefit amounts



- **Minimum number of contribution years to receive a basic pension: High in the Czech Republic**
- **Number of contribution years to receive the maximum basic pension: Comparatively low in the Czech Republic (except Estonia)**

## *OECD Recommendations:*

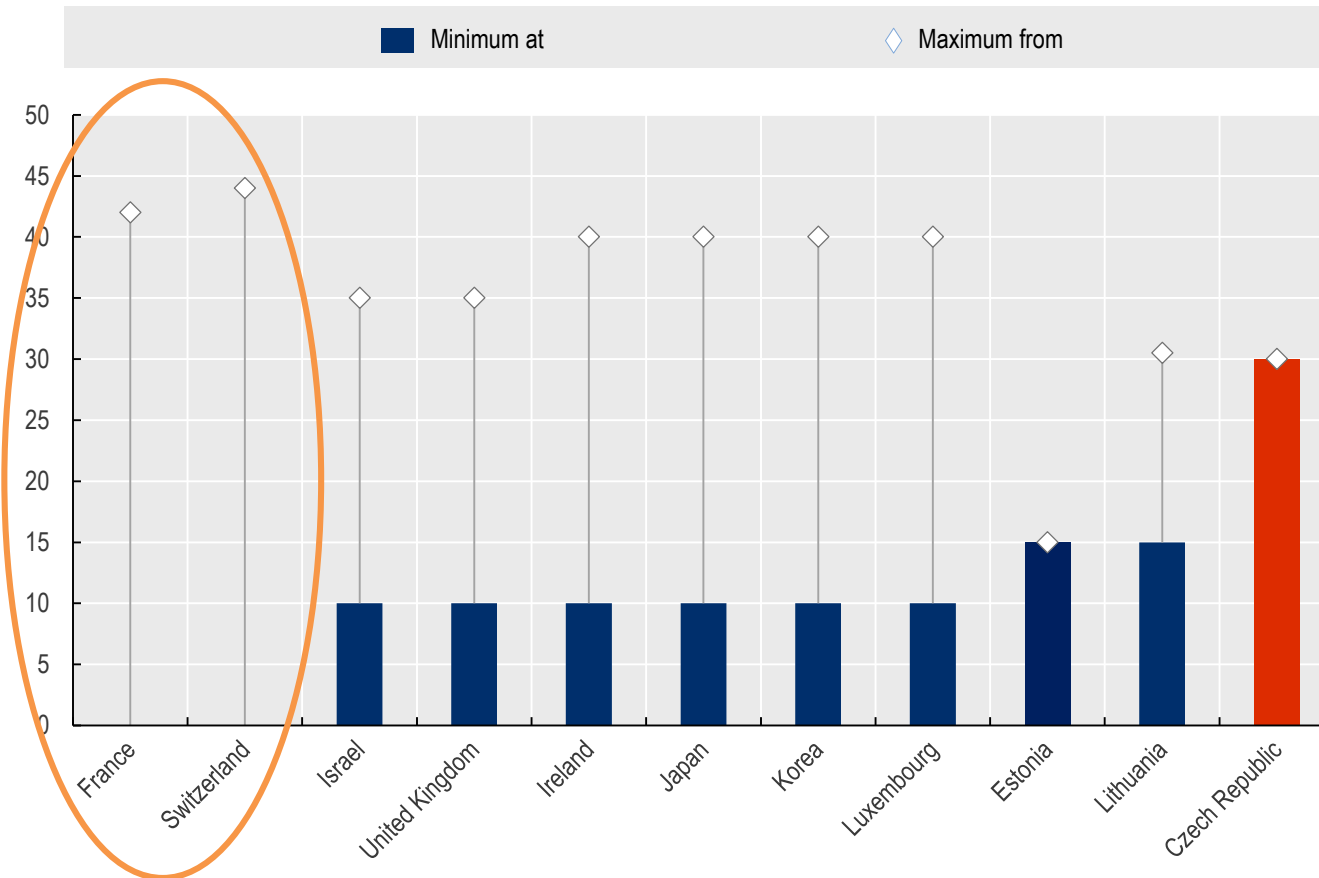
- **Drastically reduce the minimum number of contribution years required to be eligible for pension receipt**
- **Make basic pension proportional to validated period**

Source: Figure 3.8 and OECD (2019), Pensions at a Glance 2019 - country profiles. Data for United Kingdom refer to the new state pension. The indicated maximum in Switzerland applies to men while women need one year less.



