

The impact of the European Union common pension objectives on the Estonian pension system

English summary

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Introduction

The aim of the study was to analyse the Estonian pension system in the light of the 11 EU common pension objectives and indicators.

The study was commissioned by the State Chancellery and the Ministry of Social Affairs of Estonia and carried out by the expert team of the PRAXIS Centre for Policy Studies: prof. Ene-Margit Tiit, Lauri Leppik, Andres Vörk and Reelika Leetmaa.

In the context of the study, the values of EU common pension indicators, upon which the Indicators Sub-group of the Social Protection Committee had reached agreement by the time of completing the study, were calculated for Estonia.

The analysis was based mainly on the following data:

- 1) household budget surveys of the Estonian Statistical Office;
- 2) labour force surveys of the Estonian Statistical Office;
- 3) state pension insurance register of the Social Insurance Board;
- 4) funded pensions register of the Estonian Central Depository of Securities.

The population forecasts of the Estonian Statistical Office were also used.

On the basis of the findings of this study, a general assessment was given as to what extent the Estonian pension system is currently meeting the EU common objectives and what are the likely developments in this respect considering the pension reform which has been implemented over 1998-2003. In areas, where major discrepancies were observed between the EU objectives and current Estonian practices, policy recommendations were given to the Government. The Government may use the study also as a source of background information for drafting a national pension strategy paper to be presented to the European Commission in 2005¹.

¹ The full report is available in Estonian at:

http://www.praxis.ee/data/PRAXISE_Toimetised__Pension_2704049.pdf

The main findings of the study were published in Leppik, L., Tiit, E.-M. and Vörk, A. (2004). The Estonian pension system in the light of the European Union common pension objectives. Journal of the Estonian parliament, 9/2004 (in Estonian with English summary).

<http://www.riigikogu.ee/rva/toimetised/rito9/artiklid/10leppik.htm>

Background of the study

From 1 May 2004, Estonia is a Member State of the European Union. Membership entails not only application of the EU legislation, but also participation in a number of sectoral policy programs and co-operation methods. According to the EU law, development of the pension system is within the competence of the Member States. At the same time, according to Article 136 of the Amsterdam Treaty, provision of proper social protection is a common objective of the Union and the Member States. To achieve this objective, the European Council may introduce measures to encourage cooperation between Member States through initiatives aimed at improving knowledge, developing exchanges of information and best practices, promoting innovative approaches and evaluating experiences (Article 137 of the Treaty).

At the Lisbon summit of the European Council in 2000, a new working method – an open method of coordination – was launched at the European level, to be applied first for policy coordination in the field of social inclusion.

The open method of coordination (OMC) is defined as a method to implement strategic goals by means of spreading best practices and achieving greater convergence towards common goals in matters of common concern of the EU.

Procedure of the OMC involves several stages:

- 1) fixing guidelines at the EU level combined with timetables for achieving them in the short, medium and long term;
- 2) establishing quantitative and qualitative indicators and benchmarks as a means of comparing best practices;
- 3) translating the European guidelines into national policies by setting specific targets and adopting measures, taking into account national differences;
- 4) periodic monitoring, evaluation and peer review organized as mutual learning process.

The European Council in Stockholm (March 2001) emphasized the need to secure sustainability of pension systems in the context of the ageing population and decided to apply the OMC also in the field of pension policy. This was based on a broad understanding that pension systems of the EU Member States face similar challenges in the light of demographic ageing – how to maintain simultaneously social adequacy and financial sustainability.

The Gothenbourg summit of the European Council (June 2001) agreed upon 3 general principles on long-term sustainability of pension systems:

- to secure the ability of pension systems to meet their social objectives;
- to maintain financial sustainability of pension systems;
- to advance the adaptability of pension systems to changing needs and circumstances.

Finally, at the Laeken summit in December 2001, the European Council agreed upon 11 common pension objectives. Although worded in relatively general terms (which is easily understandable considering that a consensus of all 15 Member States was needed to reach an agreement), these objectives describe the common policy of the EU in the field of pensions².

In 2002, then 15 Member States of the EU presented to the European Commission their national pension strategies. In these strategy papers the Member States have evaluated the

² See the wording of EU pension objectives in Annex 1.

current situation and prospects (over the time span up to 2050) of their pension system in meeting the EU common objectives. On the basis of these national strategies, the European Commission drafted a joint report, evaluating the situation of different Member States in respect of the 11 objectives (Council of the European Union 2003).

