Public/private mix in pensions in Europe

The role of state, market and social partners in supplementary pensions

David Natali

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european trade union institute
This paper is an outcome of the OSE-ETUI joint research project ‘The governance of supplementary pension schemes’.

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Introduction

In the last two decades, pensions policy has undergone numerous innovations across Europe and the changes have been characterised by common trends. These include cost-containment measures under the public pillar; increased attention to the regulation of supplementary pension schemes; the revision of tax policy; and the introduction of new forms of governance of public and non-public pillars. In many European countries reforms have thus led to increased complexity of pension systems, insofar as they now typically entail parallel action of the first public pillar and supplementary pension funds.

Accordingly, it would seem urgent to redirect the interest of pensions policy scholars and stakeholders from the predominant past focus on public pension schemes to a more balanced focus on first-, second- and third-pillar schemes. Any reflection upon the future of pensions policy in Europe must start out from an understanding of its current and future operation under different pillars. Such a revised analytical focus may contribute to tackling the following policy challenges: defining a coherent framework for the governance of the more complex pension systems; implementing new forms of solidarity and redistribution through the first, second and third pillars; using old (contribution, benefit formulae) and new (taxation, monitoring, regulation) policy tools to define and implement broad pension policy strategies.

This paper focuses on two policy-relevant research questions. First of all, what are the key institutional and policy features of the reformed pension systems in Europe? In answering this research question we set out to assess the place of the different pillars and the key elements of their operation in European countries. Secondly, what are the key policy tools that policymakers (and stakeholders) may use for steering pensions policy? Complex governance

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1. For supplementary schemes we refer to both second- and third-pillar schemes. The second pillar consists of non-public schemes in which membership is collective and linked to employment status or occupation. These are defined as occupational or professional schemes and usually operate on a funded basis. Pensions can be defined-benefit or defined-contribution. Each programme covers a group of workers defined at the company and/or sectoral level. This arrangement is private in that it is not established by law (but by collective agreement) and is run by social partners. It can be mandatory, quasi-mandatory or voluntary. The third pillar is represented by voluntary savings set aside by an individual for his/her old age. These consist of individual provisions, and this pillar is private in that it is not established by law and is based on contracts signed by insured individuals with private institutions (e.g. life insurance companies, banks, or pension funds still with individual membership). Third-pillar schemes are fully-funded, with limited if any redistributive aims.
mechanisms will be summarised in order to offer a broad overview of the interplay between state, market and social partners, as well as of the governance tools that may be activated for the purpose of achieving a revised pensions policy strategy.

Section one refers to the European pension models characteristic of the 21st century. The aim here is to shed light on the outcome of recent reforms (largely characterised by the increased role of supplementary schemes in providing old-age protection). Section two analyses the main present and future challenges to the financial sustainability and social adequacy of pension systems in Europe. Both are increasingly shaped by the performance of supplementary pension funds. Section three introduces some of the key analytical dimensions of the interplay between state, market forces and social partners. Sections four and five provide evidence of the role of the state and social partners in the governance of supplementary schemes. This role is consistent with opportunities to deal with the above-mentioned problems of sustainability and adequacy, as well as risks of governance inefficiency. Section six concludes with a list of issues for the future of pensions policy that are of key importance for both analysts and stakeholders.
1. Reformed pension models in Europe

Contemporary literature on pensions has generally proposed two main clusters (Bismarckian vs. Beveridgean – Myles and Quadagno, 1997; social insurance vs. late-comers – Hinrichs, 2001; social insurance vs. multi-pillar systems – Bonoli, 2003), consistent with two different paradigms. While this classification was particularly useful for summarising the main features of pension programmes in western Europe throughout the 20th century, it is appropriate to consider to what extent this analytical effort is consistent with the pensions map of Europe at the beginning of the 21st century?

According to an expression used by Hemerijck (2006), we can observe a process of ‘contingent convergence’ of pensions policies and the adoption of similar policy initiatives. Much innovation has taken place in relation to social insurance and (post-) Communist systems. In many of these former Communist countries, public schemes are still the backbone of pension systems, but they no longer have the quasi- or full monopoly of the old-age benefit provision. Yet convergence towards various forms of multi-pillar system does not mean the emergence of a single European pension model, for important differences are still to be observed between clusters of countries. Table 1 summarises what we call the 21st century pension models.

