THE 2025 PENSION REFORM: A MISSED OPPORTUNITY

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One year after the debate on the sustainability of Luxembourg's pension system began, the long-awaited reform to the first pillar has just entered the legislative process. This follows a meeting between the Government, trade unions and employers on 3 September 2025, during which all three parties discussed their visions in light of updated projections from the General Inspectorate of Social Security (*Inspection Générale de la Sécurité Sociale* – IGSS).

Despite the scale of the challenges identified, the texts submitted focus on short-term adjustments. They therefore delay the necessary structural decisions to a later point in time.

THE PRE-REFORM SYSTEM: EFFECTIVE, BUT LESS AND LESS SUSTAINABLE

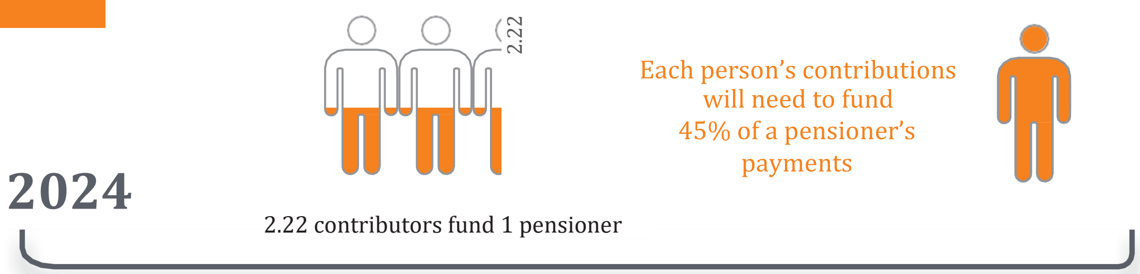
Luxembourg currently has one of the most generous pension systems in Europe and the world. The average replacement rate is around 75% of the average career salary, compared to between 40% and 58% in neighbouring countries. This generosity is underpinned by the first pillar, funded using a pay-as-you-go system via a 24% contribution rate (3 × 8%) shared between employees, employers and the State.

For a long time, this model worked thanks to exceptional growth in the working population, which maintained the supply of contributions and resulted in regular increases in the pension reserve.

As of 31 December 2024, the Compensation Fund (*Fonds de compensation*) held a record reserve of over €30 billion, equivalent to around 4.5 times the annual benefits paid.

This reserve continues to grow in absolute terms, but the tipping point is rapidly shifting. According to the latest estimate from the IGSS, under the existing system and without any changes, the contributions received will no longer be sufficient to cover pensions paid out already as from 2026. Under the baseline scenario, the reserves will be fully exhausted by 2044 even supposing average economic growth of 1.8%.

This baseline scenario assumes the following ratio of contributors to pensioners:



Year	2024	2030	2040	2050	2060	2070	Growth
Working population	504,000	553,000	605,000	644,000	658,000	659,000	0.6%
Number of pensions	225,000	286,000	391,000	507,000	642,000	755,000	2.7%
Pensioner to contributor ratio	45%	52%	65%	79%	98%	115%	-

	Critical years
Contributions ‹ Pensions	2026
Reserve exhausted	2044

A PARTIAL AND POLITICALLY PRUDENT REFORM

The 2025 reform takes an approach based on short-term adjustments. Its main measures are as follows:

1. Increase in the contribution rate

The primary measure is an increase in the contribution rate from 24% to 25.5%, with 8.5% from each stakeholder (employee, employer and State).

Impact on the CNAP's budget

In 2026, the National Pension Insurance Fund (*Caisse nationale d'assurance pension* – CNAP) is estimated to receive an additional €146 million from the State, €146 million from employees and €146 million from employers.

Over the next six years, it is estimated that additional contributions from each of the three stakeholders will total €1.202 billion.