In 2002-2004, the Social Protection Committee of the EU has been engaged in developing common indicators to compare the pension systems of the Members States in a coherent way (Atkinson *et al* 2002, Social Protection Committee 2004).

As a new Member State, Estonia will participate also in the OMC in the field of pensions. The Government has to present to the European Commission a national pension strategy paper by 2005.

The Estonian pension system and the 11 EU common pension objectives

Summary of main findings of the study

Objective 1: preventing poverty and social exclusion in old age

The relative poverty risk – measured using the relative poverty line of 60% of median income per household member with equivalence scales 1:0,5:0,3 – of elderly persons aged 65 or over was 13% in 2000, which is below the average for EU15 (17%)³. At the same time the relative poverty risk of older (65+) men in Estonia (8%) was about 2 times lower than the average for EU15 (15%), see Table 1 in Annex 2.

In contrast to several “old” EU Member States, the poverty risk of persons aged 65 or over (13%) was lower than the poverty risk of persons aged 0-64 (15%). Also at the household level, the poverty risk of pensioner households (single pensioners and pensioner couples) was lower than for families with a working age member.

This is explained from one side by the high degree of income inequality among persons below 65 years of age – the ratio of total income of the top quintile to the lowest quintile in this age group was 6,9, which is higher than in any “old” Member State. From the other side, relatively low poverty rates of elderly persons are also related to the broad coverage of the state pension system, while old age pension secures for the majority of pensioners an income above the poverty line.

Although the Estonian pension system and the social protection system in general include certain minimum income guarantees (national pension; minimum old age pension; social assistance subsistence benefit), these minimum guarantees do not take the beneficiary above the poverty line. The social assistance subsistence level does not currently cover even the cost of the minimum food basket. However, the number of pensioners affected by these minimum guarantees is relatively small. Only about 1% of all persons in pension age receive a national pension. About 2.6% of all pensioners receive social assistance subsistence benefit in addition to their pension (mainly during the winter months to compensate for the heating costs).

Incomes of persons aged 65 or over are distributed more evenly in Estonia as compared to many of the “old” EU Member States. The ratio of average income of the top quintile to the lowest quintile in Estonia was 3.6, which is below the EU15 average (4.1). This is explained by the fact that while income differences of working age persons in Estonia are high, pensions are relatively weakly differentiated.

In spite of more even income distribution, the average income of persons aged 65 or over is still considerably below the average income of persons below 65 years of age, accounting for 70%. According to this indicator, only Ireland scores less.

Due to the relatively flat structure of pensions, the poverty rate of pensioners is quite sensitive to the timing and value of pension increases. Welfare of elderly population is highly dependent on state pension, as pension is the main source of income for persons aged 65 or over.

³ Taking into account the structure of consumption in Estonia – relatively higher individual consumption and relatively smaller common expenses of the household – the PRAXIS expert team considers more appropriate to use in Estonia the equivalence scales of 1:0,7:0,5.

Objective 2: enabling people to maintain living standards

The coverage of the state pension insurance is practically universal, over 99% of persons in pension age receive a state pension. All persons aged 63 years, who have lived in Estonia for at least 5 years prior to claiming a pension, are entitled to at least a national pension.

The average gross replacement rate of an old age pension (the ratio of an average old age pension to average earnings of insured persons subject to social tax) have been in the range of 32-36%, while the average net replacement rate has been 42-46% over the last decade. Accordingly, the average pension income of old age pensioners has been less than a half of the average earnings of employed persons.

However, the median individual gross replacement rate (the ratio of the old age pension for newly retired persons to their pre-pension work income) is slightly over 50%. For about one third of all newly retired persons, the individual replacement rate of old age pension was over 60%, whereas about one quarter of all new retirees did not receive any work income at all during the year preceding their retirement.

Individual registration of social tax and calculation of first pillar pension rights on the basis of social tax has increase motivation to legalise work incomes. However, the individualised social tax data for 199-2003 indicate that by the time the new first pillar rules acquire full effect (i.e. when persons who entered the labour market in 1999 or later reach pension age), about 7% of persons reaching pension age may have problems in respect of fulfilling the required qualification period (15 years of pensionable service). Further 10% of retirees have to satisfy with the minimum rate of old age pension due to the low sum of annual pension insurance coefficients. As a result, the share of recipients of minimum pension (at the rate of national pension) would increase to 17% of all persons in pension age (from the current level of 1%). This would affect not only workers earning a minimum wage, but also parents who have been out of the labour market for longer periods for raising children.

