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Pensions in the age of Covid-19: recent changes and future challenges

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Policy recommendations

– Policymakers and stakeholders should address both financial sustainability and adequacy issues in pensions. The latter are crucial to prevent the economic recession from becoming a social crisis for the elderly.
– Reforms should address social and occupational groups that are the most at risk of suffering the economic and social consequences of the pandemic, namely atypical and self-employed workers, and women. These groups are already the target of the EPSR, and the EU should aim to provide effective old-age protection for them all.
– Policymakers and stakeholders currently see a window of opportunity to reframe reform priorities and address problems of pension adequacy in a social context that is marked by a huge recession and labour market challenges.
– Practitioners and experts should avoid referring to the oversimplified intergenerational cleavage that pits young and older generation against each other.

Introduction

This paper sheds light on pension policy in Europe in the aftermath of the Covid-19 pandemic by exploring both the short-term effects and the longer-term challenges. What has the impact of the pandemic been on old-age protection? What measures have been taken by EU Member States in the aftermath of the crisis? And what will the expected challenges be to pension policy and politics? In what follows, I address these questions and outline a three-step strategy.

Part One provides a summary of the main policy measures passed in the wake of the pandemic. These emergency measures had two primary goals: to improve old-age protection for those most at risk; and to reduce the weight of social contributions on employers' and employees' incomes. In parallel, some broad reforms that were at the top of the agenda were either shelved or postponed.

Part Two considers the longer-term challenges to pension systems. The financial viability of all pension schemes, whether of a public or private nature, and whatever their financing method (PAYG – 'pay as you go' – or fully funded), is at risk from the consequences of the pandemic (economic recession, increased unemployment, and the future potential stress on financial markets). The adequacy of old-age protection could also suffer as a consequence of the recession and of problems in labour markets (job loss, in-work poverty, etc.) and financial markets (poor performance of financial products, persistent low interest rates, etc.).

Part Three lists a number of potential effects of Covid-19 on the politics of pensions. The post-pandemic political debate is characterised by three main positions. First, we have international organisations such as the International Monetary Fund (IMF) that persist in stressing the long-term risk of ageing populations and its impact on pension systems. Such a risk has been aggravated by the pandemic. Second, we have policy- and opinion-makers who are declaring the need for a break with austerity and for more public debt. Yet, in countries with high levels of public debt and of pension spending, some commentators are proposing to cut current expenses while increasing public investments. The third

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position is represented by some international organisations (such as the International Labor Organisation, ILO, and the International Social Security Association, ISSA) and national policymakers and stakeholders that are more concerned by the challenges to the adequacy of pensions. Here, the focus is on certain occupational and social groups that had already been affected by labour market reforms and austerity before being hit by the pandemic and the consequent economic slowdown. Actors in this third group emphasise the need to increase old-age protection.

All in all, this paper stresses that pension policy is not safe from the potentially dramatic consequences of the pandemic. But in terms of pension politics, the pandemic also represents a window of opportunity to rethink the political debate on the future reform agenda.

The policy changes passed so far

In what follows we provide some examples of the key measures taken in the pension field in the aftermath of the pandemic, with information and data collected from ISSA's Covid-19 repository[1]; the Organisation for Economic Co-operation and Development[2] (2020) and IMF[3] (2020) datasets; and the European Social Policy Network[4] (2020). International datasets provide evidence of four types of intervention.

The first type of measure involves deferred payment or temporary reduction of social security (and pension) contributions. For example, in Finland, measures include lower pension contributions for 2020. Employers' earnings-related pension contributions have been temporarily lowered by around two per cent (until the end of the year). Businesses whose operations have stopped completely due to the epidemic can postpone the payment of their earnings-related pension contributions by up to three months. The loss will be compensated by raising employer contributions in 2022–2025. At the same time, pension funds may postpone the payment of pension premiums by employers and self-employed individuals by up to three months.

In Slovenia, all employer contributions towards temporarily laid-off employees were suspended up to May 2020, with the possibility to further extend this suspension. The state instead took the responsibility of paying the contributions, to preserve the insured persons' rights. Self-employed workers were also exempted from the payment of contributions (up to May 2020).