Year	Additional State contributions	Additional employee contributions	Additional employer contributions
2026	146	146	146
2027	188	188	188
2028	201	201	201
2029	211	211	211
2030	222	222	222
2031	234	234	234
Total	1,202	1,202	1,202

in €m

Year	Additional State contributions	Loss in State tax revenue	Total cost to the State
2026	146	88	234
2027	188	112	300
2028	201	120	321
2029	211	126	337
2030	222	134	356
2031	234	140	374
Total	1,202	720	1,922

in €m

Impact on the State budget

What the CNAP receives as income is, in part, an expense for the State. The latter must directly fund its third of the additional contributions, and as employees' and employers' contributions are tax-deductible, the State loses out on tax revenue.

Taking both of these effects into account, the total impact on public finances over the next six years is estimated at €1.922 billion.

2. Repeal of measures taken in 2012 that would have been beneficial

The 2025 reform walks back two provisions introduced in 2012, further harming the financial viability compared to the assumptions used by the IGSS in pre-2025 reform simulations and bringing the critical years and exhaustion of reserves even closer.

2.1. Postponing the adjustment brake mechanism

Note that in addition to being indexed, pensions currently paid are increased every year by the adjustment rate. This adjustment represents the growth generated by the working population and is also reflected in the amounts paid to pensioners. On average, pensions are increased by 2% each year due to indexing and a further 1% due to adjustment.

In 2012, a mechanism was introduced to reduce pension adjustment when contributions in a given year would no longer cover pensions for that same year.

This mechanism has been neutralised for the next six years as a result of increased contributions with the 2025 reform. This change delays the application of the corrective measure and artificially extends a costly revaluation process.

Postponing has consequences on two levels, both in terms of the private sector pension scheme and in terms of the dedicated schemes for civil servants.

The impact of postponing the adjustment brake mechanism

Statutory pensions under the general pension scheme

Impact on the CNAP's budget

Based on annual pensions totalling €7.4 billion for the private sector, the impact of this delay results in additional outlay of €1.541 billion for the CNAP over the next six years. We arrived at this estimate via the same assumptions as those used in the simulations for the IGSS's pre-reform baseline scenario – that is, adjusting pensions by 0.25% instead of 1% per year from the year in which contributions are no longer sufficient. Then, for each year, we will look at the difference in expenditure.

Year	Estimated annual pensions with a 0.25% adjustment	Estimated annual pensions with a 1% adjustment	Impact of postponing the adjustment brake mechanism to 2031
2025	7,362	7,362	
2026	7,835	7,894	59
2027	8,338	8,464	125
2028	8,874	9,075	201
2029	9,445	9,730	286
2030	10,052	10,433	382
2031	10,697	11,187	489
Total			1,541

in €m

For the sake of completeness, it should also be mentioned that from 2031, this difference of €489 million will remain an annual future cost because previously awarded adjustments will not be reversed.

Statutory pensions in the public sector

Year	Estimated annual pensions with a 0.25% adjustment	Estimated annual pensions with a 1% adjustment	Impact of postponing the adjustment brake mechanism to 2031
2025	1,347	1,347	
2026	1,407	1,418	11
2027	1,471	1,493	22
2028	1,565	1,601	35
2029	1,666	1,716	50
2030	1,773	1,840	67
2031	1,887	1,973	86
Total			271

in €m

Impact on the State budget

Based on annual pensions totalling €1.4 billion for the public sector, the impact of this delay results in additional outlay of €271 million for the State over the next six years.

Once again, for the sake of completeness, it should also be mentioned that from 2031, the difference of €86 million will remain an annual future cost because previously awarded adjustments will not be reversed.

2.2. Maintaining the end-of-year allowance:

The automatic stabilisation mechanism provided for by the 2012 reform included the automatic cancellation of the end-of-year allowance as soon as the contribution rate rose above 24%. Rather than leave this mechanism unchanged and allow it to take effect, the 2025 draft law increases this threshold to 25.5%, thus preventing its application from 2026.

This political choice weakens the guardrails created by the 2012 reform.

