The Impact of Labour Markets on Economic Dependency Ratios and on Pension Adequacy and Sustainability

The rationale of the webinar and the expert study in the framework of the ETUC SociAll project

1. Introduction

For many years, in the context of ageing populations, the public debate on the long-term financial viability of pension systems has been largely based on purely demographic arguments. Future shifts of the so-called old-age-dependency ratio, defined as the number of older people in relation to the number of people of working age, are frequently (mis)interpreted in terms of changes in the relationship between benefit recipients and contributors. From this was usually deduced that the only answer to the issue of sustainability is to raise the retirement age.

However, apart from the age structure and the (effective) retirement age, the employment integration – in both quantitative and qualitative terms – of those of working age have a huge impact, too. Economic dependency ratios, i.e. the ratio between those effectively paying into social insurance (here: pension) systems and those benefiting from them, are critical. Therefore, demographic trends and labour market aspects need to be considered jointly when assessing the impact of population ageing. The crucial question is the extent to which the ageing of the populations will translate into an increase of those who are economically dependent (i.e. in receipt of transfer payments) relative to those who are economically active.

The webinar and the relative study that will be issued shortly after will allow to focus and examine those groups that are currently not sufficiently integrated or not at all integrated in the labour market. Subsequently, proposals for policy action necessary to increase the employment participation of these groups. In a further step, the potential of an integrated strategy of "upward convergence" and "more and better jobs" will be calculated, vis-à-vis the need to contain the future increase of the "economic dependency ratio", as defined in the EU Commission's White Paper on Pensions (pensioners + unemployed / people in employment) against the background of population ageing. Finally, conclusions will be drawn on the impact of better employment integration on both pension adequacy and financial sustainability.

2. Content of the study

Almost all existing old-age protection systems in EU Member States are closely connected to the labour market. Except for flat-rate state schemes, such as applying to the state pension of the Netherlands, both the entitlements to pensions and the level of individual pension benefits are closely linked to preceding employment careers, via duration of employment, level of earnings, amount of contributions paid, etc. In parallel, the financing of pensions is primarily, or even exclusively, based on earnings through employment, be it directly via the paying of earnings-related contributions or, as far as systems are (co)financed by taxes, more indirectly via contributing to state revenue by paying income tax. Thus, the quantity and quality of jobs are key parameters needed for pension systems to function, both for today's and tomorrow's pensions and both in public and occupational schemes. Nevertheless, there are remarkable variations across EU Member States on how employment impacts on pensions both within and between generations. In this webinar, the impact of good/bad employment integration on the old-age protection of individuals (coverage, adequacy), and on the overall financial sustainability of pension systems will be described with the aid of country examples.

3. **Policy Action needed in order to improve employment integration**

The analysis will focus on shortcomings both in quantity and quality of employment integration. Issues of non-existent or insufficient access to gainful employment are in the centre. Particular attention will be paid to five mostly affected groups (unemployed, underemployed, short-term employed, discouraged job seekers and job seekers not immediately available for a job, precarious forms of self-employment and uninsured employment), examined also in the gender-specific differences.

In this context, the significance of key labour markets indicators such as employment and unemployment rate will be critically scrutinized and, as far as data availability permits, estimates will be provided of the above-mentioned categories of workers whose status raises concerns for pension adequacy and sustainability.

Based on the above-mentioned findings, policy measures focussing on existing labour market shortcomings are presented and discussed, ranging from labour market policy measures to overall macro-policy orientations. Particular attention will therefore be paid to EU policy instruments. The potential of measures such as the SURE programme that supports Member States' short time working schemes and the European Recovery and Resilience Fund will be examined. Attention will be drawn to the relevance of the macroeconomic policy framework generally, which is currently under review. The pressures on public budgets in general, including pension systems, is partly a reflection of more fundamental failings of macroeconomic management within the euro area.

4. **Calculating the potential of a strategy of "upward convergence" for containing the future increase of the "economic dependency ratio" against the background of population ageing**

For the EU 27 and some selected EU Member States two scenarios of the future development of the economic dependency ratio (pensioners + unemployed relative to people in employment / EU White Paper on Pensions) will be calculated for the period 2019-2050-2070: 1. Standard (no-policy-change) scenario, calculated based on the projections in the EU Commission's Ageing Report 2021 and Ageing Report 2018; 2. High Employment scenario, based on the same demographic projections (Ageing Report 2021) but assuming that until 2070, the 2019 values of the best performing countries will be achieved.

By contrasting the future development of the key "dependency ratios" used so far in the pension context ("old-age dependency ratio", "economic old-age dependency ratio"), the two scenarios will show the tremendous impact of good/bad labour market integration of those of working age on pension sustainability.

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Thus, it will be demonstrated that the key “dependency” indicators used in the Commission’s Ageing Reports have very limited explanatory power in this context. Furthermore, with regard to the ageing challenge, the key importance of an integrated strategy of “upward convergence” will be proved.

5. Context of the ETUC SociAll project

Changes in the labour market and in the demographic situation have put social protection systems across Europe under pressure. The evolutions in the world of work de facto hamper the capacity of workers to accrue the entitlements that are necessary to grant them effective and adequate pensions. Many national social protection systems are not appropriately equipped to face the challenges generated by the proliferations of atypical and non-standard forms of work and employment. The risk is high to perpetuate and increase inequalities in both formal and effective access to pension rights. Moreover, the increased complexity of national pension systems (articulated in different pillars and schemes) can add further problems to the effectiveness and adequacy of pensions for a huge rate of the European population.