Currently the state pays social tax (on 700 EEK a month) for about 110 thousand economically inactive persons a year (about 15% of all insured persons), including about 30 thousand parents on parental leave. The amount of social tax paid by the state gives an annual pension insurance coefficient of 0.12. As a result, more children and longer period of absence from the labour market to raise children imply a pension, which is considerably below the average old age pension or just the minimum.

The introduction of supplementary funded pensions (2nd and 3rd pillar) has opened new options to maintain the former living standard. Coverage with the second pillar exceeds 60% of the labour force. Coverage with the third pillar is about 10% of the labour force. It is notable that among the participants of 2nd and 3rd pillars women outnumber men (the share being respectively 55% and 45%). However, the influence of supplementary pension schemes on incomes of older persons is expected to increase only in about 20 years.

Objective 3: promoting solidarity within and between generations

Comparing the situation of Estonia with the other European countries, we conclude that the Estonian pension system is still characterised by a relatively high degree of intra-generational redistribution, while the inter-generational redistribution is more modest.

The value of a Gini coefficient, calculated for all old age pension incomes was 0.08 in 2003. This means that if only pension income is considered, the income inequality among old age pensioners (as measured by the Gini coefficient) is about 4 times less than for the total population.

Relatively small differentiation of state pensions relates mainly to 2 issues: the flat-rate base amount (accounting currently to 29% of the average old age pension) and the significant relevance of pre-reform (up to 1999) service periods in pensions-in-payment.

Linking the acquisition of new pension rights to the amounts of social tax paid is going to increase the dispersion of pensions. This is reflected already in increasing differentiation of amounts of old age pensions granted in 2001-2003. The amounts of state pensions will to a larger degree reflect the former earnings of the beneficiary. As a result, the deferred earnings function of the pension is going to increase and the intra-generational redistribution will decrease. Nevertheless, some elements of the intra-generational solidarity will be maintained – the flat-rate base amount and the minimum pension guarantees, which are independent of the amount of social tax paid.

The average replacement rate of state old age pension is relatively low compared to “old” EU Member States. The same applies to the total pension expenditure as a percentage of GDP, indicating that the degree of intergenerational redistribution is below the EU15 average.

Objective 4: raising employment levels

Raising the employment rate is an important way to improve financial sustainability of the pension system. The EU Member States have set targets to increase the total employment rate (for persons aged 15-64) to 70%, the female employment rate to 60% and the employment rate for older workers (55-64) to 50% by 2010.

In 2003, the female employment rate in Estonia was 58.8% and the employment rate for older workers (55-64) was 52.1%, both indicators exceeding the average for EU15, which were respectively 55.6% and 40.1%. Also compared to the other “new” Member States from the Central and Eastern Europe, the female employment rate in Estonia is one of the highest. The employment rate for older workers in Estonia is one of the highest in Europe (only Sweden, Denmark and UK show higher rates), exceeding the EU target level for 2010 already in 2003 by 2.1 percentage points.

However, the total employment rate in Estonia (62.6%) is below the EU15 average (64.3%). To reach the EU target level of 70%, the total number of employed persons should increase by about 60 thousand persons, which seems problematic. The biggest labour force potential are unemployed persons, in particular young unemployed.

Reaching the EU target for total employment rate by 2010 would increase revenues from the pension insurance part of social tax (20%) by about 900 million EEK or 0.7% of GDP. However, increasing total employment rate would help to stabilise the financial situation of the pension system only until 2020s. For the later decades demographic developments have a dominant influence, in particular, entering into the labour market of small cohorts due to low birth rates in 1990s.

Objective 5: extending working lives

Parallel to the increase of employment rates for older (55-64) workers, the EU Member States aim at increasing the average exit age from the labour market by 5 years – from 59.9 in 2001 to 65 in 2010.

The average exit age from the labour force in Estonia – 61.6 – is above the EU15 average (61.0) and one of the highest among the “new” Member States. Considering that the average life expectancy in Estonia is considerably below the life expectancy in the “old” EU countries, one may say that Estonians work for a higher proportion of their life-time than Western European nations.

Employment rates for older workers (55-64) have increased from 1995. This has been obviously influenced by the increase of the pension age (from 1994) and the payment of full pension to working pensioners (from 1996). Considering that the pension age for women is being increased to 63 by 2016, the labour supply in the 60-64 age group is going to increase further. However, there is no guarantee for simultaneous increase in the employment rates – for this the competitiveness of older workers in the labour market is important.

