PENSION REFORM IN PORTUGAL

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The views expressed in this paper are those of the author alone and do not necessarily reflect those of the Portuguese public authorities.
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1. Introduction: The Social Security System

In Portugal, there are several social security systems. On one hand, we have the major private sector workers system, which covers the risks of sickness, maternity, occupational diseases, unemployment, invalidity, old age, death, family charges and incapacity to earn sufficient economic resources.

On the other hand, there are special schemes of protection for civil servants, police and the military forces.

Finally, bank workers are covered by the general social security system in the events of unemployment, occupational diseases and family charges. Their employers by means of collective agreements cover the other risks.

The right to health care does not depend on the link with the social security system. Health care covers all the residents and is carried out by the National Health Service, which depends on the Ministry of Health.

The main purpose of this paper is to address the reform in progress on the public pension system. Therefore, after a brief presentation of the private sector workers pension scheme, we'll address its reform in detail, and, in the end, give a hint on the debate that is being held on the reform of civil servants scheme. Anyway, these are the most significant schemes, if one considers its relevance on public expenditure. The author can provide further information on the general features of the social security system, upon request.
2. The Private Sector Workers Pension System

2.1 The General Contributory Scheme

Invalidity Pension

Any worker enrolled in the general social security scheme suffering from permanent incapacity to earn more than 1/3 of his normal wage, before being entitled to an old-age pension, is alternatively entitled to an invalidity pension.

The amount of the pension relates to the salaries earned in the years prior to the occurrence of incapacity, and there are global minimum and maximum values for the percentage that the pension can represent if compared to the last salaries of the worker. Even so, there are minimum amounts of pensions (which are different in accordance to the career duration) calculated as a fraction of the general minimum national salary.

This pension can be accumulated with work earnings, up to the maximum limit of 100% of reference wage.

Old-Age Pension

From the age of 65 (except in some special cases, to be detailed ahead), and upon the completion of a qualifying period of 15 insured years of work, people are entitled to an old-age pension.

This is an earnings-related pension, since the best 10 of the last 15 years of work are taken in account in the calculation of the reference wage. The total amount of the pension will be equal to 2% of the reference wage for each work year contributing to the public system, and there are global minimum and maximum values for the percentage that the pension can represent if compared to the last salaries of the worker. Even so, there are minimum amounts of pensions (which are different in accordance to the career duration) calculated as a fraction of the general minimum national salary.

The beneficiaries are entitled to claim the old-age pension before or after the age of 65, on certain restrictive conditions, and with a reduction or an increase in the amount of pension, calculated in order to equal the present value of pension with the total amount that would be received if the pension would be claimed at 65 years old.

For some occupational groups (such as miners, professional ballet dancers, aircraft pilots and controllers) there are special conditions for early retirement. The older long-term unemployed are entitled to a pension from the age of 60. There is also a reduction coefficient for the grant of pension at 55 years old for the long-term unemployed.

Old-age pensions can accumulate with other pensions, on some conditions, and can freely accumulate with work earnings.
**Survivors Pension**

On certain conditions, related to the nature of the relationship, a survivors pension is payable to the spouse, former spouse, person living in marital status, descendants or ascendents, of any person who had a minimum qualifying period of 36 months of contribution prior to the date of death.

The amount of the pension is calculated as a part of the invalidity or old-age pension that the insured person received or would be entitled to, at the date of death. The duration of the pension is generally unlimited for spouses over 35 years old, provided that they don’t remarry. In the case of descendants the pension is generally granted up until they enroll in a paid activity.

**2.2 The Non-Contributory Scheme**

The non-contributory scheme aims at the protection of economically or socially needy persons who are not effectively covered by the general scheme.

In terms of allowances in the sphere of invalidity or old-age, there is a social pension, which is means-tested, and only granted if the retiree is not covered by the general contributory scheme.

**3. The Main Challenge: The reform of the public pension system**

A number of factors can influence the financial sustainability of any social security system: these are mainly the demographic evolution, the macroeconomic performance of a nation and the specifics of each system (the degree of social protection, the maturity of the system, etc.).

On this section, we will briefly analyze the characteristics of the portuguese economy and demography, and we’ll also give some hints on the main relevant features of the public pension system.

**3.1 The consequences of an ageing population**

The projections on the demographic evolution of portuguese population bring to our mind immediately a common expression: *déjà vu*. The age structure of the population is going in the same direction of many other developed countries. Portugal, as the rest of Europe and a considerable number of developed countries, is getting older.