Had the 2025 reform left this article provided for by law unchanged, the stabilisation measure would have prevented CNAP expenditure totalling €1 billion over the course of the next six years.

Statutory pensions under the general pension scheme

Year	Impact of maintaining the end-of-year allowance
2026	144
2027	153
2028	164
2029	175
2030	186
2031	199
Total	1,021

in €m

Year	number of whole months
2026	1
2027	2
2028	4
2029	6
2030	8
after 2030	8

3. Other one-off adaptations as part of the 2025 reform

Alongside these measures are a number of one-off adaptations:

3.1. Early retirement reform

Early retirement at 57 remains possible for those who have a total of 40 years of contributions.

For others who will be working for the full 40 years, the retirement age of 60 will be gradually extended by a few months of contributions each year (see table).

This measure protects the spirit of the current system while seeking to slightly extend the effective contribution period without affecting the rights acquired.

3.2. Tax relief for keeping employees in work

A monthly tax relief of €750 (equivalent to €9,000 per year) is awarded to contributors who already qualify for early pension but choose to continue working, up to the statutory retirement age of 65.

The draft law estimates the measure's annual cost to the State at around €11 million per year, based on approximately 4,000 potential beneficiaries and an average tax rate of 30%.

In terms of the State budget, the cost to the State over six years could be €66 million.

It is estimated that, by extending careers using these two measures (additional months of contributions and tax relief), the CNAP will save around €0.984 billion over the next six years.

Statutory pensions under the general pension scheme

Year	Impact of career extension
2026	37
2027	85
2028	128
2029	182
2030	244
2031	313
Total	984

in €m

3.3. Gradual part-time retirement

The reform introduces the option for employees qualifying for an early pension to reduce their working time by at least 25% while receiving a compensatory partial pension until the age of 65 at the latest.

Throughout the three years preceding the request, the requesting employee must have worked at least 75%.

The process requires the employer's agreement and is subject to a minimum requirement of 16 hours of work per week.

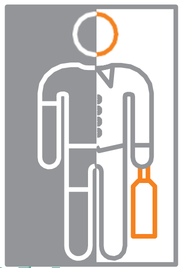
The pension fund reimburses the employer for the corresponding portion of the early retirement benefit and employer costs.

The aim is to encourage a smooth transition to retirement while avoiding a significant immediate impact on public finances.

3.4. Extended recognition of study and training periods

Up to nine years of assimilated periods (including after the age of 27) may now be credited towards the insurance career.

This provision improves coverage for long academic courses, but helps to increase future pension entitlements without corresponding revenue.



3.5. Increased ceiling for tax-deductible contributions to the third pillar (Article 111bis LIR)

The ceiling is rising from €3,200 per contributor per year to €4,500 per contributor per year.

The draft law estimates the measure's budget cost at €25 million based on an €83 million increase in annual premiums, which would correspond to 40,000 new contracts with €2,000 of annual premiums.

However, this estimate seems extremely optimistic, not only given the current number of policies and the actual growth potential of the pension savings plan market, but also because it does not take account of the fact that the capital is taxed at half the normal rate at maturity.

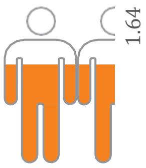
In other words, the net cost to the State has probably been overestimated.

ASSESSMENT OF THE IMPACT OF THE 2025 REFORM

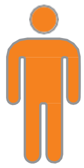
The IGSS has assessed the impact of all of these measures on the pension system's long-term sustainability (see the financial statement of the draft law).

Impact on the pensioner to contributor ratio and critical years

caused by increasing the contribution rate, delaying the adjustment brake mechanism, maintaining the end-of-year allowance and extending mandatory contribution periods:



Each person's contributions
will need to fund
61% of a pensioner's payments



2040

1.64 contributors fund 1 pensioner

Year	2024	2030	2040	2050	2060	2070	Growth
Working population	504,000	563,000	621,000	664,000	680,000	680,000	0.7%
Number of pensions	225,000	278,000	381,000	493,000	622,000	732,000	2.6%
Pensioner to contributor ratio	45%	49%	61%	74%	91%	108%	-

At the CNAP level, the exhaustion of reserves has been pushed back by four years.