Table 1 21st century pension models

<table>
<thead>
<tr>
<th>Public schemes’ goal</th>
<th>1st generation multi-pillar</th>
<th>2nd generation multi-pillar</th>
<th>Social insurance in transition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public schemes’ goal</td>
<td>Basic protection (poverty prevention)</td>
<td>Salary savings (some adequacy)</td>
<td>Salary savings (some adequacy)</td>
</tr>
<tr>
<td>Private schemes’ coverage</td>
<td>Mandatory or quasi-mandatory (mainly private)</td>
<td>Mandatory Public/private</td>
<td>Voluntary (mainly) public</td>
</tr>
</tbody>
</table>

Source: Natali (2008)

For a first group – represented by the UK, Ireland, Denmark and the Netherlands – we use the label ‘first generation of multi-pillar systems’. In such cases, the system has proved stable. Earnings-related schemes are mainly private, while the key role of public programmes is to prevent the risk of poverty. The latest wave of reforms in multi-pillar systems has entailed the stabilisation of public pension spending (through cutbacks and some improvements for low earners). Supplementary schemes have taken on a growing importance especially in the UK. This has been paralleled by the
increased complexity of the ‘public/private’ partnership and abandonment of the purely voluntary approach (Holzmann and Hinz, 2005).

Some central-eastern European countries (e.g. the Baltic states, Poland and other CEE countries) represent the second generation of multi-pillar systems. The role of supplementary schemes is increasing (through mandatory coverage) but the provision of future earnings-related benefits will be based on both public and non-public programmes. While in the first generation of multi-pillar systems public programmes provide basic and homogenous protection (with flat rate and/or means-tested benefits), in these post-Communist systems the public programme provides contribution-based and earnings-related benefits. This is consistent with the actuarial (insurance) principle. Further voluntary pension funds are of limited significance in these countries. The level of public protection varies from country to country. In the Baltic countries the average replacement rate is particularly low (much lower than in Poland). The interaction between public earnings-related schemes and minimum (means-tested) pensions is decisive for defining the future role of public programmes. If minimum benefits are set at a high level, a major part of earnings-related benefits are likely to be below the threshold such that pensioners come to be included in the group receiving means-tested benefits. This may be expected to lead to a pension system rather similar to the first generation of multi-pillar systems.

The third group, ‘social insurance systems in transition’, is represented by continental and southern European countries (e.g. Belgium, France, Italy) and some eastern countries, including Slovenia. In this latter country, reforms undertaken during the transition phase confirmed the key features of the public pillar, insofar as they opened up opportunities for supplementary non-public schemes, thereby ending the public monopoly. The resulting system is thus similar to that of social insurance countries. In all these countries, recent innovations have aimed at bringing public spending under control. Average old-age benefit is projected to decline (Holzmann et al., 2001), while non-public schemes are expected to play a greater role in the future. In comparison with the pre-reform scenario, the goal of maintaining similar living standards before and after retirement is shared between public and non-public programmes. As in the second generation of multi-pillar systems, public pensions are earnings-related and based on actuarial principles. However, the public benefits are more generous and expected to play the major role in providing incomes for the elderly. Moreover, supplementary schemes are not mandatory, a fact that has led to the much slower widening of their coverage. These systems are still in transition and various alternative scenarios for their future evolution appear plausible.

The first scenario consists of the completion of the transition towards second-generation multi-pillar systems. Lower public protection will be supplemented by widespread (mandatory and/or quasi-mandatory) supplementary schemes. Recent reforms in continental and southern European countries could represent the gradual extension of second and/or third pillar coverage through collective bargaining and some forms of ‘auto-enrolment’. The second scenario
is that of the stabilisation of a ‘Bismarckian Lite’ model, similar to that found in the USA (Weaver, 2005). Lower protection from public earnings-related schemes would be implemented in parallel with voluntary private schemes of limited coverage. A third and less probable scenario would be that of the future reversal of reforms introduced in the last twenty years. A lengthy transition before the full implementation of the new rules could leave room for a further increase in public benefits. In such a case, recent innovations would represent ‘false’ path departures from the social insurance model (Natali, 2008).