In Spain, contribution deferment and/or temporary exemption have been conditional on retaining workers in paid employment, although with reduced working hours and wages. Exemptions are more generous for companies that reinstate part of their staff. Employers who temporarily reduce employees' working hours or suspend work contracts are exempt from paying all or part of their social security contributions. The government covers 100 per cent of these contributions for employers with less than 50 employees, and 75 per cent for those with 50 or more employees. In order to avoid possible cash-flow problems for the self-employed and small and medium-sized enterprises, the government decided to offer tax deferrals for a period of six months and provide subsidies. This is expected to allow up to 14 billion euros of liquidity to be injected into this area of economic activity. In other countries, governments also decided to suspend contribution payments for private pension funds (see the cases of Estonia and Poland, ISSA 2020).

The second type of measure consists of additional resources contributed through the public purse in order to stabilise the pension system. In Germany, the government decided on a cash injection of 5.3 billion euros in 2020 and additional funds in 2021 in its social security budget. This should help both companies and employees by keeping their social contributions below the 40 per cent income threshold. In France, as well as suspending the envisaged major pension reforms due to the pandemic (see below), it was agreed that the French Pension Reserve Fund (FRR) would pay at least an additional 13 billion euros to help finance state pensions (Sutcliffe 2020).

The third type of measure consists of the improvement of pension benefits. This is the case in Slovenia, where pensioners with the lowest pensions have received a solidarity bonus due to the impact of the pandemic.[5] Lithuania also introduced a special bonus in the form of a lump sum of 200 euros to elderly people, disabled people, survivors and orphans. In Bulgaria, all medical certificates determining the degree of lost working capacity which expired during the period of the state of emergency and have to be renewed, were automatically renewed for the whole period of the state of emergency, and for two more months after that. About 75,000 disability pensioners benefited from this measure. Meanwhile, Hungary passed new measures that include the introduction of a 'thirteenth month' (an extra month of benefits for pensioners).

The fourth type of intervention consists of a temporary postponement of broad reforms. This is the case in France, where pension reforms keenly supported by President Emmanuel Macron in 2019 were stopped in their tracks in February 2020, due to the pandemic. The reform plan, which includes increasing the retirement age by two years to 64, was also deferred until after the 2022 presidential elections.

To sum up, the first interventions passed in the aftermath of Covid-19 have consisted of emergency measures to address short-term problems of pension adequacy and economic support; some improvement of benefits to buffer the social consequences of the crisis; the reduction of employers' and employees' social contribution payments, to alleviate the burden on their activities; and the provision of additional resources to social security budgets. While the long-term impact of the measures mentioned above on pension expenditure is expected to be low, the potential imbalance

1 International Social Security Association, 'Coronavirus – Social Security Responses'. https://ww1.issa.int/coronavirus

2 OECD, 'Tackling coronavirus (COVID-19)', Country Tracker. http://www.oecd.org/coronavirus/en/#country-tracker

3 IMF, COVID-19 Knowledge Hub. https://www.imf.org/en/Topics/imf-and-covid19.

4 ESPN. https://bit.ly/3jhtYfo

5 A set of measures to preserve jobs will also be implemented, including the establishment of a new regime of co-financing wages for temporarily laid-off workers.

(between outlays and revenues) may remain present for years to come and contribute to further fiscal pressures (Feher and De Bidegain 2020).

Policy challenges

Since the outbreak of the pandemic, public pensions have continued to guarantee retirees a stable source of income, while large swathes of working people have had to fear losing their jobs, faced wage and earnings cuts, or been confronted with unprecedented challenges in reconciling work and family life (Ebbinghaus 2020). However, while pension systems may at first glance seem to be unaffected by the pandemic, they in fact face longer-term challenges.

In order to shed light on the major long-term effects, it is important to clearly identify some key issues. The first set of challenges arises from the lower output resulting from the restrictions to the economic activity that followed the emergence of the pandemic. According to Eurostat, the EU28 average GDP trend for the second quarter of 2020 was 12.1 per cent, with a dramatic fall of 18.4 per cent in Spain, and even 9.7 per cent in economic powerhouse Germany. The EU GDP is forecast to decline by about 7.5 per cent this year, far more than during the recession of 2008–09 (European Commission, 2020). In many EU countries, the future level of benefits is directly influenced by GDP trends: the more GDP declines, the less benefits increase. What is more, economic decline invariably generates pressures on public budgets and limits the possibility of spending on the welfare state, and pensions in particular. At the end of the first quarter of 2020, the quarter in which Covid-19 containment measures began to be introduced by Member States, the average government debt-to-GDP ratio in the euro area stood at 86.3 per cent. It was 84.1 per cent at the end of the fourth quarter of 2019. And compared with the fourth quarter of 2019, 24 out of 27 Member States registered an increase in their debt-to-GDP ratio at the end of the first quarter of 2020. The highest ratios of government debt to GDP at the end of the first quarter of 2020 were recorded in Greece (176.7 per cent), Italy (137.6 per cent), Portugal (120.0 per cent), Belgium (104.4 per cent) and France (101.2 per cent). The largest increases in the ratio were observed in Belgium (+5.7 per cent) and Finland (+4.9 per cent).[6]