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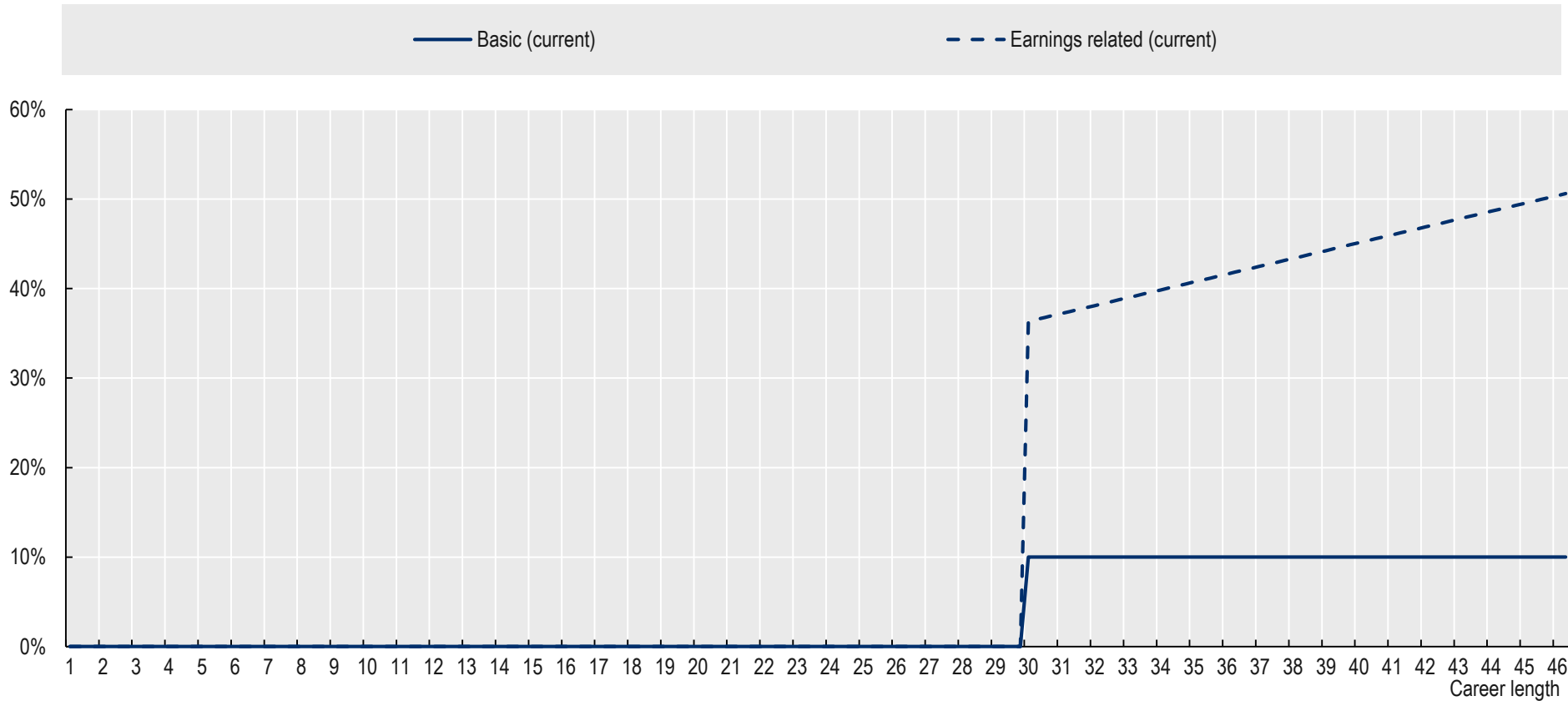
-> Example of countries that fully pro-rate their minimum pension: France, Switzerland

Source: Figure 3.8 and OECD (2019), Pensions at a Glance 2019 - country profiles. Data for United Kingdom refer to the new state pension. The indicated maximum in Switzerland applies to men while women need one year less.



# Policy option: pro-rated basic component in combination with accruals from the first year of contributions

Gross pension benefit (in % of average wage) by career length, for average earners at the statutory retirement age

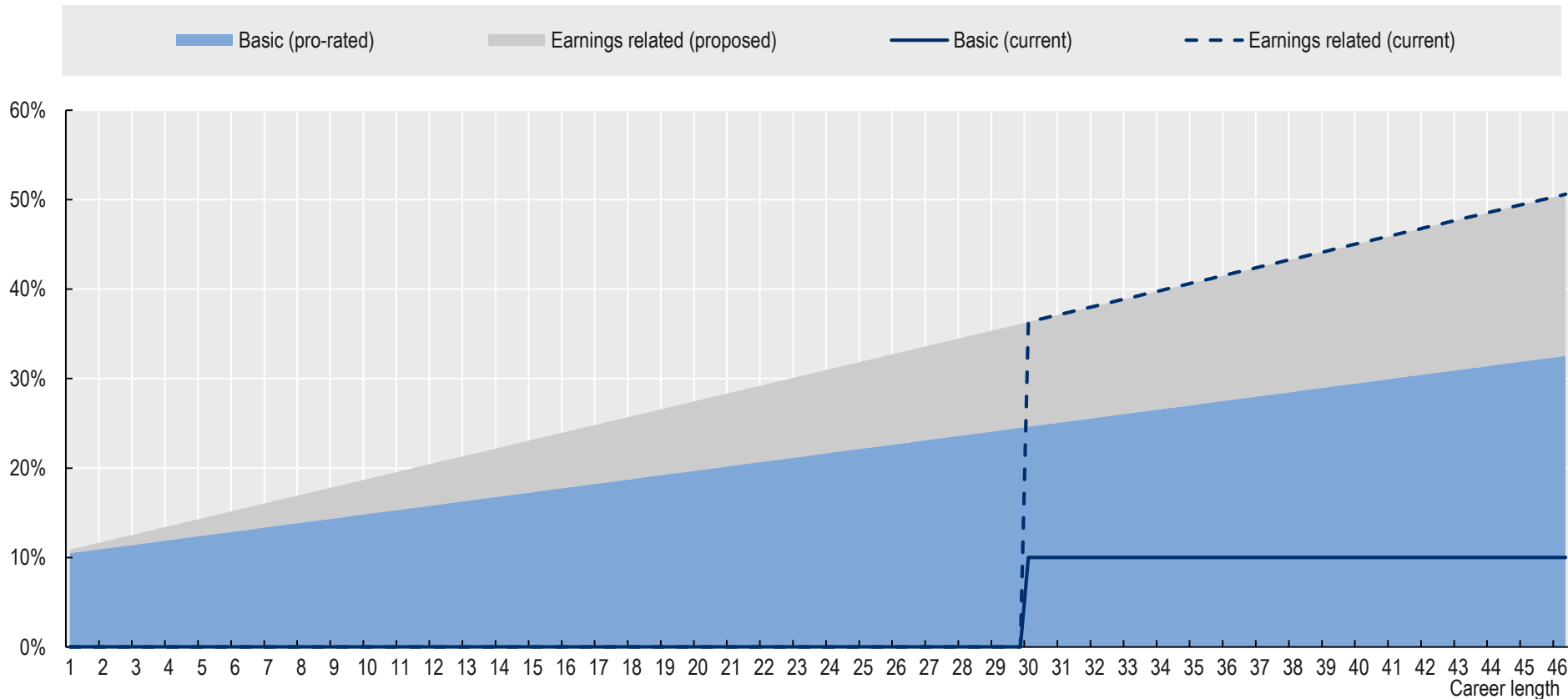


Source: Figure 1.32.