While Sweden shares some of the key features of the post-reform social insurance countries, in this country the transition to some form of multi-pillar system is more advanced. Public pensions are earnings-related and increasingly based on actuarial principles. Non-public programmes are widespread, occupational schemes (second pillar) being quasi-mandatory and covering the totality of the workforce. Individual schemes (third pillar) are also well developed and further contribute to the incomes of the elderly. ‘Premium pensions’ (third tier of the first pillar) are additional mandatory funded schemes. To a major extent, therefore, the system is a ‘composite’ one in that pensioners’ income is determined by many sources: public, private and mandatory, occupational and quasi-mandatory, as well as individual and voluntary schemes.
2. Present and future challenges to pensions policy

Pension systems thus, after the reforms, consist of new forms of interaction between the sectors providing protection against old-age risks. The new form of pension mix is also bound to entail a re-articulation of the roles of the different institutions involved in the provision of benefits (Leinert and Hesche, 2000). The role of the state in providing protection through social policy (redistribution) is expected to decline, while that of social partners and the market will increase. Figure 1 below shows the increased role of pension funds across OECD countries.

Table 2 shows the projected ‘recalibration’ of first public pillar schemes and supplementary programmes and the expected consequences on pension benefit levels, namely, the decrease of public pensions and the increase of supplementary benefits (Berghman et al. 2007; Bonoli, 2005).
In parallel with the growing role of occupational and individual supplementary schemes, questions concerning the financial viability and the social adequacy of pension systems have come increasingly to the fore (De Deken, 2007; Gora and Palmer, 2004). Recent innovations in many European countries have aimed at bringing public spending under control. As a result of this, average old-age benefits are projected to decline and non-public schemes will play a greater role in the future. Compared with the pre-reform scenario, the goal of maintaining similar living standards before and after retirement is now shared between public and non-public programmes. The degree to which these more complex pension systems can provide adequate protection against old-age risks is still up for discussion. It has been seen that new problems arise and seem to demand state intervention. Problems related to to mis-selling and mis-management of private products have, for instance, led to the increased regulation and coordination of the private pensions market (see UK and the Netherlands).

Table 2 Projected trends of gross replacement rates in selected EU countries

<table>
<thead>
<tr>
<th></th>
<th>2004</th>
<th>2030</th>
<th>2050</th>
<th>Diff. 2004-50</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>BELGIUM</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross replacement rate*</td>
<td>43</td>
<td>48</td>
<td>47</td>
<td>4</td>
</tr>
<tr>
<td>First pillar</td>
<td>39</td>
<td>38</td>
<td>37</td>
<td>-2</td>
</tr>
<tr>
<td>Second pillar</td>
<td>4</td>
<td>10</td>
<td>10</td>
<td>6</td>
</tr>
<tr>
<td><strong>ITALY</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross replacement rate*</td>
<td>78.9</td>
<td>79.8</td>
<td>79.6</td>
<td>0.7</td>
</tr>
<tr>
<td>First pillar</td>
<td>78.9</td>
<td>70.7</td>
<td>64.1</td>
<td>-14.8</td>
</tr>
<tr>
<td>Second pillar</td>
<td>-</td>
<td>9.1</td>
<td>15.5</td>
<td>15.5</td>
</tr>
<tr>
<td><strong>SWEDEN</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross replacement rate*</td>
<td>68</td>
<td>58</td>
<td>56</td>
<td>-12</td>
</tr>
<tr>
<td>First pillar</td>
<td>53.0</td>
<td>42.6</td>
<td>40.4</td>
<td>-12.6</td>
</tr>
<tr>
<td>Second pillar</td>
<td>14.7</td>
<td>15.8</td>
<td>15.4</td>
<td>0.7</td>
</tr>
<tr>
<td><strong>UK</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross replacement rate*</td>
<td>67</td>
<td>68</td>
<td>69</td>
<td>2</td>
</tr>
<tr>
<td>First pillar (1st tier)</td>
<td>17.0</td>
<td>18.0</td>
<td>19.0</td>
<td>2.0</td>
</tr>
<tr>
<td>Second pillar</td>
<td>50.0</td>
<td>50.0</td>
<td>50.0</td>
<td>-</td>
</tr>
<tr>
<td><strong>POLAND</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross replacement rates*</td>
<td>63.2</td>
<td>51.7</td>
<td>35.7</td>
<td>-27.5</td>
</tr>
<tr>
<td>First pillar</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Second pillar</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>SLOVENIA</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross replacement rate**</td>
<td>64</td>
<td>45</td>
<td>39</td>
<td>-25</td>
</tr>
<tr>
<td>First pillar</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Second pillar</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