The second direct effect of the crisis on pension systems is related to the growing problems in the labour market: namely the wage base reduction, with lower taxes and social contributions. The same effect will be aggravated by the rise of unemployment (in June 2020, the seasonally adjusted unemployment rate in the EU was 7.1 per cent, with a further expected increase of up to 9 per cent at the end of the year, while in June 2019 it was 6.3 per cent) and the contraction of employment. These trends will shrink the contributory inflows needed by public PAYG schemes to stay on the path of fiscal sustainability. What is more, they hinder the accumulation of individual retirement savings. This will result in a deteriorating social security balance and a declining funding ratio in both public and private defined benefit (DB) schemes (Feher and De Bidegain 2020).

The third projected effect is related to the financial markets. Rates of return that pension assets earn in the financial markets are crucial for the profitability of non-public pension schemes, but also for the ability of reserve funds in the public pillar to provide unfunded pension programmes with short-term financial relief. Asset price shocks reduce the value of pension reserves in funded DB schemes, negatively impacting funding ratios (the relationship between a DB scheme's assets and liabilities measured over the same horizon). In the absence of a rebound of asset values, this may happen through a negotiated reduction of liabilities or by increasing the pension schemes' reserves at the expense of the sponsoring entity. Funded pension schemes are also hurt by low-yield government bonds which negatively impact discount rates applied to future payment obligations. In the case of funding gaps, employers sponsoring pension schemes may need to transfer additional resources to those schemes, which, in turn, may have adverse effects on their own financial position (Antolin and Despalins 2020). In the aftermath of the pandemic, in Europe's riskier market segments (such as equities and high-yield corporate bonds), investors cut exposure, causing the fastest market sell-off since the global financial crisis of 2008–09. Yet, due to the reaction of monetary and fiscal authorities (such as the European Central Bank) and their support measures, financial markets have since shown signs of stabilisation at a much faster rate than in 2008. Equity markets recovered part of their losses (ibidem).

The pandemic and its impact on the economy and labour and financial markets will thus have consequences for the long-term viability of public and private pensions. Compared with the Great Recession, experts expect more dramatic challenges. This also concerns future prospects of pension adequacy: many future pensioners will have lower old-age protection as a consequence of increased inactivity (due to unemployment and care obligations), and lower returns from their investments in the financial markets. They could also suffer from further cutbacks in a context of growing budgetary strains (Ebbinghaus 2020).

Political challenges

The Covid-19 pandemic has also led to some changes in the pension reform debate and in the way actors frame their discourse around reforms. In this new context, we identify three main positions. The first position (in continuity with longer-term debates on pensions) focuses on the persistent, if not increased, financial tensions over pensions. Recent publications from international organisations (like the IMF) are a clear example of the persistent focus on the financial viability of pension systems. Feher and De Bidegain (2020: 6), for example, stress that governments must resist any temptation to use the pension system as a tool to address the negative consequences of the crisis, and should implement temporary regulatory changes sparingly. If their line of reasoning were to be taken on board, then early retirement and disability pension schemes should not be used

6 According to Eurostat (2020), in the first quarter of 2020, when Covid-19 containment measures began to be widely introduced by Member States, the seasonally adjusted general government deficit-to-GDP ratio stood at 2.2 per cent in the euro area and 2.3 per cent in the EU. This is a sharp increase in both areas in comparison with the fourth quarter of 2019, and the highest deficit recorded in the euro area since the second quarter of 2015.

for the purpose of accommodating temporary labour market and economic pressures.