# Policy option: pro-rated basic component in combination with accruals from the first year of contributions

Gross pension benefit (in % of average wage) by career length, for average earners at the statutory retirement age



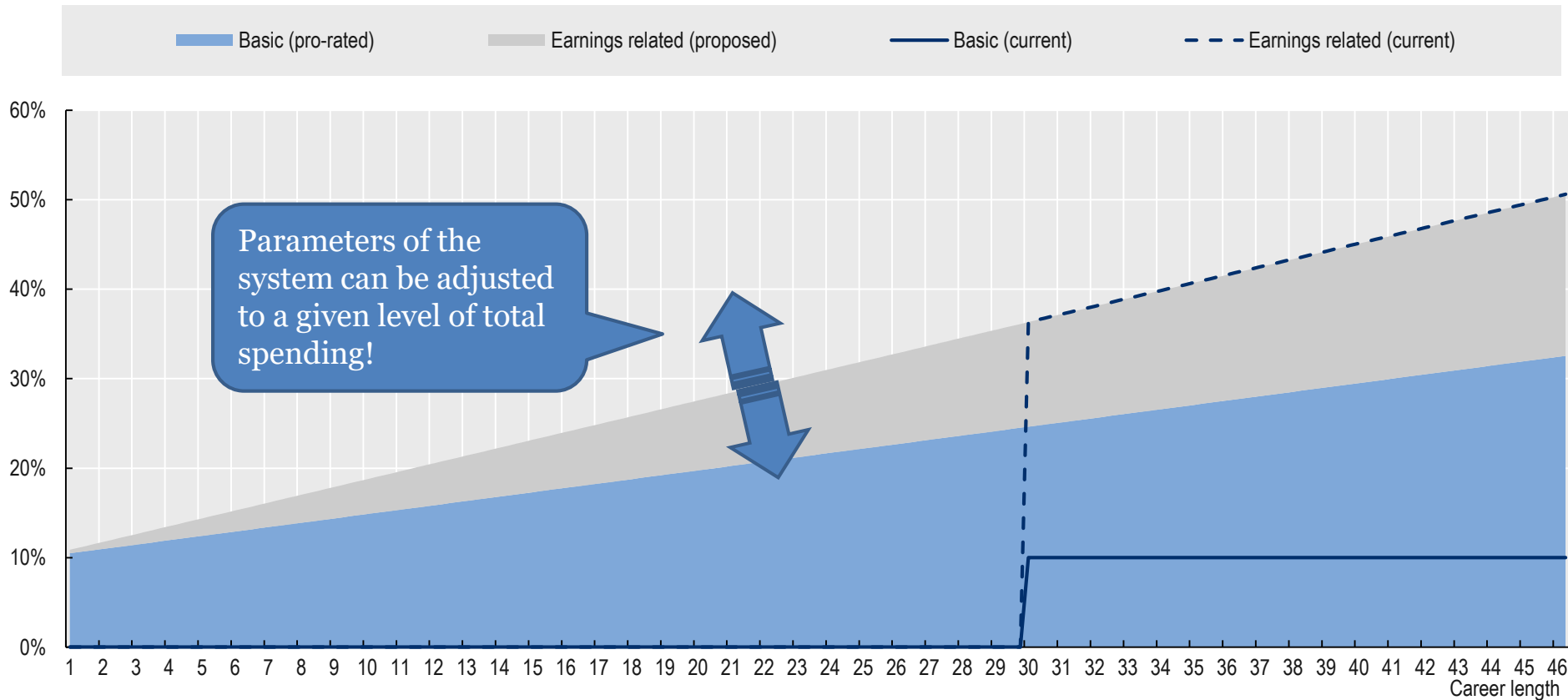
- **Can maintain similar benefits as those provided by the current system**
- **Provides benefits in line with contributions to the system**