* Ratio between first gross pension and last gross earnings of a 65-year-old worker with 40 years of contributions.
Source: Natali (2008)
Financial and adequacy problems in relation to supplementary fully-funded schemes are increasingly evident after the recent economic and financial downturn. According to the OECD (2009: 2), in 2008 funded pension systems in the OECD countries lost about $5.4 trillion in market value (from USD 27.8 trillion in December 2007 to USD 22.4 trillion in December 2008). In 2008, OECD pension funds experienced on average a negative return of 21.4% in nominal terms (24.1% in real terms). During the first half of 2009, pension funds have regained a fraction of the investment losses made in 2008. For the countries for which information is available, on average, pension fund assets were, as of 30 June 2009, 14% below their December 2007 levels. The impact of the crisis on investment returns has been greatest among pension funds in the countries where equities represent over a third of total assets invested. These countries have also experienced the sharpest drops in equity allocations: this is the case of the UK and Ireland. In other countries, pension funds have benefited from having a large proportion of their assets invested in bonds, whose rates of return have been more stable. The data summarised above shows the huge impact of financial turmoil on pension funds’ investment and assets. Both the sustainability of supplementary pension schemes and the adequacy of benefits have been placed in jeopardy.
3. What role for state, market and social partners in supplementary pensions?

Pension policy innovations of the last two decades are thus consistent with the reduced role of public provision and the consequent need for workers (and citizens) to find alternative protection in the market (or through other non-public institutions). The interaction of state, market and social partners is central to any assessment of the balance of the pension system and to an understanding of the scope for new forms of redistribution, in particular in terms of risk-pooling. The way supplementary schemes implement a coherent distributional logic – i.e. the logic of allocation of pension rights, resources, and risks of old-age funding – is of key importance (Arza, 2007: 109; Clark and Whiteside, 2005).

3.1 A basic glossary for the public/private pension mix

The role of state, market and social actors in relation to the different policy dimensions says a great deal about the logic of a pension system and its redistributive effects. We refer here to eight dimensions related to:

- the setting up of private pensions;
- supervision and monitoring functions;
- taxation;
- investment regulation and information;
- rules on participation;
- management;
- participation in financial costs and guarantees;
- competition between funds.

In relation to each dimension, the state and social partners may act to limit market inefficiencies. The arrangement of this interplay in fact has huge consequences on the adequacy of supplementary pensions and risk-pooling (Gillion et al., 2000; Clark et al., 2006).

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2. This is not an exhaustive summary of the many issues on which public and non-public actors may interact.
a) **Setting up of private pension funds:** Basically the state may lay down, by means of legislation, the rules governing the establishment of private pension funds, thereby making important choices in relation to their design (see Müller, 2002). Most notably, the size of the funded tier, relative to the public tier, may be determined by the government. This includes the decision about the level of contributions. In the case of mixed or parallel systems, the state also sets the incentives for public-private competition that is either fair or biased. Another key aspect to be regulated is the benefit structure. In particular, pension calculation may be based on two mechanisms: the ‘defined-benefit’ (DB) or ‘defined-contribution’ (DC) systems. Under the former, the ‘resources/benefits’ balance is adjusted by modifying contribution rates while keeping benefits ‘defined’. Under the latter, the balance operates in the opposite direction, by fixing contribution rates and letting benefits fluctuate according to individually accumulated resources or ‘rights’ to resources. In hybrid DB/DC schemes, benefit levels are related to average wages, and contribution and indexation depend on the financial position of the pension fund (Ponds and Van Riel, 2007).

