

NET PENSION REPLACEMENT RATES

Key results

Whilst the gross replacement rate gives a clear indication of the design of the pension system, the net replacement will matter more to the individual, as it reflects their disposable income in retirement in comparison to when working. For average earners, the net replacement rate from mandatory pension schemes averages 63% across the OECD, which is 10 percentage points higher than the average gross replacement rate. This reflects the higher effective tax and social contribution rates that people pay on their earnings than on their pensions in retirement, mostly due to the progressivity of tax systems, some tax advantages to pensions and the absence of pension contributions on pension benefits. Net replacement rates vary across a large range, from less than 30% in Mexico and the United Kingdom to over 100% in the Netherlands and Turkey for average-wage workers. For low earners (with half of average worker earnings), the average net replacement rate across OECD countries is 73% while it is 59% for high earners (150% of average worker earnings).

The previous indicator of the “Tax treatment of pensions and pensioners” showed the important role that the personal tax and social security contribution systems play in old-age income support. Pensioners often only pay health contributions and receive preferential treatment under the income tax. Tax expenditures and the progressivity of income taxes coupled with gross replacement rates of less than 100% also mean that pensioners have a lower income tax rate than workers. As a result, net replacement rates are generally higher than gross replacement rates.

For average earners, the net replacement rate across the OECD averages 63% for mandatory schemes, from a low of 29% in Mexico and the United Kingdom to a high of about 101% in the Netherlands and 102% in Turkey. Moreover, the pattern of replacement rates across countries is different on a net rather than a gross basis.

On average, for average earners, the net replacement rate is ten percentage points higher than the gross replacement rate. The difference is over 30 percentage points in Hungary and Turkey and around 20 percentage points in Belgium, Portugal, the Slovak Republic and Slovenia. In Hungary, the Slovak Republic and Turkey, pension income is neither liable for taxes or social security contributions, whilst in Belgium and Portugal they are much lower because of either higher tax allowances or much lower contribution levels.

For low earners, the effect of taxes and contributions on net replacement rates is more muted than for workers higher up the earnings scale. This is because low income workers typically pay less in taxes and contributions relative to average earners. In many cases, their retirement incomes are below the level of the standard reliefs in the personal income tax (allowances, credits, etc.). Thus, they are often unable to benefit fully from any additional

concessions granted to pensions or pensioners under their personal income tax.

The difference between gross and net replacement rates for low earners is 9 percentage points on average. Belgium, Germany, Portugal, Slovenia and Turkey have much higher replacement rates for low earners on a net basis than in gross terms. The net replacement rate for workers earning 150% of the average is highest in Turkey. The lowest replacement rates for high earners are found in Ireland, Mexico, New Zealand, Switzerland and the United Kingdom where workers earning 150% of the average will receive pensions that amount to less than one-third of their net earnings when working. In addition to the higher contribution levels in the occupational system for higher earners in Sweden, the net replacement rates are furthermore affected by the fact that pension income and work income are taxed differently and at different rates.

For non-OECD countries, there is very little variation in net replacement rates within countries across the earnings range. However, there is considerable difference between countries, ranging from 13% for average earners in South Africa to 93% in India. As with the gross rates, the EU28 average net replacement rate for average earners is markedly higher than the OECD35 figure, at 72%.

Definition and measurement

The net replacement rate is defined as the individual net pension entitlement divided by net pre-retirement earnings, taking account of personal income taxes and social security contributions paid by workers and pensioners. Otherwise, the definition and measurement of the net replacement rates are the same as for the gross replacement rate. Details of the rules that national tax systems apply to pensioners can be found in the online Country Profiles available at <http://oe.cd/pag>.

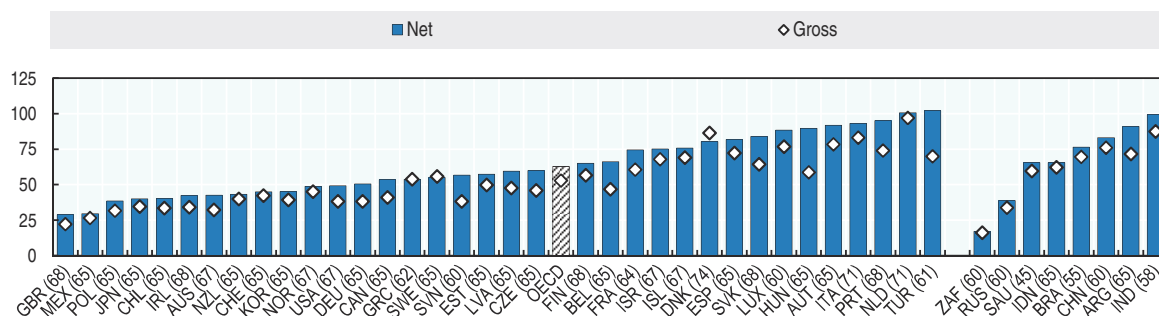
4.8. Net pension replacement rates by earnings