# Policy option: pro-rated basic component in combination with accruals from the first year of contributions

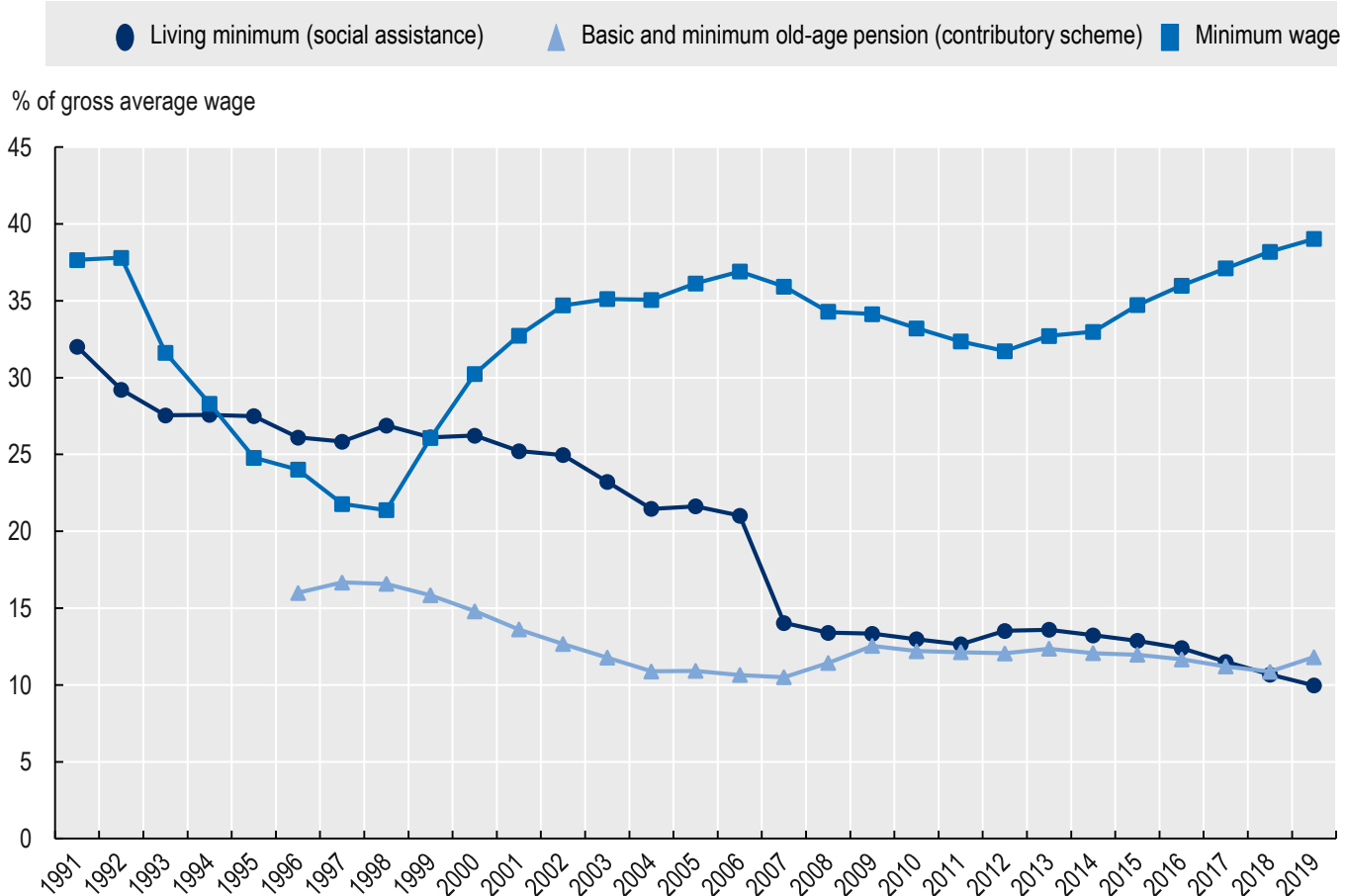
Gross pension benefit (in % of average wage) by career length, for average earners at the statutory retirement age



- **Can maintain similar benefits as those provided by the current system**
- **Provides benefits in line with contributions to the system**
- **Parameters can be adjusted to target a given level of total spending**



# Social assistance level (“living minimum”) has declined drastically in relative terms



Source: Figure 3.13.

- Living minimum is fixed in nominal terms
- It fell in real terms and declined sharply relative to wages
- It will lose relevance in the future if no change

## *OECD Recommendations:*

- Index the social assistance benefit level to nominal wage growth



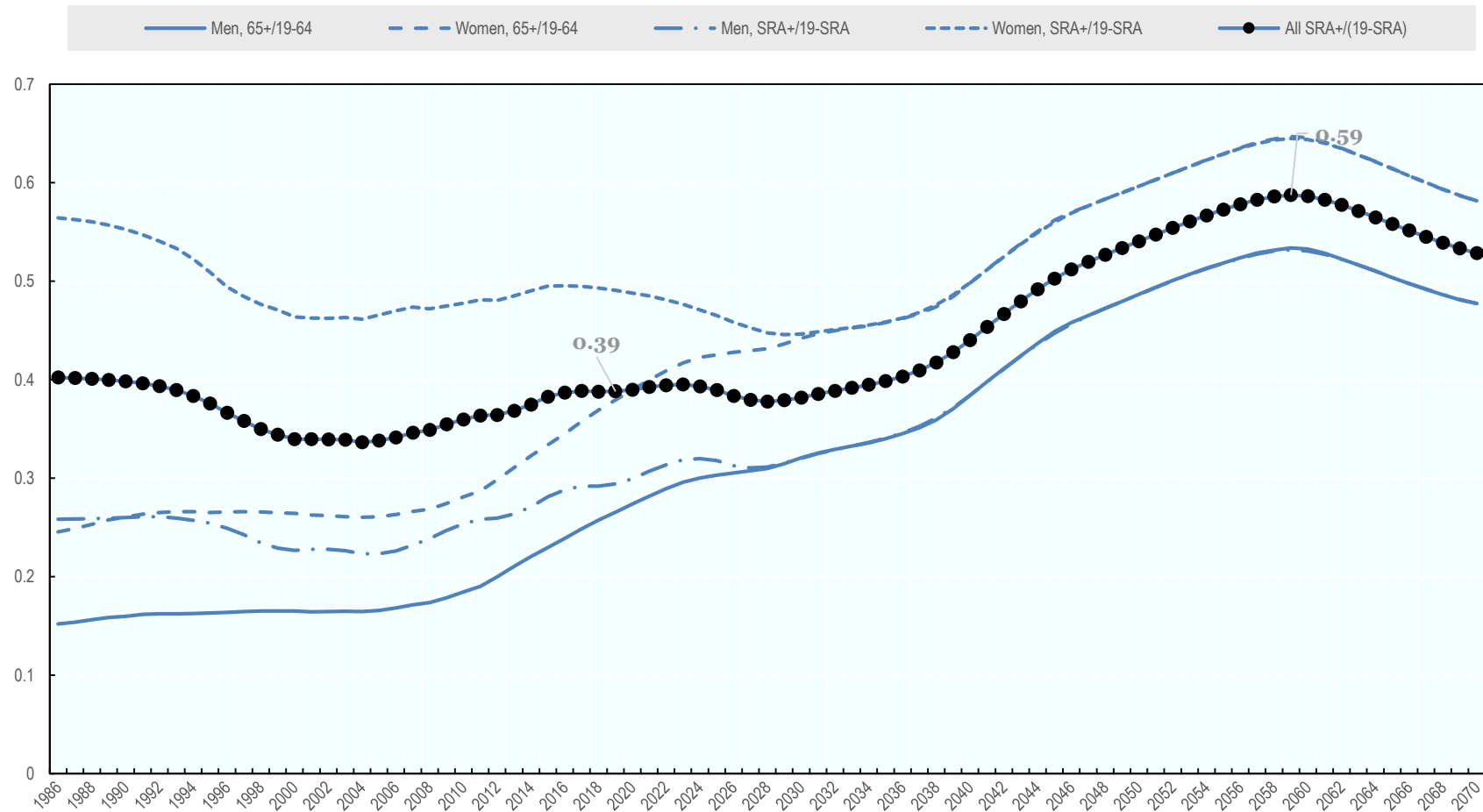
# Assessing the impacts of ageing on the fiscal sustainability of the the Czech pension system