b) **Supervision and monitoring** is of major significance and recent innovations are expected to extend its importance even further and to reinforce public-private partnership (Whiteside, 2000). There is a strong case for an efficient supervision and monitoring of a mandatory funded tier by the state, in order to reduce management and investment risks. This can be done either through a separate supervisory entity or as part of existing financial sector agencies. As shown by the example of the UK, pension markets are increasingly regulated and the state is asked to intervene to deal with market failures (Barr, 2004 and 2006; Myles, 2005). This, and the evolution of pension markets in other countries, seems consistent with the growing coordination of private forces.

c) **Taxation:** Three economic transactions together constitute the process of saving via a funded pension scheme, each of which provides an occasion on which taxation is possible: when money is contributed to the fund, normally by employers and employees; when investment income and capital gains accrue to the fund; and when retired scheme members receive benefits. There are examples of many of these in practice (see Whitehouse, 2000).

The first tax system exempts contributions from tax, does not tax fund income, but does tax the pension in payment. This can be termed an exempt, exempt, taxable (EET) system. The second involves saving out of taxed income, no tax on the fund’s investment return and tax-free withdrawal of pension benefits, i.e., a TEE system. In this simple framework with a flat tax rate, these two systems are equivalent in effect. They both confer a post-tax rate of return to saving equal to the pre-tax rate of return. They are neutral between consumption now and consumption in retirement. In practice, the EET and TEE systems may
not have the same effect because of the point at which the tax exemption occurs\(^3\).

Under the third tax regime, savings are made out of taxed income; income earned by the fund is then taxed but benefits received are exempted (TTE). The tax exemption in the last system occurs at the point of contribution, while fund income and benefits are taxable (ETT). The effects of these two systems are the same in this simple model. However, the post-tax rate of return is now below the pre-tax rate. These two systems result in a disincentive to saving, because consumption now is worth more than consumption in the future. The EET and TEE treatments are equivalent to the 'expenditure tax' of the public finance literature, while the ETT and TTE systems correspond to a 'comprehensive income tax'. The first two regimes tax only consumption (or expenditure) and at the same rate whether consumption is undertaken now or in the future. In contrast, the last two systems tax all accruals to income, whether from earnings or investments, irrespective of whether they are saved or consumed. These two benchmark tax systems are different ways of interpreting 'tax neutrality' with respect to savings. Equalising pre- and post-tax rates of return is neutral between present and future consumption. A comprehensive income tax is neutral between consumption and saving, treating savings in exactly the same way as any other form of consumption. Neutrality between consumption now and consumption in retirement is the relevant concept for taxing pensions, and that is the form of neutrality achieved by the expenditure tax.

\textbf{d) Investment regulation and information:} pension regulation also concerns security of investments (Blome \textit{et al.}, 2007). Some countries adhere to the flexible 'prudent person principle', regulation in this case being targeted towards the quality of the person responsible for investments. Few quantitative restrictions on investment strategies are thus defined. Public authorities may have a significant role to play in financial education programmes on pensions through public awareness campaigns and should provide a strong lead, coordinating projects with a range of other partners (Barr and Diamond, 2006). Governments and other public authorities may also promote awareness and education of financial and regulatory issues that bear on pension financial education such as information disclosure guidelines and corporate and financial governance guidelines (OECD, 2008).

\textbf{e) Participation:} Participation may be based on a purely voluntary approach. Alternatively, there may be legislative provisions to ensure mandatory participation. In between the two extremes, there are instances of the introduction of more encompassing supplementary

\(^3\) If an individual pays a different marginal income tax rate while in work from the tax rate paid in retirement, then pre- and post-tax rates of return will no longer be equalised. The individual will benefit more from a regime granting tax relief when his or her marginal rate is higher.
schemes (through ‘auto-enrolment’ and collective bargaining in Belgium and Italy and UK) (Nugé and Persaud, 2006).

f) **Management:** Additional functions may be diverted to the state. The clearing-house model represents a more recent form of public-private partnership based on allocation of managerial tasks between public and private institutions. In the case of Sweden, for example, contributions for the statutory third tier are collected by the state, and benefits are still paid by the public authorities. Moreover, social insurance institutions collect information on each contribution record and provide annual compounds of both pension contributions and rights. However, their investment in the financial markets is handled by private managers. The private funds selected by the insured thus use resources collected by public authorities. Fund managers do not know the identity of those who have sent in their contributions. Such complex systems have lowered administrative costs, while also reducing the problems of mis-management (of pension funds) and mis-selling (of savings products in the exclusive interest of the fund) that occurred under some first-generation multi-pillar systems (Barr, 2004).

