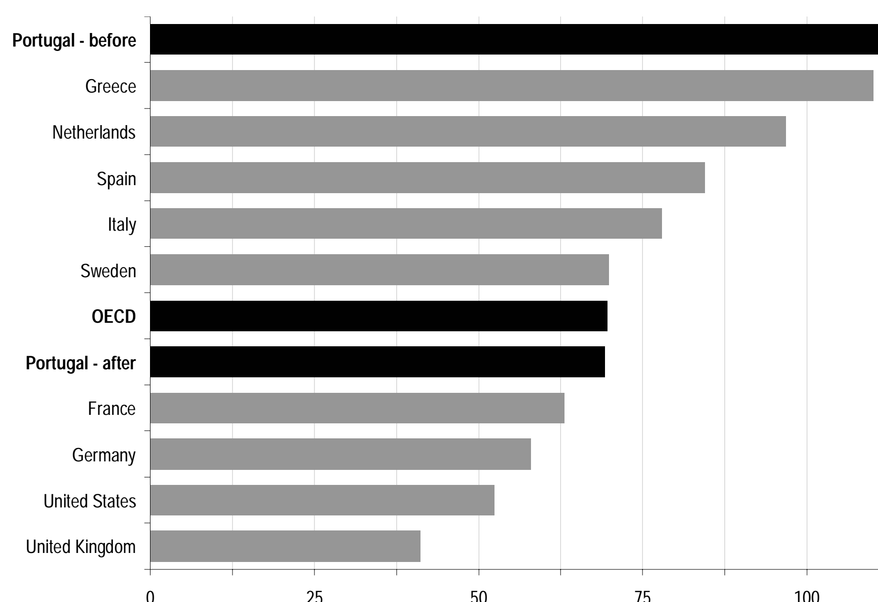
- Portugal's public pension spending is 36% higher relative to national income than the average in the 30 OECD countries and is growing rapidly: virtually doubling between 1990 and 2003.
- Pension reforms have significantly reduced future pension benefits for today's workers from the highest in the OECD to around the OECD average.
- Although recent reforms have increased incentives for older workers to work longer, it will still be possible to retire at 55, the lowest age in the OECD.

Portugal spent 10.5% of gross domestic product (GDP) on old-age and survivors' pensions in 2003, compared with an OECD average of 7.7%. Spending exceeds Portugal's in France (12.3%), Germany (11.7%) and Italy (13.9%). But Portugal's pension spending has grown faster: from 5.4% of GDP in 1990 to 10.5% in 2003.

Recent reforms should bring future pension spending under control. The changes include basing pensions on lifetime average rather than best 10 (of final 15) years of earnings and linking future benefits to changes in life expectancy. Figure 1 and Table 1 show how these reforms will affect the net replacement rate: pension relative to earnings when working, net of taxes and contributions.

Figure 1. **Net replacement rate in 10 OECD countries, average earner**



Source: OECD *Pensions at a Glance*

Before reform, an average earner in Portugal could expect a net replacement rate of 113%, meaning that net income in retirement for a full-career worker would exceed net earnings when working. This would have delivered the highest net replacement rate in the OECD, just above Greece but much higher than Italy and Spain, for example.

After the reform, the projected net replacement rate for an average earner is just under 70%, similar to the average for the 30 OECD countries as a whole. The pension reform has therefore reduced benefits to a much more sustainable level: it is difficult to believe that it would have been possible to maintain benefits at the pre-reform level without fiscal meltdown.

Recent reforms improved incentives for older workers to remain in work, but the rules still encourage early retirement. Benefits are in theory cut by 6% for each year of early retirement to reflect the longer period over which the pension must be paid. This is above the 5.1% average for the 18 OECD countries that allow early retirement. But for every three years of contributions above 30 years, the reduction is applied to one less year than actually taken as early retirement. So an individual working from age 25 to 61 could retire earlier than the normal age of 65 with benefits cut by just 6% but for two rather than four years, giving an effective cut of just 3% per year.

Finally, Portugal is one of only three OECD countries to allow early retirement on an old-age pension before age 60. Moreover, the qualifying conditions – 30 years' contributions in Portugal – are laxer than in the other two countries. Greece allows people to retire at 55 with 35 years' contributions and Luxembourg allows retirement at 57 with 40 years' contributions.

Table 1. **Net replacement rate in 10 OECD countries at 50%, 100% and 150% of average earnings**

	50%	100%	150%
France	63.4	63.1	58.0
Germany	53.4	58.0	59.2
Greece	113.6	110.1	110.3
Italy	81.8	77.9	78.1
Netherlands	97.0	96.8	96.3
Spain	82.0	84.5	85.2
Sweden	84.7	69.8	76.5
United Kingdom	66.1	41.1	30.6
United States	67.4	52.4	47.9
OECD 30	83.2	69.7	65.5
Portugal			
Before reform	106.1	113.2	112.1
After reform	81.6	69.2	72.2

Source: OECD *Pensions at a Glance*