*OECD Pension Review: Czech Republic,  
Chapter 2*

**Falilou Fall,**  
OECD Economics Department



# The old-age dependency ratio is increasing





## A framework to project pension schemes

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- **A cohort model to project**
  - Old-age pensions
  - Disability benefits
  - Survivor pensions
- **Coupled to a macroeconomic framework**
  - GDP projections based on:
    - Labour force demographics
    - Productivity
    - Unemployment

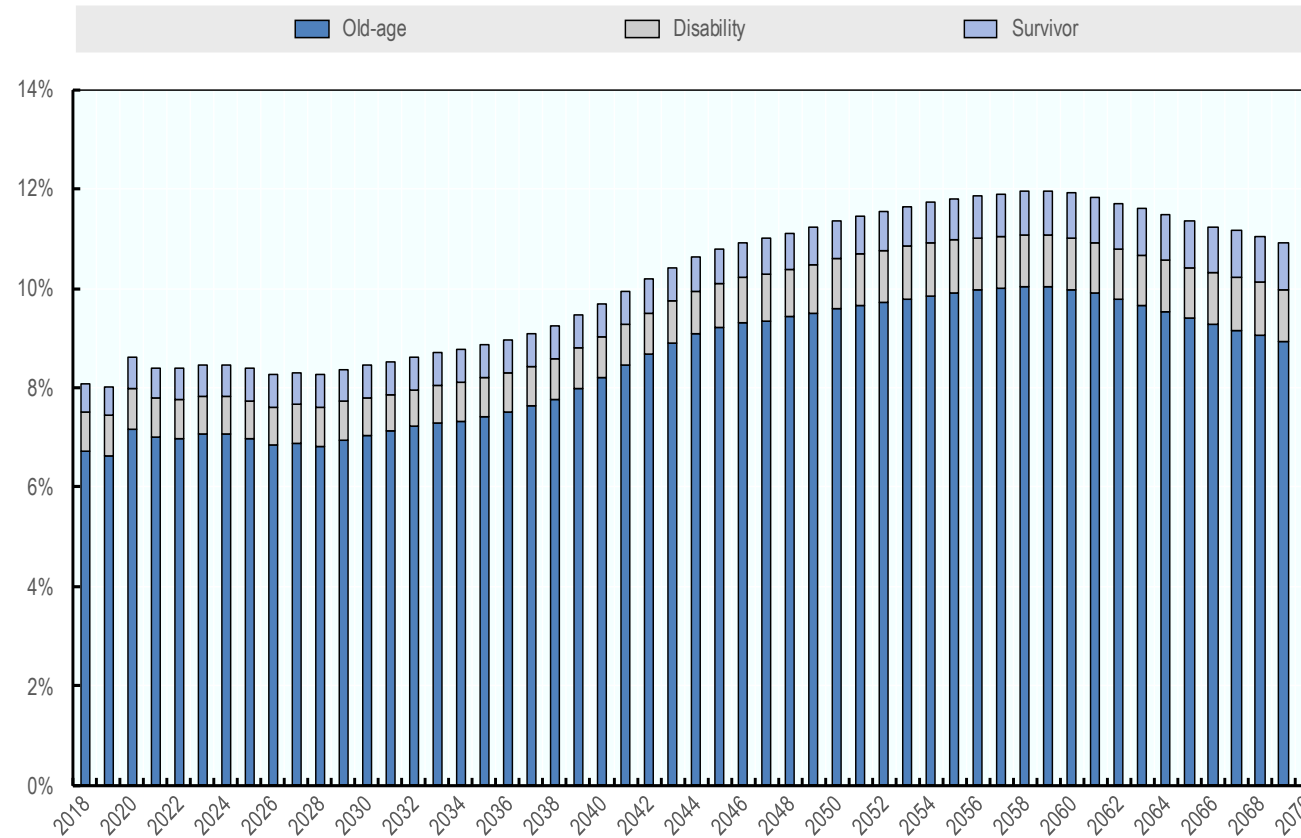


# A pension sampling framework

- **A representative sample of individuals**
  - Representative: 2100 weighted individuals for each cohorts, out of which 1000 natives by gender and 45 immigrants by gender, representing people arriving at age 19 to 64
  - Distribution of characteristics representative of the population through random draws: disability, participation, unemployment, wages, self-employment, and being widowed.