From all old age pensioners about one quarter are working. However, for nearly one half of all working pensioners earnings from work remain below the minimum wage. Nevertheless, social tax from earnings of working pensioners is an important source of revenues for the pension insurance budget, accounting for about 10% of all revenues from social tax.

While the statutory pension age is currently 59 for women and 63 for men, the state pension system still includes different possibilities to retire before the statutory pension age – the general early retirement, old age pensions on favourable conditions, superannuated pensions, certain special pensions (e.g. military, police).

Early retirement pensions in 2001-2003 have accounted for 20-24% of all newly granted old age pensions. Analysis of the labour market status of persons opting for early retirement pension revealed that about 75% of these persons were out of job at the time of granting the pension, most of them were unemployed for over one year preceding the granting of pension. This points to a labour market segregation among older workers – while some persons continue to work long after the pension age, there is another group of persons, facing unemployment in pre-retirement age and opting for early retirement pension to get stable income.

Taking into account all different forms of early retirement, in 2001 about one half of men and one-third of women actually retired at least one year before the statutory pension age. Most often this occurs through old age pension on favourable conditions, followed by general early retirement pension, granting of invalidity pension in pre-retirement age, superannuated pensions and special pensions. As the statutory pension age of men is higher than that of women, it is logical to expect that the pressure on early retirement is higher among men.

The average age of granting an old age pension is about 2.5 years lower than the average exit age from the labour force. In conclusion, whereas the average exit age from the labour force in Estonia is higher than the EU15 average, the statutory pension age as well as the average effective pension age are lower than in the “old” Member States.

Starting from 2002, the Estonian state pension insurance includes a possibility to postpone the time of granting old age pensions with an increase in pensions by 0.9% per month (i.e. 10.8% per year). In spite of this generous increase, the deferred old age pension has met only marginal interest so far.

Objective 6: making pension systems sustainable in a context of sound public finances

Expenditures on state pensions as a percentage of GDP in Estonia (7.1% in 2003) are below the average for EU15 (10.4% in 2000). The expenditure level as a percentage of GDP was less than in Estonia only in the UK and Ireland (respectively 5.5% and 4.6%). However, when comparing countries by this indicator, differences in the population age structure, pension age, taxation and social security contributions on pensions and other aspects shall be taken into account.

According to the population projections, ageing of population would increase pension expenditures considerably (under the assumption that the rules of the pension system remain unchanged). Together with increasing health care costs these developments would lead to a significant additional burden for the budget. In this context the EU Member States have aimed to reduce public sector debt level in order to pre-empt the budgetary consequences of ageing populations. The Commission and Council have also recommended to undertake ambitious reforms of pension systems in order to contain pressures on public finances and to place pension systems on a sound financial footing. It is further recommended to set up public pension reserve funds (e.g. demographic reserve funds) to create a fiscal room for manoeuvre in the pension system.

The general fiscal position of Estonia is rather good compared to the “old” Member States. The consolidated general government budget surplus in 2003 was 2.6% of GDP. The total government sector debt was rather low, about 5.8%. Estonia is fulfilling so-called Maastricht criteria (budget deficit not to exceed 3% of GDP, public debt not to exceed 60% of GDP). At the same time only 5 of the 15 “old” Member States showed budget surplus in 2002 and the average public debt for EU15 is above 60%, i.e. over 10 times higher than in Estonia.

Furthermore, the Estonian government has developed several reserves. By the end of 2003, the stabilisation reserve (established to reduce macro-economic risks and to finance long-term structural reforms, incl. pension reform) amounted to 4.5 billion EEK (about 3.9% of GDP). Reserves of the state pension insurance amounted to 1.6 billion EEK or 1.4% of GDP.

The general fiscal policy context for sustainability of pension system in Estonia is thus considerably better than in many of the “old” Member States. Transformation of the pension system – parametric changes in the first pillar and introduction of the second pillar – have further increased the financial sustainability.

In 2002, the distribution of social tax revenues (paid by employers) was changed in connection with the introduction of the second pillar. For persons who have joined the second pillar, 16% of wage is transferred to the first pillar determining their future state pension while 4% of wage is transferred to the individual account in private pension fund, supplemented by an individual contribution of 2% of wage. Total transfers to the second pillar amounted to 0.5% of GDP in 2003. However, in spite of the introduction of the second pillar, expenditures on state pensions (as a percentage of GDP) increased in 2003 as compared to 2002. Moreover, reserves of the state pension insurance also increased. This is explained by

the increase in the number of employed persons. From the other side, the relatively conservative formula for indexing pensions (50% on CPI increase and 50% on increase of social tax revenues) is relevant in this context.