Before the 2025 reform

	Critical years
Contributions ‹ Pensions	2026
Reserve exhausted	2044

After the 2025 reform

	Critical years
Contributions ‹ Pensions	2029
Reserve exhausted	2048

CONSOLIDATED ESTIMATE OF EXPENDITURE AND REVENUE FOLLOWING THE 2025 REFORM

We will now take a closer look at what the estimated consolidated result would be for the CNAP and State budget.

The CNAP and State budgets are always presented separately. As both are collectively funded, a consolidated look at the next six years is of interest.

Total over 6 years (2026 - 2031)	CNAP Expenditure	CNAP Revenue		State Expenditure	State Revenue
0.5% increase in the State contribution rate		1,202		1.202	
0.5% increase in the employee contribution rate		1,202			-360
0.5% increase in the employer contribution rate		1,202			-360
Maintenance of total adjustment	1,541			271	
Maintenance of the end-of-year allowance	1,021				
Delayed retirement	-984				
Tax relief if actual retirement › possible early retirement date				66	
Outcome of the 2025 reform	2,027			-2,259	
			-232		

It should be noted that over the next six years, the additional contributions paid by employees and employers will be used to fund the maintenance of the end-of-year allowance paid to current pensioners as well as the total increase – via adjustment – in pensions currently being paid.

Who shoulders the burden of the reforms?

In 2012, the reform involved two components:

- Changing the parameters used to calculate future pensions. Reductions in future pensions were estimated at between 0% for those retiring in 2012 and 15% for those who would retire in 2052. This burden was therefore shouldered by future pensioners, i.e. those working at the time of the reform.
- Reducing the pension adjustment rate and abolishing the end-of-year allowance once contributions were no longer sufficient to pay pensions. This was a means to ensure that pensioners would in the future contribute to the stabilisation of the pension system.

In 2025

- Increased contributions: cost borne by the working population
- The contribution to be made by pensioners, as provided for in the 2012 reform, has been delayed by at least six years. As such, pensions will continue to grow at a higher rate than if no reform had taken place and pensioners will continue to receive the end-of-year allowance.
- Pushing back the age of early retirement: borne by future pensioners, i.e. the working population.

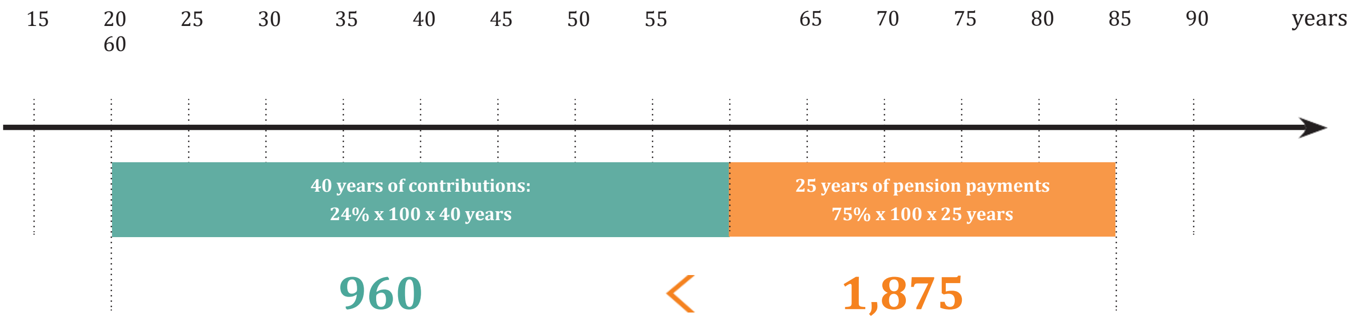
All of these measures reflect a desire to achieve social balance and encourage people to work longer, but have no real structural effect on the system's sustainability. On the contrary, the country will spend an additional €232 million over the next six years than if the 2025 reform had not occurred.