- **Allows taking into account:**
  - Education (3 levels)
  - Gender, including number of children
  - Non-linear factors such as thresholds for contributions and entitlements
- **Framework structured by macroeconomic assumptions**
  - Demographic projections
  - Labour participation
  - Unemployment and productivity assumptions
- **Distribution**
  - Distribution of validated contribution periods at statutory retirement age by birth cohort
  - Distribution of wages per year
  - Distribution of the number of children by generation and women
  - Distribution of pensions



# Projections of pension spending by schemes in percentage of GDP





# Comparing with EU projections

Percentage of GDP

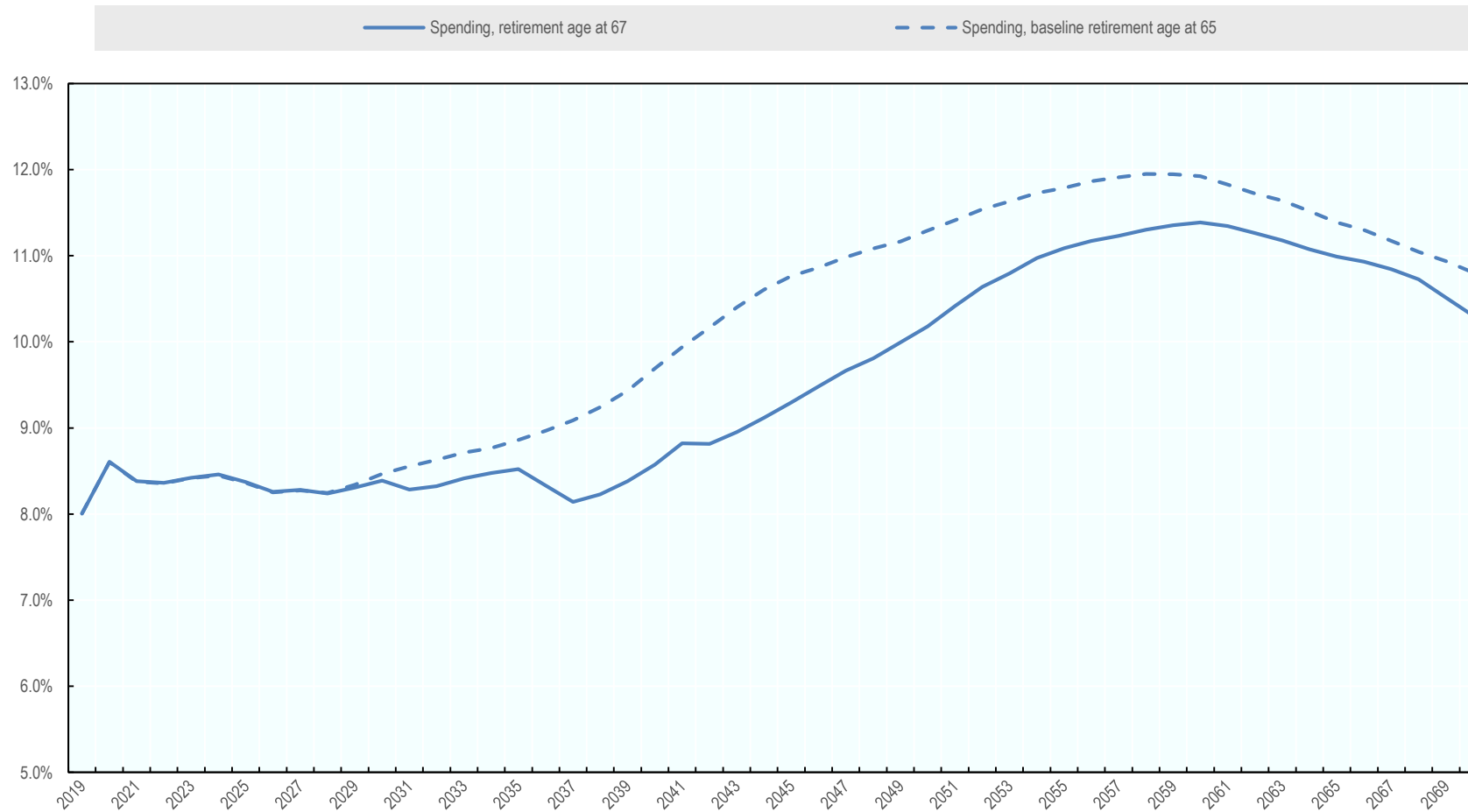
	2016	2020	2030	2040	2050	2060	2070
EU - Pension spending	8.2	8.1	8.2	9.2	10.8	11.6	10.9
OECD - Pension spending		8.6	8.4	9.6	11.3	11.9	10.8
EU old-age pensions	6.8	6.7	6.8	7.7	9.4	10.2	9.5
OECD old-age pensions		7.2	7.0	8.2	9.6	10.0	8.8