As we know, the ageing of population poses a great problem to any social security system, and particularly in the short-term, to all the Pay-as-you-go systems.
However, in the Portuguese case, it as to be noted that the ageing is going a little bit slower than in other OECD countries. The OECD figures indicate that the estimated Age Dependency Ratio in 2030 will be the second lowest among EU countries, United States and Japan (just behind Ireland). If one would consider the figures from EUROSTAT, although the exact numbers would be slightly different, the main conclusions would be the same.

3.2 The Macroeconomic Performance

In macroeconomic terms, a favorable evolution of GDP will depend a lot on the evolution of employment and productivity.

However, in the Portuguese case, the rates of employment are already very high (among the highest of EU), and it is foreseen a zero growth of labor force some years ahead. The rates of employment of elderly people are already quite high. Therefore, the pressure is nowadays mainly on the increase of women’s rates of employment.

On the other hand, two other variables will be decisive on the evolution of the Portuguese economy: the inflows of labor force (currently there are significant inflows of eastern European and African-born people to Portugal) and the capacity to increase the productivity of labor force, through the upgrade of education levels and professional qualifications.

A main scenario was built upon the results of ECOFIN Council Agreements on the desirable GDP growth and inflation rates and also on unofficial projections for the evolution of other variables, such as productivity and unemployment rates. This scenario is envisaged as coherent with the prospects of stable growth and low inflation, and therefore it was used as the basis of the projections that will be presented in the late sections, when we’ll address the ongoing reform.

3.3 The Degree of Social Protection

One of the main challenges of the reform of the pension system in Portugal, was the fact that one has to cope the need to ensure long-term financial sustainability of the system with the fact that the system is still granting mid-low levels of social protection, when compared with the majority of European developed societies. This unique feature of the Portuguese system is the result of its youth. This means that ageing population is already a problem that the system faces in the next decades, but simultaneously there is a need to increase the amounts of expenditure in pensions, since the system is far from maturity.

The youth of the system can be easily understood when one considers the fact that the average career of old-age retirees is about 20 years, when it is foreseen that the average career for that type of pensioners can go up to more than 30 years. The same applies when one considers invalidity pensions instead. Currently, the average career of

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1 See Annex - Table A1
2 See Annex – Table A2
invalidity retirees is well under 20 years, being foreseen a maximum average career of more than 25 years. Indeed, one has to recall that only in the beginning of the 70’s the general system of social security was finally compulsory to the majority of the private sector workers.

And, of course, this kind of problem can be particularly stringent in a system like the Portuguese, which is a Pay-as-you-go system, with the amount of pensions being directly related with the retiree's past earnings and career duration.

This is obviously a great challenge for the reform, since the majority of the developed countries taking decisive steps onto the reform of the pension system has already a more mature system, and therefore won’t be permanently pressed by the increase of the expenditure in pensions. On the Portuguese case, the fact that Social Expenditure as a % of GDP is still below the EU average just means that we’re still not there. Demography is not the only problem, demography is just one of the main problems.

3.4 Financial Problems in the Current Scenario

As it was stated, the foreseen demographic evolution will cause major problems all over the pension systems of the developed world.

From 1995, with the beginning of the work that would lead in the end to the approval of a new Basic Law on the Solidarity and Social Security System (in the year 2000), several studies were elaborated by the Commission for the White Paper on the Reform of Social Security.

The final estimates allowed us to conclude that there were significant problems ahead, which had to be addressed in a vigorous and corajous way. The results indicated that in a few years from then, there would start to occur annual deficits in the public system, and even by using the monetary reserves accumulated over the years, still before 2015 the system would need permanent and ever growing inflows from the public budget.

So, it was clear to the public authorities that something really significant had to be done.

3.5 Facing the Challenge

The reform which was generally approved in 2000, and that is now being detailed and put in practice (hopefully, the major changes will be fully operational from 2002 onwards), has some three major goals:

- Improve the levels of social protection, protecting more those who actually need more protection;
- Assure the financial sustainability of the public pension system;
- In order to put together at the same time the first two objectives, improve substantially the capacity of the system to get the best results, with the least resources.

3 See Annex – Table A3
To attain all this three objectives, some major steps were taken. The most relevant ones are related to the financing of expenditure and to the pensions calculation formula:

- A new share of responsibility was adopted, being now the Public Budget totally responsible for the financing of the Non-contributory scheme, and the workers contributions only used to pay the general scheme pensions;

- On the other hand, a part of the annual contributions coming from employees will be directly transferred to a reserve fund, in order to create a buffer which will be used, if necessary, to pay the pensions in times ahead, when the inflows come to be under the annual volume of expenditures; furthermore, all the annual surpluses in the social security budget will also be directed to the reserve fund, making the system in the years to come a partially funded system.