Projections made using the PRAXIS pension model indicate that with the current rules of the pension system, revenues of the first pillar decline to about 6% of GDP over the next 50 years. At the same time, expenditures of state pensions would decline below 5% of GDP. Although due to introduction of the second pillar, the current reserves of the first pillar would be exhausted by 2007 and the I pillar would have to face a current deficit over the period 2007-2011 (requiring subsidies from the general state budget), from 2012 surplus of the first pillar would emerge again, increasing to about 30% of GDP over the next 40 years.

In case of changing the pension index to take into account only the increase of social tax revenues, the current surplus would turn quickly into deficit. Annual deficit over the next decade would be around 1% of GDP, increasing to 2% of GDP by 2020s. Cumulative deficit, having to be financed from the general state budget, would increase to 45% of GDP by 2050s.

Testing the different weights for CPI and social tax revenues in the pension index formula, authors of the study found that a suitable index would depend on social tax revenues by the weight of two-thirds and on CPI by one-third. In this case, the deficit of the first pillar in the coming years would be manageable, while also in the long run the pension index would not create too high surplus.

To conclude, if the current rules of the pension system remain unchanged, financial sustainability of system would not be a major problem in spite of population ageing. At the same time, meeting the objectives of pension adequacy is becoming a problem. Although even with the current index the real value of state pensions would increase by about twice over the 50 year time horizon, the replacement rate would decline by about twice over the same period. Obviously, indexation solely on the basis of social tax increases would lead to the highest real value and replacement rate of pensions. With such an index, the replacement rate of average old age pension would even increase over the next 30 years. However, even this index could not maintain the replacement rate for longer periods.

Objective 7: adjusting benefits and contributions in a balanced way

Under this objective (solidarity in the context of financial sustainability), the European Commission and Council recommend to avoid two extremes – from one side, not to overload the active generation by continuous increase of pension insurance contributions, from the other side, not to reduce pensions below the adequacy level. Several “old” EU Member States have in their national pension strategies expressed a view that increasing pension expenditures related to the ageing of population can not be covered by increasing contribution rates.

In Estonia, both the first as well as the second pillar principally operate on the defined-contribution principle, hence in practical terms the contribution rate is fixed.

Comparisons of the financial burden of pension insurance contributions on economically active persons to finance the pension system in the EU countries are complicated as the total contribution rate covers different social risks in different countries.

Comparing the financial burden of the compulsory pension system in Estonia (20% part from the social tax paid by employer, 2% individual contribution for the second pillar) with other countries where the pension insurance contributions is more clearly separated from other risks (e.g. Austria, Germany, Finland, Sweden), we can see that the contribution rate in Estonia is close to the rates in these countries.

To compare the pension levels in different countries, the EU Social Protection Committee has recommended an aggregate replacement rate (i.e. by individual median pension income of persons aged 65-74 divided by individual median earnings of persons aged 50-59 years).

The value of this indicator for Estonia was 45.0% in 2002. However, comparative data on the other Member States was not yet available at the time of drafting this report. It may be expected that in the majority of Member States, the aggregate replacement rate is higher than in Estonia. However, it may also be expected that Estonia looks somewhat better in the light of this indicator as compared to the theoretical replacement rate, as the income level adversely correlates with age.

If this holds true, the contribution rate to finance the pension system is about the average in EU countries, while the replacement rate is below the EU average. This is caused by the lower than average employment rate and higher than average system dependency ratio (ratio of pensioners to employees).

Objective 8: ensuring that private pension provision is adequate and financially sound

In most of the EU Member States the role of private pension schemes is playing increasingly important role in ensuring adequate income protection in old age. Access to private pensions and efficiency and security of their operation require appropriate legal regulation and supervision.

Private pension schemes in Estonia commenced their activity fairly recently. Third pillar schemes started in 1998, second pillar in 2002. The state has provided incentives both for joining the second and the third pillar schemes.

The main incentive to join the second pillar is the possibility to re-direct 4 percentage points of the social tax paid on wages, on the condition that the person pays an additional individual contribution of 2 % of wage. However, there are also other incentives to join the second pillar. Although the re-direction of 4 percentage points of social tax respectively reduces pension rights acquired in the first pillar, this reduction is not fully proportional to the re-directed share of social tax – it does not affect the flat-rate base amount of pension and minimum pension guarantees in the first pillar.