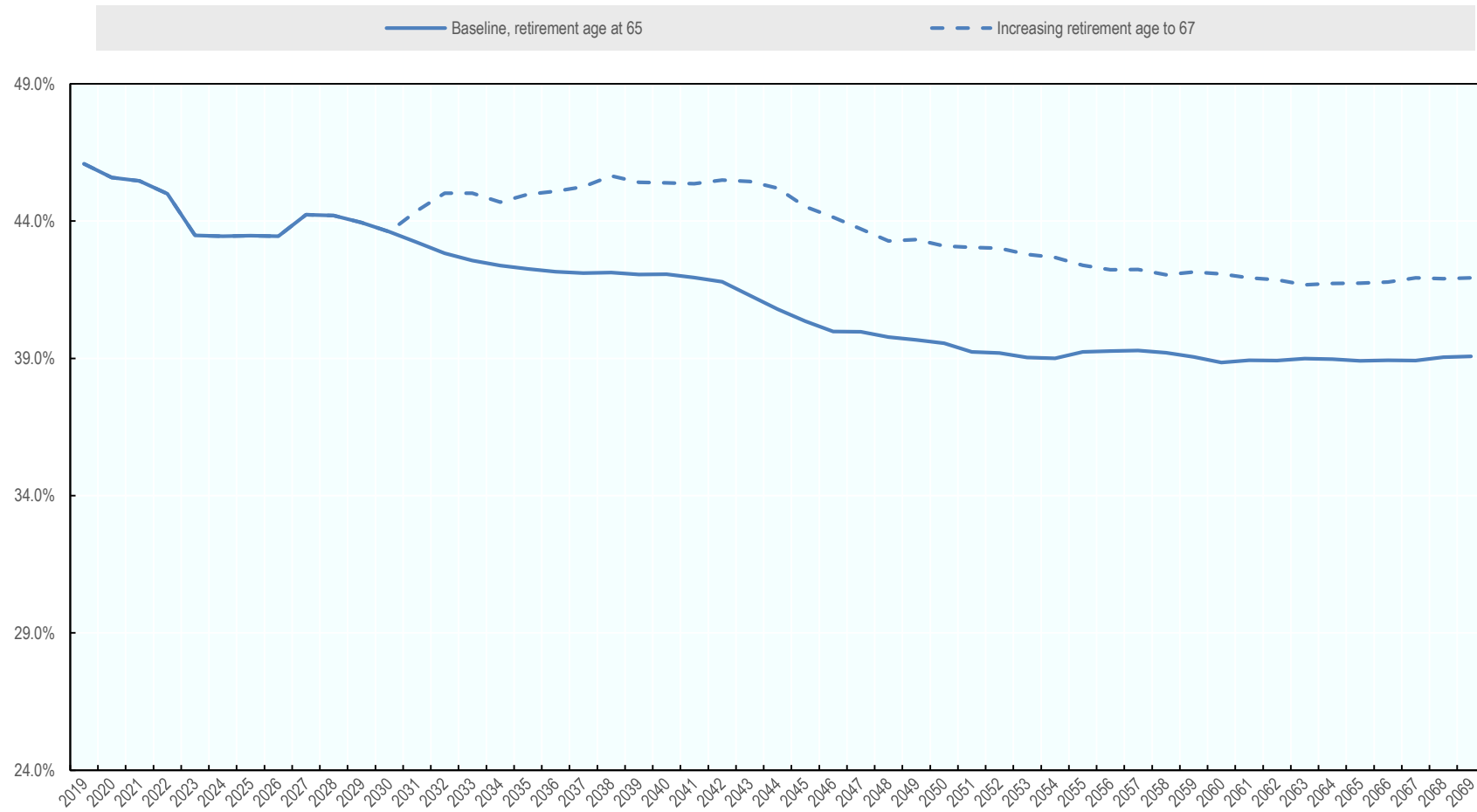
# Policy options

## Increasing retirement age to 67 from 2030



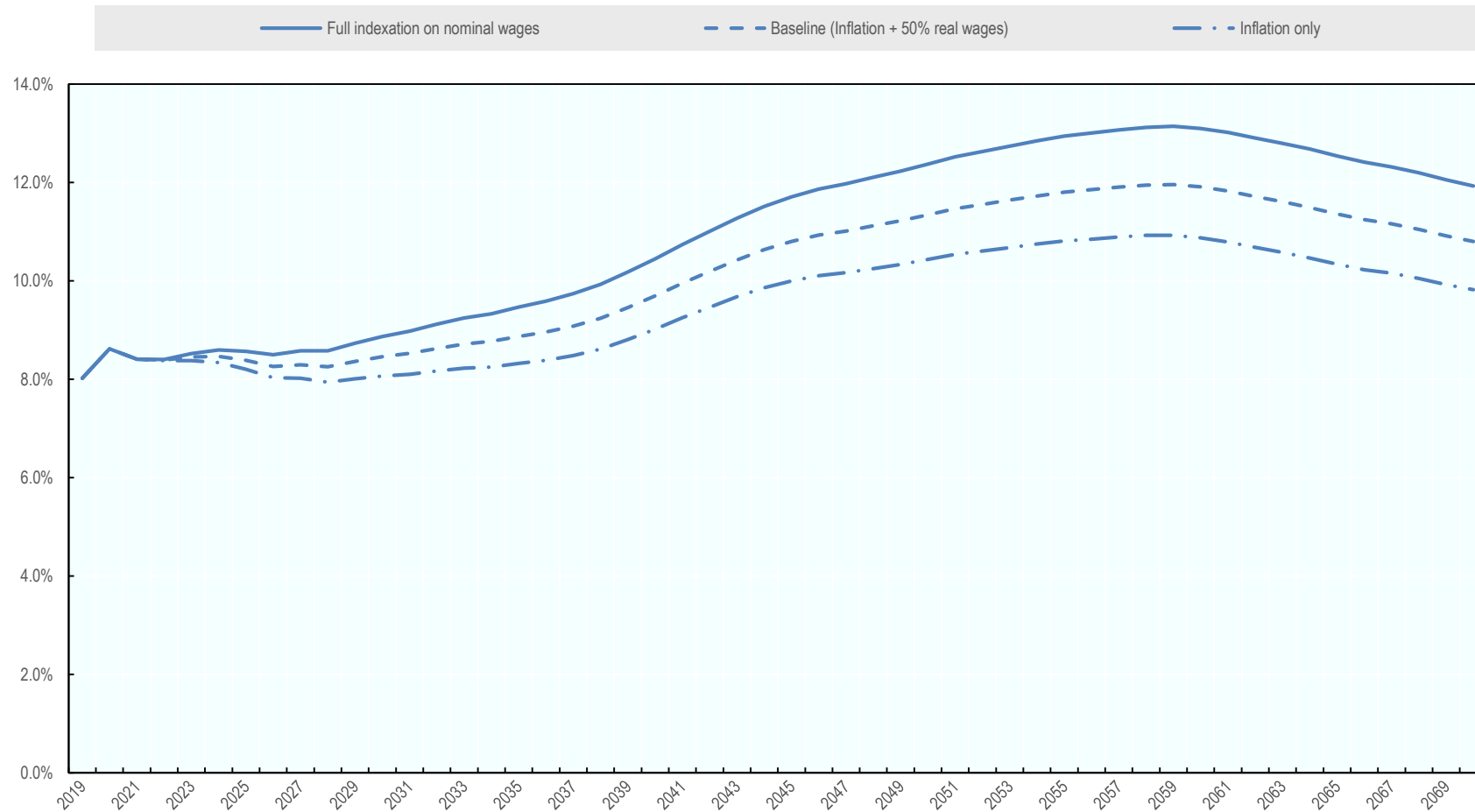


# The pension replacement rate increases with retirement age





# Indexation of pensions with inflation will reduce expenditures





# Comparing policy options

Policy options	Deficit at peak year (in pp)	Impact on employment (in percentage)	Impact on GDP (in percentage)	Other effects
Relaxing mandatory contribution period	+0.2	Marginal	Marginal	Bridge coverage of “unlucky” workers
Increase effective capital tax rate by 2.2 percentage points.	-0.5	-0.8	-1.7	Foreign capital losses are fully taken account, but are likely to be lower in practice, as transfer of production units abroad take time.
Increase self-employed effective contribution rate by 5 points	-0.2	-0.7	-0.8	Increase in fairness, increased tax evasion of self-employed
Increase SRA until 67	-0.7	+3	+3	Productivity losses, actual participation likely lower than projected
Old pensions indexed with inflation	-0.8	Limited	Limited	Impact on GDP likely negative but precise estimate would require much more complicated macroeconomic modelling with heterogeneous agents.



# VOLUNTARY FUNDED PENSION ARRANGEMENTS

## *OECD Pension Review: Czech Republic, Chapter 4*

**Stéphanie Payet,**  
OECD Directorate for Financial Affairs



## Main issues identified

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- Coverage is high for a voluntary system
  - 52% of the 15-64 participate, but <20% for the 20-24 and <40% for the 25-29
- Contribution levels are small
  - Average contributions by participants ~2% of national average wage
  - <25% of participants receive employer contributions
- Investment performance among the lowest in the OECD
  - Conservative investment strategies due to the annual non-negative return guarantee for 74% of participants
- Retirement benefits are low
  - Overall, only 4% of pensioners' income come from the supplementary pension schemes
  - Mostly lump sums payments
- Pension management companies compete through their distribution network, not on fees



## Strengthen the role of the funded system in the overall pension system

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- Introduce a new, occupational pension scheme or improve the design of the existing supplementary pension schemes
  1. Improve net performance
  2. Encourage higher contributions