- In terms of the pension calculation formula, it was stated that this should take in account all the salaries of each new pensioner, and not only the salaries earned in the last 15 years of each one’s career; hopefully, this will mean that everybody will have an additional incentive to contribute more to social security in the early part of their career, and not “use” the system, by only maximizing their contributions in the years closer to retirement; of course, this has to be done in a way that those who are already too close to retirement won’t be affected by this law, since they can’t change their past contributions; therefore, a period of transition is envisaged, which will be probably of about 15/20 years, in which new retirees won’t be affected by this new formula;

- This reform has also another concern, which is to protect more those who really need social protection; so, a new pension formula is currently being designed in order to ensure that it will lead to higher pensions, relative to last salary, to those who had low income through working life, and would therefore have lower pensions; this is also one of the main changes coming from this Basic Law, since it means the adoption of the principle of solidarity among workers, to go with already existent national solidarity.

All this reform was prepared in order to improve in a substantial manner the financial sustainability of the public pension system. The results coming from the calculations that are now being done by the Commission for the implementation of the new Basic Law are quite significant, since they show that it is possible to contain the financial problems foreseen some years ago, and still improve constantly the levels of social protection4.

Comparing this results with the early calculations of the Commission for the White Paper on Social Security Reform, one can see that public expenditure on pensions as a share of GDP is expected to increase significantly, since it goes from about 5,9% in 2000 to 8,9% in 2030 (similar to the global results of the White Paper Commission), and even so, the accumulated deficits are now totally contained during all this period. As a matter of fact, it is now foreseen that, with the new financing regime and new pension calculation, it is possible to get to 2030 with still an accumulated surplus in the public pension system, while the White Paper Commission results for the "current"

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4 See Annex – Table A4
system indicated that the accumulated deficit in 2030 would rise to something around 27% of GDP. The annual deficits on the "current" system were estimated as approximately 3.5% of GDP, while the results from the reform embodied in the new Basic Law indicate that by 2030 the system will be practically in equilibrium.

Furthermore, the fact that this reform contains significantly the annual deficits means that further measures that can be taken in order to improve the financing of the system won’t have to be too radical. On this matter, one should add that, following the approval of the new Basic Law, a debate is currently going on, that will hopefully lead to new sources of funding for the public pension system. Eventually, this will be the final step needed to ensure the long-term financial sustainability of the public pension system.

Other provisions of the new Basic Law include also:

- The support to the development of the normally so-called 3rd pillar of the pension system, through incentives (both by the means of reduction of contributory rate and/or tax reduction) to supplementary professional schemes or individual initiative of any employee;
- Progressive adaptation of civil servants scheme, in order to make it more similar to the general social security scheme, and therefore increase its financial sustainability;
- Improvement of the general protection granted by the system of solidarity and social security, and reorganization of the system’s management (making it closer to the citizens);
- Reinforcement of the protection to families in general, in the event of occurrence of new social risks.

4. Concluding Remarks

Portugal was coming to a crossroad five or six years ago. It was clear that the public pension system was facing major problems, due to the aging of population. Simultaneously, the levels of social protection were still far from the desired ones. Some tough decisions had to made. A corajous reform was initiated, with a national debate on what way to go: the decision was that the reform shouldn’t ever cause any significant reduction of social protection, since this was always and still is a major pillar of european societies (and particularly of the portuguese society). So, the challenge was tackled by attacking on the efficiency of the system and calling for reinforcement of national solidarity. Some innovations were also put in place in terms of financing.

The steps taken seem to have been in the correct direction. Anyhow, the goal will always be the reinforcement of social protection. So the debate is never over, and the challenge goes on in the years to come.
5. Bibliography


- Comissão de Regulamentação da Lei de Bases do Sistema de Solidariedade e Segurança Social (2001), 'The Impact of the new Basic Law on the Financial Sustainability of Public Pension System: Draft Reports and Unofficial Projections', unpublished