Impact on structural imbalance

The underlying imbalance remains: an average career with 40 years of contributions continues to fund around 25 years of pension at 75% of former income.

<u>An extremely simplified example of an average career</u>
Assumption: constant salary for 40 years = **100**

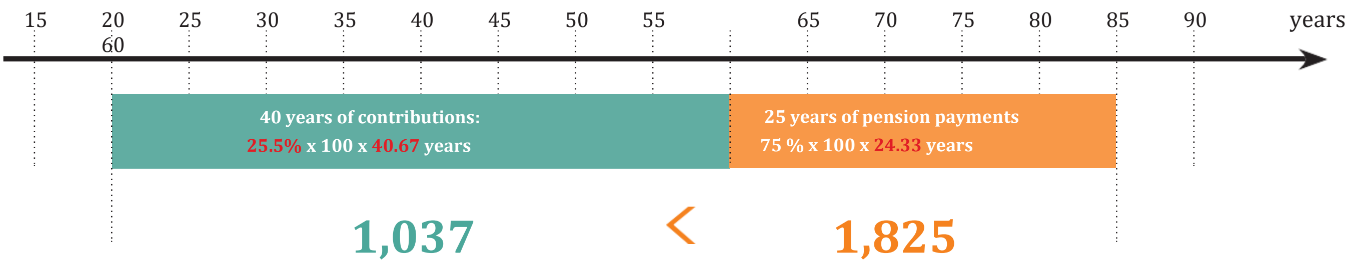
Before the reform



Profound imbalance between money paid in and out over the course of an individual's life

After the reform

Clear imbalance remains



Profound imbalance between money paid in and out over the course of an individual's life

CONCLUSIONS

A reform dictated by the political situation

Discussions between the government, trade unions and employers in September revealed the deep-rooted differences between stakeholders.

The Luxembourg Employers' Association (*Union des Entreprises Luxembourgeoises* – UEL) based its position on the IGSS's detailed simulations, which confirm the scale of the imbalance to come. Trade unions questioned these projections, believing them to be too pessimistic.

In response to this impasse, the Government opted for a political compromise: a moderate increase in contributions alongside symbolic social measures, while making significant adjustments neither to retirement age nor to the formula used to calculate pensions.

Additionally, the adjustment will not be reduced for pensions currently being paid and the end-of-year allowance will remain in place.

This decision is understandable as a means of reaching social consensus. Nevertheless, the current reform does not tackle the key tools for achieving intergenerational balance.

The IDEA Foundation expressed it clearly in documents published in October 2025:

"'The pension system does not need to be adjusted because of its generosity, but because its generosity is a promise that cannot be kept."

A social compromise, but a structural step backwards

In practice, the 2025 reform provides short-term reassurance without resolving the underlying imbalance.

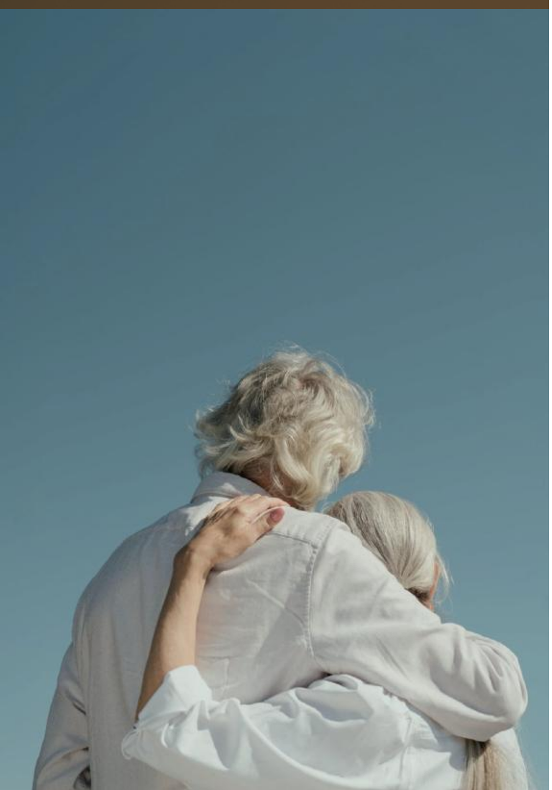
It delays the introduction of the brake mechanism on automatic pension adjustments, pushes back the abolition of the end-of-year allowance, postpones early retirement and increases costs for the three contributors.