The second position is more nuanced and represents a novelty. The position of Mario Draghi, former President of the ECB, is an interesting case to look at. In press interviews he stressed the need for a new European effort towards economic recovery. For Draghi, Covid-19 represents a massive crisis that needs unprecedented answers: in particular, a significant increase in public debt. The loss of income incurred by the private sector must eventually be absorbed, wholly or in part, into government balance sheets. According to Draghi, much higher public debt levels will become a permanent feature of our economies and will be accompanied by private debt cancellation.[7] In a further speech, Draghi clarified his message: more debt would be justified by the need to protect younger generations that risk being massively hit by the pandemic. He also proposed to distinguish between 'bad' and 'good' debt. The latter consists of spending in research, critical infrastructure investment in human capital, and education (targeted to younger generations), while for the former he said: 'if debt is used for unproductive purposes, it will be seen as "bad" debt and its sustainability will be eroded'.[8] As we show in the concluding remarks, this position might have as-yet unknown implications for the pension reform debate. On the one hand, it opens the possibility for expanding the public role (also in social protection policies). On the other, it may represent a justification of further pension cutbacks in the name of 'intergenerational justice' (Natali 2018).

The third position in the debate represents a more explicit change. We could call this the result of an 'austerity backlash' that has spread across Europe over recent years and seems to have been accentuated by the pandemic. Political leaders (especially from the populist camp) and public opinion have shown signs of 'reform fatigue': they have increasingly shared the perception of having accomplished much of the reform programme. The huge impact of cost-containment on social rights and the dramatic experience of fast retrenchment have further contributed to the growing opposition to fiscal austerity, with an increased demand for a 'post-austerity' programme (ibidem).

It is worth mentioning a few examples. At the national level, the key issue of increasing the legal retirement age – a top priority in the reform agenda of the last decades – has been increasingly challenged. In anticipation of the post-Covid-19 phase, Italy is debating the revision of the retirement age to make it more flexible for those who want to leave work early. The changes debated so far are less generous than the reform of 2018 (passed by the populist government) but less severe than the 2011 regime, imposed by former prime minister Mario Monti at the height of the euro area debt crisis. The pension policy priorities seem to have also slightly changed at the EU and global level: the improvement of old-age protection is now a priority. In the EU, the introduction of the European Pillar of Social Rights (EPSR) has contributed to stressing the importance of protecting social rights (de la Porte 2019). Old-age protection for atypical workers is a case in point. Further evidence is provided by the recent publication of the country-specific recommendations (CSRs) in the context of the European Semester. Recommendations on pensions have largely been dropped, while the emphasis has shifted from cost-containment to the improvement of social protection (Rainone 2020). At the global level, ISSA has focused on the issue of increasing old-age pensions for some vulnerable groups: for example, the self-employed, migrant workers, and women. In the post-Covid-19 phase, these vulnerable groups are proposed to be the target of new measures to improve old-age protection (Juergens and Galvani 2020).

7 M. Draghi (2020), We face a war against coronavirus and must mobilise accordingly. https://on.ft.com/37sS7xp

8 A. Speciale (2020), Draghi Tells Governments Only 'Good' Debt Can Save Economies. https://bloom.bg/3ocaBIk

Conclusions and policy recommendations

This brief analysis has aimed to shed light on the short- and long-term consequences of Covid-19 for pensions in Europe. The three sections above have shown that short-term measures have consisted of temporary reduction and/or deferral of social contributions, ad hoc benefits for at-risk elderly people, and the provision of additional resources to the social security budget. However, the longer-term effects are projected to be massive (more dramatic than those of the Great Recession) both for financial sustainability (in terms of reduced revenues and increased spending) and social adequacy (in terms of lower benefits due to GDP decline, a more limited wage base, and poor performance of the financial markets). Moreover, the political debate on pension reforms has seen some changes. Three different positions have emerged: some (such as that of the IMF) still focus on the financial constraints of supporting ageing populations, while others seem more keen to push for the improvement of old-age protection (including stakeholders, new political forces, and to some extent the renewed EU strategy in the field). A third group of experts stress the need to push for more public debt to help the European recovery. The latter discourse has uncertain consequences for the pension debate. On the one hand, it seems to open more room for social spending to buffer the effects of the crisis; on the other, it recalls old debates regarding the intergenerational clash between younger generations in need of greater financial support and older generations with unsustainable social (and pension) rights (see Mercher 2013). While it is not possible to address the debate on intergenerational justice here (see Concialdi and Lechevalier 2004), the reduction of the societal relationship between the young and the elderly to a zero-sum game is an oversimplification that should be avoided.

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