Rebuilding state pension systems with fairness and urgency

These are the reforms needed to restore sustainability and trust to a system under demographic strain.



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For many countries around the world, state pensions are sacrosanct. Yet their sustainability

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faces three profound challenges: declining birth rates (meaning fewer new workers paying into the system), people living longer (meaning many more years of retirees receiving a pension) and labor markets that no longer guarantee long, continuous careers. Systems designed for younger societies with stable employment and steady contributions must adapt to these new realities.

Some countries — notably the Netherlands, which leads the Mercer CFA Institute Global Pension Index 2025, and Sweden, ranked sixth — have introduced reforms that combine fiscal discipline, transparent rules and clear communication with the public. Their experience shows that, beyond technical design, trust in the system is essential.

France offers a telling example. In October 2025, the government suspended an undeniably necessary reform to raise the legal retirement age from 62 to 64, following mass protests and parliamentary deadlock. The lesson is clear: pension reforms fail not for economic reasons but because they are social and political nonstarters.

Factors undermining pension sustainability

The sustainability of the state pension system is shaped by two major forces:

- **An aging population.** Across many advanced economies, life expectancy has risen while the number of contributors per pensioner has fallen. Whereas the average length of retirement used to be 10 years, today it is more like 20-25+ years. And the number of years worked for every year of retirement has gone down.
- **Declining labor income.** Labor income — the share of GDP generated by employee compensation, the basis of social security contributions — has fallen over recent decades. In Spain, it accounted for 55% of GDP in the 1990s; in 2025 it stands at around 50%. The main drivers of GDP now are automation and digitalization, which shift income toward capital ownership and reduce labor's share of value creation. When the wage share diminishes, so does the financing capacity of the pension system.

Given these demographic and economic pressures, some countries are considering the role of migration in making up for these imbalances. Theoretically, allowing in more migrant workers would expand the base of contributors. But as economist Joan Monras notes, many young migrants do not stay permanently or work in the formal economy, limiting their contribution to the system. Even in Spain — the EU country with the highest net migration — the Independent Authority for Fiscal Responsibility (AIReF) estimates that from 2029 onward,

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migration will not be enough to prevent a decline in the working-age population. This reinforces the need for structural pension reform.

A growing problem

Like many, Spain's state pension system faces a common challenge: paying out more than it is bringing in.

17.7 %
of Spanish GDP will go toward state pensions by 2050, compared with 12.9% today, if no changes are made.

5 reforms to secure the viability and sustainability of state pensions

Drawing upon our research and extensive simulations, Julian Diaz-Saavedra and I propose five strategic lines of reform.

1. Introduce objective adjustment mechanisms

The most resilient pension systems incorporate mechanisms that automatically adjust contributions or benefits independent of political cycles. Linking pensions to objective indicators such as life expectancy or the system's financial balance is essential. Countries like Sweden have shown that such mechanisms reduce fiscal pressure as populations age, stabilizing the system and avoiding the need for frequent, improvised, politically driven reforms.

- **The fix:** Pensions should be adjusted according to life expectancy. Pension indexation should account not only for inflation but also for the financial position of the system.

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2. Combine pay-as-you-go with mandatory savings

With fewer workers contributing, relying solely on a pay-as-you-go system is increasingly risky. To diversify sources of retirement income, a mandatory individual savings component should be introduced. Moving toward a mixed model — half pay-as-you-go, half privately funded — would help shield the public system from demographic shocks and distribute the burden more fairly across generations.

- **A model to follow:** Sweden combines collective pay-as-you-go with mandatory individual defined contribution (DC) accounts managed by the state and invested in private funds. Its "premium pension" system has turned millions of workers into active savers and investors to guarantee their financial security in their retirement years.

3. Increase contributory fairness

In many countries, pensions are calculated using only part of a worker's career or based on formulas that ignore actual lifetime contributions. This favors individuals with high salaries late in their careers and penalizes those who contribute steadily over time. To reduce such inequalities, pension entitlements should reflect every amount contributed over a worker's full working life.

- **Make it fair:** Abolish the maximum contribution ceiling while keeping the maximum pension unchanged. This raises revenue without negatively affecting the middle classes.

4. Separate pensions from other social security costs

Sustaining pensions requires transparent accounting. Many public expenses covered by social security contributions — such as disability or parental leave — are not related to retirement. Financing these items separately, either through differentiated contributions or via the general budget, would clarify which costs belong to pensions and which reflect broader social welfare policies. Ultimately, pensions are deferred wages, and the portion of contributions allocated to them is mandatory retirement savings.

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- **Ringfence:** Separating out pensions from other social security expenses would improve accountability and transparency without increasing total spending.

5. Ensure the political viability of reforms

Pension reforms fail more often due to social resistance than to technical shortcomings. Governments that have attempted reforms without addressing the interests of those most affected have been forced to backtrack in the face of public protests (as France did in 2025). To avoid such backlash, compensation mechanisms must be designed into any reform.

- **Legitimize:** Complement reforms with transfers — financed through public debt or tax incentives — for the groups most adversely affected, typically younger workers with high contribution rates. This enhances social acceptance and reduces the political cost of reform.

Time to act on pensions

There is still time to adapt state pension systems before demographic change overwhelms them. The goal is not to spend less, but to spend better: to build stable, transparent and fair rules that distribute pension costs equitably.

These reforms must be accompanied by financial literacy initiatives that help citizens understand how pensions are financed and what personal financial decisions they should make to enhance their future wellbeing in retirement.

With social responsibility and a long-term vision, state pensions can remain a sustainable intergenerational pact rather than a source of social division and conflict.

Retirement: the global panorama

A 2025 ranking of 52 pension systems around the world by Mercer Consulting, the CFA Institute and Monash Business School in Australia graded pension systems according to three benchmarks — adequacy, sustainability and integrity — which Javier Diaz-Gimenez and Julian Diaz-Saavedra also highlight in their research on Spain’s pension system.

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What follows are five common policy areas that governments are targeting to safeguard the future of their state pension systems in response to the changing retirement landscape.



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MORE INFO: "Public pension reforms: financial and political sustainability" by Javier Diaz-Gimenez and Julian Diaz-Saavedra. *European Economic Review* (2025).

"Factor income shares and pension sustainability: a primer" by Julian Diaz-Saavedra and Javier Diaz-Gimenez (2024).

WATCH: In this IESEconomics video, "Pensions under stress," Javier Diaz-Gimenez discusses the pension crisis and how we can best adapt to the new demographics.

READ ALSO:

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