  3. Lengthen contribution periods
  4. Extend the take-up of lifelong retirement income products



## Improve net performance

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- Encourage or nudge participants to switch to participating funds
- Promote the access to an appropriate default investment strategy, e.g. life-cycle
- Better align fees charged to participants with the costs incurred by the pension management companies
  - Analyse the cost of investing in different asset classes before increasing the fee cap for alternative funds
  - Apply a regressive scale for management fees to pass on economies of scale to participants as assets under management grow





## Encourage higher contributions

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- Redesign some elements of state financial incentives
  - Keep current structure but link the state contribution to the contribution rate, or
  - Change to a simple matching contribution
- Set up a mechanism where contributions increase automatically up to a pre-set maximum (easier with occupational plans)
- Promote employer contributions
- Provide information about expected benefits from the entire pension system



## Lengthen contribution periods

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- Increase the minimum savings period
- Consider introducing automatic enrolment into an occupational pension plan or a participating fund, with appropriate default contribution rates and investment strategies



## Extend the take-up of lifelong retirement income products

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- Discourage the full lump sum pay-out option
- Increase the attractiveness of life annuities through additional product features (e.g. guaranteed period, survivor option, or profit sharing)
- Establish clear rules to build appropriate mortality tables including future improvements in mortality and life expectancy, and check that providers of retirement income products apply these rules properly



OECD Pensions Outlook 2018

# Contact



Pensions at a Glance 2019

## OECD Pension Reviews

[herve.boulhol@oecd.org](mailto:herve.boulhol@oecd.org)

[falilou.fall@oecd.org](mailto:falilou.fall@oecd.org)

[christian.geppert@oecd.org](mailto:christian.geppert@oecd.org)

[stephanie.payet@oecd.org](mailto:stephanie.payet@oecd.org)

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