The third pillar enjoys quite generous tax advantages. Contributions to third pillar schemes are tax-deductable up to 15% of annual taxable income. However, together with other tax deductions, these shall not exceed 50000 EEK a year. Investment income from the third pillar is not taxable. Third pillar benefits are taxed at the reduced rate of income tax (10%, instead of normal 26%), while annuities are tax exempt if the endowment period lasted at least 5 years.

Regulation of operation of private pension funds follows internationally recognised prudential rules. Investment regulation guarantees spreading of investment risk geographically and by instruments.

The fee structure of private pension funds is transparent and comparable. Limits of administrative fees for second pillar funds is established by the Minister of Finance (1.5% of net asset value of assets under management per year for conservative funds and 2% for equity funds). The maximum rate for redemption fee is set at 1% of net asset value of pension units. Maximum rate of subscription fee is 3%. In the reality, for most of the funds administrative fees are below the maximum allowed rates. Actual administrative fees of conservative funds vary in the range of 0.75-1.5%, for equity funds 1.25-2%. Subscription fees vary from 1% to 3%.

Private pension funds and insurance companies are supervised by an independent Financial Supervision Authority.

Although the Estonian second pillar does not provide any guarantees on the rate of return and as a result, the pension fund unit holders have to bear investment and inflation risks, there are incentives for pension fund managers to maximise the rate of return (e.g. the law requires compulsory participation of pension fund managers in the pension fund). Participants of the second pillar can also choose the pension fund according to the investment strategy and the risk level, which they deem acceptable.

Objective 9: adapting to more flexible employment and career patterns

Different from some of the “old” EU Member States, where pension schemes were historically developed to suit the situation of full-time workers and life-time career, the main elements of the Estonian pension system (first and second pillars) are well compatible with the changing forms of work and increasing flexibility of the labour market.

The principles of acquiring pension rights through the payment of social tax guarantees equal treatment to all economically active persons regardless of the type of work contract and/or work-load (working hours). Different forms of remuneration are also treated equally in respect of payment of social tax.

From the perspective of labour market flexibility, old age pensions on favourable conditions, superannuated pensions and special pensions present some problems, as these link pension rights to work in particular occupations.

Self-employed persons do not face any particular legal problems for participation in the first pillar, they pay social tax on net earnings from self-employment. Legislation sets currently 231 EEK per month as the minimum contribution for self-employed, which is considerably less than social tax calculated from the minimum wage. Self-employed persons, contributing for their pension only at the minimum rate, would acquire an annual pension insurance coefficient less than 0.15. In the longer term, this may lead to a situation, where the person does not fulfil the qualification period for old age pension (15 years) and ends up only with the national pension or minimum old age pension.

Up to 2004, self-employed persons could not pay second pillar contributions on income from self-employment, and therefore many self-employed persons had no rationale to join the second pillar. From 2005 contributions to the second pillar can be made also on income from self-employment.

Objective 10: meeting the aspirations for greater equality of women and men

From the perspective of legal criteria, the main schemes of the Estonian pension system guarantee equal treatment of men and women. The pension age of women is gradually equalised with the pension age of men at the level of 63 years, over the transition period lasting until 2016.

However, Superannuated Pensions Act has not yet been harmonised with the EU legislation on equal treatment of men and women in social security schemes (Directive 79/7), as this act prescribes for some occupations different qualification periods for men and women (e.g. personnel of aircrafts and ships), or limits some pension rights only for women (workers in textile industry).

Due to higher difference between the life expectancy of men and women in Estonia compared to “old” Member States, the share of women in the elderly population is considerably above the EU15 average. In 2003 the share of women among persons aged 65 or over was 67% and among persons aged 75 or over the share of women was 74%. The same ratios in the EU15 were respectively 60% and 67%.

Women account for 69% of all old age pensioners in Estonia. However, men outnumber women among the recipients of early retirement pension and superannuated pension. The share of men in these pension categories is respectively 65% and 77%.

Relatively high intra-generational solidarity in the state pension insurance scheme is reflected also in the comparison of average pensions of men and women. Average old age pension of women amounts to 97% of average old age pension of men. Contrasting this result with the wage differences of men and women, we can observe that while wage differences in Estonia are considerably higher than in the “old” Member States, pension differences are rather small.