The current reality would determine the necessity for growing groups of the workforce to take recourse to tax-funded safety nets of last resort in case of social risk, while the number of people contributing to social protection seems to be proportionately smaller.

However, in the framework of the European Economic Governance and the European Semester, the fiscal sustainability of public expenditure results has been prioritised over the need of inclusiveness, adequacy and effectiveness. The priority of fiscal coordination, especially in the Eurozone, has impacted the margin of manouver for national budgets to ensure universal coverage and adequacy of pensions. Many MS have dramatically reduced to the social assistance budget. Pension systems have been progressively reformed, under the pressure of the Country Specific Recommendations, shifting towards defined contribution and fully funded logics, whereas redistributive systems are considered as not sustainable any longer, because of the ageing of the population in Europe.

The ETUC calls for a greater coherence developed between the right-based approach prescribed by the EPSR and the indications provided in the framework of the European Economic Governance. Considering the current economic, labour market and employment situation, the project also investigates possible reforms that could foster greater fiscal sustainability of adequate pension systems. It does so by proposing an integrated approach to equal opportunities, quality jobs, employment conditions and social protection rights, in the belief that such approach could determine a more balanced pension policy between fiscal sustainability and social rights priorities.

6. Context of the expert study

In the long run, issues of access, effectiveness and adequacy of pensions put the social and economic sustainability of national social protection systems at stake, especially given the current employment and demographic trends. Unequal, ineffective access to and lack of adequacy of pensions in particular deserve great attention within the European Economic Governance framework.

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The EU must engage for the adequacy of sustainable pensions for all. In this view, an ambitious implementation of the Recommendation on access to social protection and reform the national pension systems is all the more necessary. In advocating these positions, the ETUC confirms, also in the light of the developments of the SociAll project so far, the importance of adopting a comprehensive and integrated approach, that takes into due consideration the potential of the labour market to ensure the accrual of effective and adequate benefits and to contribute to their fiscal sustainability.

In the past decade, the demographic trends have been considered as the main (and only) determinants of the increase of the "Costs of Ageing". The fiscal projections up to 2030-2070 foresee the necessity to keep the public pension expenditure as stable to ensure the fiscal sustainability of public budget given the demographic challenge posed by the ageing population. Despite the massive population ageing all across Europe, this approach requires not to engage further public resources in public pensions (on which most of EU retirees can rely), but rather to increase the legal retirement age across the member states – or to reduce their adequacy, or at least to find alternative – and uncertain – strategies to try to ensure it. De facto, the responsibility to ensure the right to adequate pensions of an ageing population would shift from MS and national governments towards the individuals. Such trend, confirmed by the approach of the 2018 Pension Adequacy Report, inter alia, is confirmed by the proliferation of national reforms and EU initiatives aimed at the privatisation and the marketisation of pensions that have proliferated in the recent years.

The fiscal sustainability discourse sketched above is based on the assumption that the huge potential of raising employment rates and improving employment quality will remain unused in the next decades. However, it fails in recognising the reality of the world of work, which shows huge gaps between the legal retirement age (higher and higher) and the effective retirement age (stable and even lower in time). The fiscal approach thus fails to address the importance of working and employment conditions to support the sustainability of adequate pensions.

Too focused on the purely demographic data, such as the old age dependency ratio, the Economic Governance approach does not consider enough the potential of improving labour market integration across all working ages and of 'more and better jobs' on containing the future increase of the economic dependency ratio5 - and its contribution to the sustainability of adequate systems. On the contrary, the efficiency of the labor market to provide fair remuneration, career continuity, quality employment, fair social contributions… should both allow individuals the accrual of adequate pension entitlements via their work and improve the overall sustainability of pension systems.

The European Pillar of Social Rights, proposing principles for upward convergence based on social rights suggests a strong interrelation between the rights in the world of work and employment and the fulfilment of the social protection rights. Such an approach is not a novelty in the EU pension policy discourse, addressed by many pieces of research6 as well as the White Paper on Pensions of 20127, amongst other EU documents.

The ETUC believes that investments in boosting a more equal, efficient and highly inclusive labour market, able to guarantee quality jobs and fair working conditions to the EU working-age population, represents the major guarantee for ensuring both the adequacy, the effectiveness and the fiscal

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sustainability of pension systems. Such an approach would also make more public and tax-based resources available to fuel public safety-nets for those in need.

7. The Current economic and financial outlook and the Covid pandemic impact

However, creating jobs is one of the most challenging tasks ever. COVID-19 adds new challenges. The ILO forecast unemployment for 140 million people with the risk to have 340 million jobs losses after a pandemic second wave. The GDP will sure rebound, however a job-rich recovery requires economic transformation otherwise the risk is to have growth without jobs, as is already happening. It implies moves to high added value productions, people movements, especially from rural to urban area. Labour demand moves toward new skilled jobs, triggering a transition toward better remunerated jobs. More productivity is sought for higher wages and good jobs.

The pandemic context imposes to propose new paths for a job-rich recovery, that may begin with the implementation of the Recovery and Resilience Facility plans and the injection of EU funds in the framework of the New Generation EU. The ETUC priority is in fact “A People’s Recovery”, and it would be important to understand how the focus on the labour market as suggested in this policy vision can also positively impact the pension policy.

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