INEQUALITY IN LIFE EXPECTANCY AND PENSIONS

Navigating the future: challenges and opportunities of longevity in Europe
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Inequality in life expectancy and pensions : distinguishing the static from the dynamic analysis

- Static: Regressive features of differences in life expectancy

- Static: Gender dimension

- Dynamic: very different question as the demographic context matters greatly

Increasing the retirement age (regressive) as a response to longevity gains (progressive)

Static:
Regressive features of differences in life expectancy

In essence, pension systems redistribute from those who die early to those who live long: insurance mechanism against longevity risks

Problem: strong socio-economic pattern of differences in life expectancy, resulting *all else equal* in a redistribution from low-income to high-income pensioners

<u>Illustration:</u>

- Assume remaining life expectancy at 65 is equal to:

17 years for a low-income group and 20 years for a high-income group

- **Static life-expectancy effect of 15%** (=(17-20)/20), detrimental to the low-income group on top of lower monthly pensions

Static effect: How to deal with it?

- Very tricky: difficult to differentiate retirement ages by socio-economic groups

- Elephant in the room: gender differences in life expectancy

- Mistargeting of sectoral retirement-age rules / long-career schemes

- Pension schemes for arduous and hazardous work

This strengthens the case for redistributive pension instruments:

- provides higher replacement rates to workers with low income

- can be articulated with flexible retirement to e.g. provide similar replacement rates for low-income groups but accessible a few years earlier

Dynamic:
(small) regressive impact of raising the retirement age

- Raising the retirement age by e.g. one year means more for people with lower remaining life expectancy

- *Illustration: raising the retirement age from 65 to 66*

assume that remaining life expectancy for the low-income group diminishes as a result from 17 to 16 years and for high-income group from 20 to 19 years

The regressive effect increases **from 15.0% (=3/20) to 15.8% (=3/19)**, hence a 0.8 percentage point increase

Dynamic:
Dealing with old-age life-expectancy gains

- Calls to raise retirement ages are not made in a static environment but typically to accompany longer lives: broadly shared life-expectancy gains are progressive

- *Illustration: assume remaining life expectancy at age 65 increases by one year for all*

From 17 to 18 years the low-income group and from 20 to 21 years for the high-income group

The regressive effect diminishes **from 15.0% (=3/20) to 14.3% (=3/19)**

- Raising the retirement age from 65 to 66 to accompany health improvements moves the effect back to **15.0%** (even when passing on 100% of life expectancy gains into the retirement age)

- What is key to deal with increases in longevity (dynamic) is ***how inequality in life expectancy changes over time***

- No consistent cross-country evidence of increasing life-expectancy inequality

Summary

- Inequality in life expectancy is a very serious issue for pension systems

- Difficult to tackle it and to differentiate retirement ages across population groups

- Taking into account the gender dimension even complicates this further

- This strengthens the case for redistribution within pension formulae or for redistributive instruments more generally

- But dealing with longevity gains is a very different question

- Raising retirement ages to deal with old-age life-expectancy gains remains a valid policy response, at least to the extent that inequality in life expectancy does not increase

THANK YOU !

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