As a result of acquisition of new pension rights on the basis of social tax paid, wage differences of men and women will in a longer run lead also to the pension differences in the Estonian first and second pillars. The future pension of women is further influenced by the fact that pension rights for the periods of child care are very modest.

However, from the other side the unemployment rate of men has been higher than that of women and the employment rate of men has declined more rapidly than for women. These aspects somewhat counterbalance the development of average pensions of men and women. As a further aspect, women outnumber men among participants of the second pillar.

Objective 11: demonstrate the ability of pension systems to meet the challenges of changing circumstances

The European Commission and Council have emphasised that social and financial sustainability of pension systems has several important pre-requirements: open discussion, public support and political leadership of the process. For development of open discussion, accessibility of information on the current situation and future prospects of the pension system is important. This in turn requires continuous monitoring of the pension system, provision of information to insured persons and pensioners, development of political consensus.

Pension reform implemented in 1998-2003 has increased transparency of acquiring pension rights and financing of the pension system. Since in principle both the first and the second pillar are defined-contribution schemes, the main uncertainty for the insured person is the development of benefit rate – what is going to be the real value and replacement rate of his/her future pension at the time he/she is going to retire.

The amount of state pension would be better predictable, if factors influencing its development were predictable. Over the last 3 years pensions have been increased using a combination of two methods – regular indexation (by a combined index depending on CPI and social tax revenue increase) and *ad hoc* political decisions. A longer term political consensus on indexation formula would contribute to higher predictability of the development of state pensions.

Adjustment to demographic situation has been facilitated by the increase of pension age and introduction of supplementary pension pillars.

EU common pension objectives

Adequacy of pensions

Member States should safeguard the capacity of pension systems to meet their social objectives. To this end against the background of their specific national circumstances they should:

- 1. Ensure that older people are not placed at risk of poverty and can enjoy a decent standard of living; that they share in the economic well-being of their country and can accordingly participate actively in public, social and cultural life;*
- 2. Provide access for all individuals to appropriate pension arrangements, public and/or private, which allow them to earn pension entitlements enabling them to maintain, to a reasonable degree, their living standard after retirement; and*
- 3. Promote solidarity within and between generations.*

Financial sustainability of pension systems

Member States should follow a multi-faceted strategy to place pension systems on a sound financial footing, including a suitable combination of policies to:

- 4. Achieve a high level of employment through, where necessary, comprehensive labour market reforms, as provided by the European Employment Strategy and in a way consistent with the BEPG;*
- 5. Ensure that, alongside labour market and economic policies, all relevant branches of social protection, in particular pension systems, offer effective incentives for the participation of older workers; that workers are not encouraged to take up early retirement and are not penalised for staying in the labour market beyond the standard retirement age; and that pension systems facilitate the option of gradual retirement;*
- 6. Reform pension systems in appropriate ways taking into account the overall objective of maintaining the sustainability of public finances. At the same time sustainability of pension systems needs to be accompanied by sound fiscal policies, including, where necessary, a reduction of debt. Strategies adopted to meet this objective may also include setting up dedicated pension reserve funds;*
- 7. Ensure that pension provisions and reforms maintain a fair balance between the active and the retired by not overburdening the former and by maintaining adequate pensions for the latter; and*
- 8. Ensure, through appropriate regulatory frameworks and through sound management, that private and public funded pension schemes can provide pensions with the required efficiency, affordability, portability and security.*

Modernisation of pension systems in response to changing needs of the economy, society and individuals

- 9. Ensure that pension systems are compatible with the requirements of flexibility and security on the labour market; that, without prejudice to the coherence of Member States' tax systems, labour market mobility within Member States and across borders and non-standard employment forms do not penalise people's pension entitlements and that self-employment is not discouraged by pension systems;*

- 10. Review pension provisions with a view to ensuring the principle of equal treatment between women and men, taking into account obligations under EU law; and*
- 11. Make pension systems more transparent and adaptable to changing circumstances, so that citizens can continue to have confidence in them. Develop reliable and easy-to-understand information on the long-term perspectives of pension systems, notably with regard to the likely evolution of benefit levels and contribution rates. Promote the broadest possible consensus regarding pension policies and reforms. Improve the methodological basis for efficient monitoring of pension reforms and policies.*

