Summary for non-specialists
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Assessing the economic and budgetary impact of linking retirement ages and pension benefits to increases in longevity

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Policy makers need to ensure long-term fiscal sustainability in the face of large demographic challenges as well as significant economic uncertainty in the wake of the financial and economic crisis. In this context, especially public pension expenditures represent a challenge for public finances. A majority of Member States have adapted pension systems so as to put them on a more sustainable footing and enable them to weather the demographic changes that are set to take hold. However, further reforms are in many cases necessary.

This paper focuses on potential public pension expenditure, pension adequacy and fiscal sustainability effects when linking retirement ages and pension benefits with future increases in longevity. The analysis of the fiscal impact of a link of retirement ages to gains in life expectancy suggests that both the sustainability as well as the adequacy of pension systems can increase by such a policy approach. Simulation results show that the expected increases in public pension expenditures as a share of GDP could almost be halved, when fully linking retirement ages to life expectancy gains in the future. The expected decrease in the benefit ratio due to recent pension reforms could be diminished, based on a longer contributory period and higher accrued pension rights.

Even higher reductions in future pension spending would materialize with a rule that links pension benefits to longevity gains without adapting statutory retirement ages. In the simulations for such a scenario, the projected increase in pension expenditure as a share of GDP could be reduced by as much as two thirds relative to the 2012 Ageing Report results. However, if people do not extend their working lives in order to maintain the level of pension benefits, serious adequacy problems may arise.

Under the assumptions of a convergence of all Member States to the EU average lifetime spent in retirement in the year 2010, the projected pension expenditure increase due to population ageing could even be more contained over the long-run in the EU as a whole.

In most of the scenarios – and especially when taking into account increases in pension entitlements due to longer working lives – to fully stabilize public pension expenditures, further reform measures on top of a retirement age or pension benefit link to gains in life expectancy need to be considered in most Member States. This therefore entails further changes in eligibility and generosity of different (early) retirement options.