	Individual earnings, multiple of mean for men (women where different)				Individual earnings, multiple of mean for men (women where different)			
	Pension age	0.5	1	1.5	Pension age	0.5	1	1.5
OECD members								
Australia	67	95.0 (91.8)	42.6 (38.8)	45.4 (41.4)				
Austria	65	92.2	91.8	90.9				
Belgium	65	62.6	66.1	50.1				
Canada	65	62.2	53.4	38.5				
Chile	65	48.3 (45.6)	40.1 (36.3)	40.6 (36.7)				
Czech Republic	65	88.3	60.0	48.7				
Denmark	74	110.3	80.2	76.2				
Estonia	65	73.7	57.4	51.1				
Finland	68	66.9	65.0	65.1				
France	64	70.4	74.5	70.3				
Germany	65	54.7	50.5	49.8				
Greece	62	60.7	53.7	54.1				
Hungary	65	89.6	89.6	89.6				
Iceland	67	85.5	75.7	77.8				
Ireland	68	70.0	42.3	32.4				
Israel	67 (64)	100.4 (91.9)	75.1 (67.4)	54.9 (49.3)				
Italy	71	93.0	93.2	93.8				
Japan	65	52.6	40.0	35.3				
Korea	65	63.8	45.1	33.7				
Latvia	65	55.7	59.5	59.0				
Luxembourg	60	98.3	88.4	83.6				
Mexico	65	35.1	29.6 (27.7)	29.3 (27.5)				
Netherlands	71	105.1	100.6	100.2				
OECD members (cont.)								
New Zealand	65	80.7	43.2	30.5				
Norway	67	64.8	48.8	41.3				
Poland	65 (60)	37.2 (35.3)	38.6 (34.1)	37.9 (33.8)				
Portugal	68	92.9	94.9	93.1				
Slovak Republic	68	85.0	83.8	83.5				
Slovenia	60	57.3 (60.3)	56.7 (59.2)	54.1 (56.6)				
Spain	65	79.3	81.8	81.7				
Sweden	65	62.4	54.9	67.6				
Switzerland	65 (64)	57.4 (56.8)	44.9 (44.5)	31.5 (31.2)				
Turkey	61 (59)	99.1 (95.0)	102.1 (97.9)	105.8 (101.4)				
United Kingdom	68	52.1	29.0	20.7				
United States	67	59.9	49.1	42.4				
OECD	65.8 (65.5)	73.2 (72.7)	62.9 (62.2)	58.9 (58.2)				
Argentina	65 (60)	98.9 (90.3)	91.0 (83.1)	89.3 (81.3)				
Brazil	55 (50)	92.4	76.4 (58.1)	76.4 (58.1)				
China	60 (55)	104.4 (89.7)	83.0 (71.3)	77.0 (66.3)				
India	58	99.3 (94.4)	99.3 (94.4)	99.3 (94.4)				
Indonesia	65	65.4 (60.8)	65.5 (60.9)	66.1 (61.6)				
Russian Federation	60 (55)	53.0 (47.2)	38.8 (32.9)	33.5 (27.7)				
Saudi Arabia	45	65.4	65.4	65.4				
South Africa	60	32.1	17.1	11.9				
EU28	65.9 (65.5)	79.7 (79.6)	70.6 (70.4)	66.8 (66.6)				


Source: OECD pension models.

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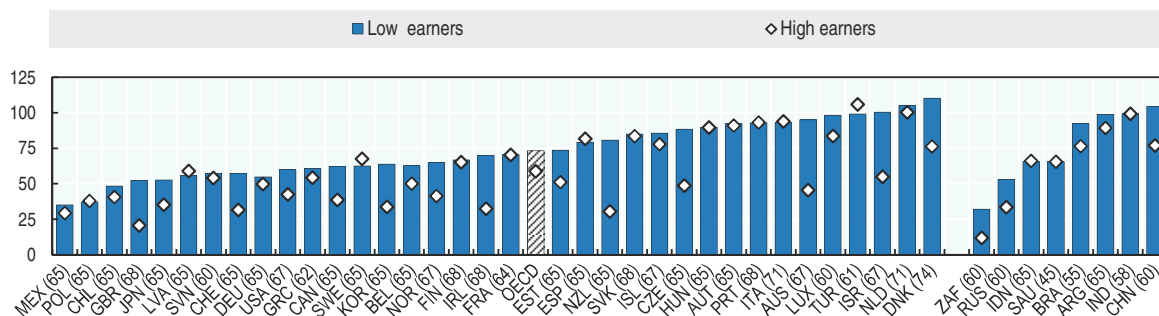
4.9. Net pension replacement rates: Average earners




Source: OECD pension models.

StatLink  <http://dx.doi.org/10.1787/888933634021>

4.10. Net pension replacement rates: Low and high earners



Source: OECD pension models.

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