| | a) At-risk-of-poverty rate, people aged 65 years and over (%) | | | | | | | b) At-risk-of-poverty rate at 60% of median income (%) | | | c) At-risk-of-poverty rate at 60% of median income: Difference between people aged 65 years and over and people aged 0-64 | | | d) Income of people aged 65 and over as a percentage of income of people aged 0-64 (%) | | | e) Inequality of income distribution: ratio of total income of top quintile to lowest quintile | |
|-------------|--|-----------|----------|---------------|---------------|-----------|-----------|--|-----------|-----------|---|----------|-----------|---|-----------|-----------|--|------------|
| | 50% of median | | | | 60% of median | | | | | | | | | | | | | |
| | Men | Women | Total | 0-64 years | Men | Women | Total | 0-64 | 65+ | 75+ | Men | Women | Total | Men | Women | Total | 0-64 | 65+ |
| B | 11 | 12 | 12 | 6 | 20 | 22 | 22 | 11 | 22 | 25 | 10 | 9 | 11 | 77 | 76 | 76 | 4,1 | 4,3 |
| DK | 4 | 6 | 5 | 3 | 23 | 26 | 25 | 7 | 25 | 31 | 17 | 19 | 18 | 77 | 73 | 74 | 2,7 | 2,6 |
| D | 5 | 6 | 6 | 6 | 9 | 13 | 11 | 11 | 11 | 12 | -1 | 2 | 0 | 98 | 96 | 97 | 3,5 | 3,6 |
| GR | 24 | 25 | 25 | 12 | 34 | 33 | 33 | 18 | 33 | 39 | 17 | 15 | 15 | 74 | 74 | 74 | 5,8 | 7,0 |
| E | 7 | 7 | 7 | 14 | 16 | 16 | 16 | 19 | 16 | 17 | -3 | -4 | -3 | 94 | 88 | 91 | 6,0 | 4,2 |
| F | 8 | 12 | 10 | 8 | 16 | 21 | 19 | 14 | 19 | 23 | 2 | 6 | 5 | 94 | 88 | 90 | 4,4 | 4,1 |
| IRL | 7 | 19 | 14 | 10 | 26 | 41 | 34 | 17 | 34 | 42 | 10 | 24 | 17 | 74 | 65 | 69 | 4,9 | 4,5 |
| I | 7 | 9 | 8 | 13 | 12 | 16 | 14 | 19 | 14 | 14 | -7 | -3 | -5 | 98 | 94 | 96 | 5,1 | 4,2 |
| L | 3 | 4 | 4 | 6 | 6 | 10 | 8 | 14 | 8 | 14 | -7 | -4 | -6 | 101 | 98 | 99 | 4,0 | 3,2 |
| NL | 4 | 5 | 4 | 6 | 7 | 7 | 7 | 11 | 7 | 8 | -4 | -5 | -4 | 98 | 89 | 93 | 3,7 | 3,7 |
| A | 8 | 12 | 10 | 6 | 15 | 29 | 24 | 10 | 24 | 31 | 6 | 18 | 14 | 90 | 81 | 84 | 3,6 | 4,1 |
| P | 18 | 25 | 22 | 12 | 30 | 36 | 33 | 18 | 33 | 39 | 12 | 17 | 15 | 80 | 73 | 76 | 6,4 | 5,8 |
| FIN | 1 | 8 | 6 | 5 | 9 | 23 | 17 | 10 | 17 | 20 | 0 | 13 | 7 | 86 | 74 | 78 | 3,4 | 2,9 |
| S | 2 | 3 | 3 | 5 | 6 | 10 | 8 | 10 | 8 | 12 | -4 | 1 | -2 | 92 | 78 | 83 | 3,2 | 2,9 |
| UK | 7 | 13 | 11 | 12 | 17 | 25 | 21 | 19 | 21 | 26 | -1 | 5 | 2 | 81 | 75 | 78 | 5,4 | 4,1 |
| <i>EU15</i> | <i>7</i> | <i>10</i> | <i>9</i> | <i>10</i> | <i>15</i> | <i>19</i> | <i>17</i> | <i>15</i> | <i>17</i> | <i>19</i> | <i>0</i> | <i>3</i> | <i>2</i> | <i>92</i> | <i>86</i> | <i>89</i> | <i>4,6</i> | <i>4,1</i> |
| EST | 3 | 7 | 6 | 10 | 8 | 17 | 13 | 15 | 13 | 14 | -8 | 2 | -2 | 76 | 67 | 70 | 6,9 | 3,6 |

Sources: Council of the European Union 2003; Estonian Statistical Office, calculations by authors
Data: EL Member States -1998, Estonia -2000; Equivalence scales 1:0,5:0,3.

Table 1. Relative poverty risks and relative income situation of older people.