ANNEX
TABLE A1. ESTIMATES OF DEPENDENCY RATIOS 1990-2030

<table>
<thead>
<tr>
<th>Country</th>
<th>Elderly Dependency Ratio</th>
<th>Total Dependency Ratio</th>
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<tbody>
<tr>
<td></td>
<td>1990</td>
<td>2030</td>
</tr>
<tr>
<td>Germany</td>
<td>21.7</td>
<td>49.2</td>
</tr>
<tr>
<td>France</td>
<td>20.8</td>
<td>39.1</td>
</tr>
<tr>
<td>Italy</td>
<td>21.6</td>
<td>48.3</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>24.0</td>
<td>38.7</td>
</tr>
<tr>
<td>Austria</td>
<td>22.4</td>
<td>44.0</td>
</tr>
<tr>
<td>Belgium</td>
<td>22.4</td>
<td>41.1</td>
</tr>
<tr>
<td>Denmark</td>
<td>22.7</td>
<td>37.7</td>
</tr>
<tr>
<td>Finland</td>
<td>19.7</td>
<td>41.1</td>
</tr>
<tr>
<td>Greece</td>
<td>21.2</td>
<td>40.9</td>
</tr>
<tr>
<td>Ireland</td>
<td>18.4</td>
<td>25.3</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>19.9</td>
<td>44.2</td>
</tr>
<tr>
<td>Netherlands</td>
<td>19.1</td>
<td>45.1</td>
</tr>
<tr>
<td>Portugal</td>
<td>19.5</td>
<td>33.5</td>
</tr>
<tr>
<td>Spain</td>
<td>19.8</td>
<td>41.0</td>
</tr>
<tr>
<td>Sweden</td>
<td>27.6</td>
<td>39.4</td>
</tr>
<tr>
<td>USA</td>
<td>19.1</td>
<td>36.8</td>
</tr>
<tr>
<td>Japan</td>
<td>17.1</td>
<td>44.5</td>
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Source: Disney (1999)
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</thead>
<tbody>
<tr>
<td>GDP (real growth)</td>
<td>3.3</td>
<td>3.1</td>
<td>3.4</td>
<td>3.2</td>
<td>3.3</td>
<td>3.3</td>
<td>3.2</td>
</tr>
<tr>
<td>Employment</td>
<td>1.7</td>
<td>0.5</td>
<td>0.5</td>
<td>0.5</td>
<td>0.3</td>
<td>0</td>
<td>0</td>
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<tr>
<td>Productivity</td>
<td>1.6</td>
<td>2.6</td>
<td>2.9</td>
<td>2.7</td>
<td>3.0</td>
<td>3.3</td>
<td>3.2</td>
</tr>
<tr>
<td>Salary (real growth)</td>
<td>2.7</td>
<td>3.6</td>
<td>3.8</td>
<td>3.2</td>
<td>3.0</td>
<td>3.3</td>
<td>3.2</td>
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<tr>
<td>Inflation</td>
<td>2.9</td>
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<td>2.0</td>
<td>2.0</td>
<td>2.0</td>
<td>2.0</td>
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<tr>
<td>Unemployment Rate</td>
<td>4.2</td>
<td>4.2</td>
<td>4.2</td>
<td>4.2</td>
<td>4.5</td>
<td>4.4</td>
<td>4.0</td>
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**Source:** Comissão de Regulamentação da Lei de Bases do Sistema de Solidariedade e Segurança Social (2001), Unofficial projections
**Table A3. Projected Evolution of Current Public Pension System**

<table>
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<tr>
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<tbody>
<tr>
<td><strong>Annual Surplus/Deficit (% GDP)</strong></td>
<td>0,0%</td>
<td>0,2%</td>
<td>-0,1%</td>
<td>-0,7%</td>
<td>-1,6%</td>
<td>-2,5%</td>
<td>-3,5%</td>
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<tr>
<td><strong>Accumulated Surplus/deficit (% GDP)</strong></td>
<td>-0,2%</td>
<td>0,5%</td>
<td>0,7%</td>
<td>-1,5%</td>
<td>-7,1%</td>
<td>-15,6%</td>
<td>-27,0%</td>
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*Source: Comissão do Livro Branco da Segurança Social (1998)*
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</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Pension Expenditure (% GDP)</strong></td>
<td>5,9%</td>
<td>6,9%</td>
<td>8,4%</td>
<td>8,5%</td>
<td>8,7%</td>
<td>8,7%</td>
<td>8,9%</td>
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<tr>
<td><strong>Annual Surplus/Deficit (% GDP)</strong></td>
<td>1,1%</td>
<td>0,1%</td>
<td>0,0%</td>
<td>-0,2%</td>
<td>-0,4%</td>
<td>-0,3%</td>
<td>-0,4%</td>
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<tr>
<td><strong>Accumulated Surplus (% GDP)</strong></td>
<td>2,7%</td>
<td>6,2%</td>
<td>7,3%</td>
<td>6,3%</td>
<td>4,4%</td>
<td>2,8%</td>
<td>1,1%</td>
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*Source: Comissão de Regulamentação da Lei de Bases do Sistema de Solidariedade e Segurança Social (2001), Unofficial projections*