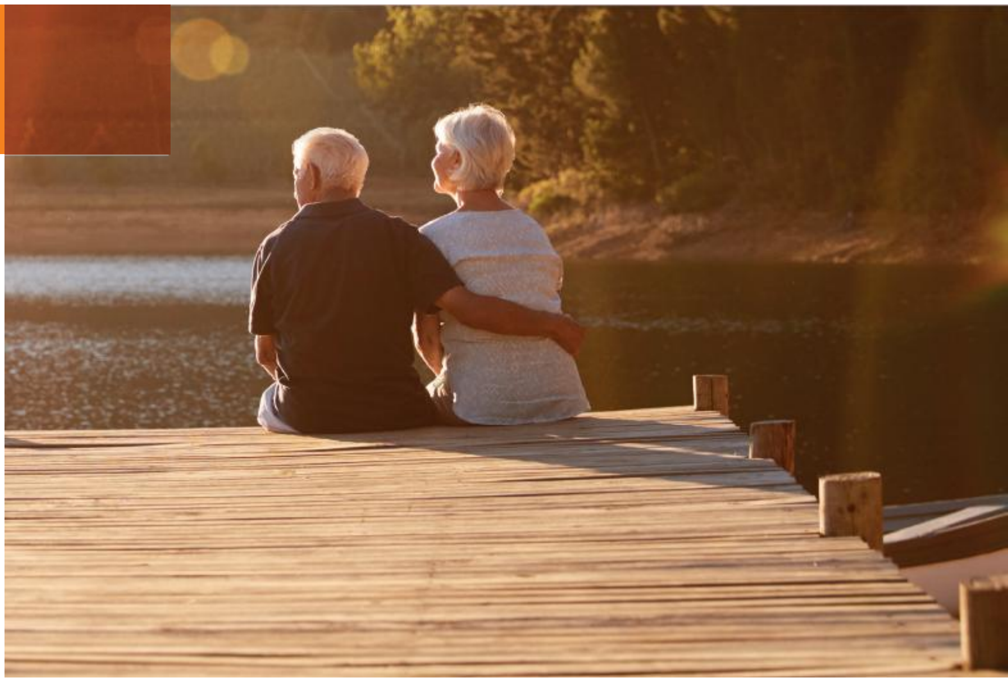
The risk is twofold

- weakening confidence among younger generations who doubt that they will receive a fair pension in the future;
- and increased pressure on businesses' competitiveness and on public finances.

The country's growth, which STATEC estimates at between 0.2% and 1.7% in the long term, will not be sufficient to compensate for the increased burden.

If these underlying parameters are not reviewed, the financial trajectory will remain unsustainable beyond the next decade.





Maintaining the balance between solidarity and responsibility

Luxembourg remains a model of intergenerational solidarity.

However, such solidarity can only continue to exist if it is underpinned by sustainable mechanisms.

The 2025 reform aims to ease social tensions, but is not an overhaul of the system.

By suspending the regulatory instruments introduced in 2012 and focusing on one-off measures, it delays the debate on the crux of the matter: how to ensure a pension system that is fair to all generations and sustainable in decades to come.

Future reforms will have to be more substantial, more costly and more painful for everyone, because in the medium term, it is impossible to pay out more than revenues allow.

GLOSSARY

CNAP Caisse Nationale Assurance de Pension
IGSS Inspection Générale de la Sécurité Sociale
CNS Caisse Nationale de Santé