g) **Participation in financial costs and guarantees:** Contributions that are diverted to the private funds are likely to worsen the financial situation of the public tier. This effect has been particularly pronounced when the number of people who switched exceeded the original estimates (such as in Hungary and Poland). These costs are not only likely to affect pensioners who rely on the public scheme, but may also crowd out other public expenditure items. Excessive reliance on deficit financing can lead to an increase in macroeconomic risks. To address these financing needs, in several countries a huge part of the private funds’ portfolio is in government bonds. This may be the result of a deliberate government policy, such as in Poland, where private funds are obliged to invest in public instruments. A portfolio structure biased towards government bonds may also reflect the scarcity of other titles with a suitable risk-return profile. If the private tier underperforms and guarantees are insufficient, the government may find itself obliged to supplement the retirement income. Hence, ultimately the risk of old-age poverty is borne by the state, even when the system is formally DC. In the context of an overall strengthening of earnings-related elements, a trend extending to the existing PAYG schemes, this may result in sizeable contingent liabilities for the state (Muller, 1999; 2002).

h) **Public/private competition** in the pensions market: If the insured person does not choose a private fund, his/her contributions are managed by public authorities through the ‘default’ fund. Each worker can choose among hundreds of private funds in competition with each other and the public ‘default fund’ mentioned above. This is the case in Sweden where public/private competition on supplementary pensions is a key feature of the reformed system.
4. The role of the state in the governance of supplementary pensions

Pension schemes with alternative designs cover against old-age risks to different degrees. Pension systems with broad risk-pooling transfer resources from 'low risk' to 'high risk' individuals and generations. Universal flat-rate and 'defined-benefit' systems are a typical case of broad intra- and inter-generational risk-pooling. The PAYGO system is funded by younger generations and the state. By contrast, in a fully 'defined-contribution' (DC) arrangement there is no risk pooling between workers with different career paths or income levels, nor between generations. If individually accumulated resources are not sufficient to reach a reasonable level of benefits under DC systems, the individual bears the costs in the form of lower pension benefits.

The emergence and evolution of public pensions in Europe – between the end of the 19th and the 20th century – has seen the progressive socialisation of the old-age risk. The development of universal pension schemes over the last century formed an element in the public management of social risks (Barr, 2004; Arza, 2006).

In relation to the most recent reforms, by contrast, authors have argued that there has been a common trend towards the individualisation of old-age risks and the so-called 'passive' privatisation of pension systems (Bonoli et al., 2000; Pemberton, 2005). Passive privatisation consists of the first and preliminary intervention by the legislator to cut public protection against social risks without the parallel launch of an effective alternative provision (Bridgen and Meyer, 2007: 223). In other words, citizens are placed in the position of finding alternative social protection provision (family, market, community), without intervention by the state in this field. Reforms are thus expected to lead to the residualisation of the role of the state. Other scholars, however, have seen signs of ‘active’ privatisation (Barr, 2000; Muller, 2002; Resine, 2000). In this case, the state reduces the direct provision of social benefits but maintains an active role in regulating and/or subsidising the activity of non-governmental actors, while the interplay between public and private provision is more complex, with a central role being played in many countries by social partners and collective bargaining (Haverland, 2007).

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4. Recent reforms have introduced a third option: that of notional defined contribution systems. NDC schemes lie somewhere between fully PAYGO DB and fully-funded DC systems. The risk of low ‘theoretical’ accumulation is borne by the individual, as in DC systems, but, as they entail no financial accumulation, financial market risks are excluded and, as they are financed on a PAYGO basis, they still pass part of the demographic risk on to the state and taxpaying generations.
The operationalisation of the concepts mentioned above (passive/active privatisation) has been ambiguous and in some cases arbitrary. On the one hand, the concept refers to both the reform’s output (the definition of rules to favour private protection) and its outcome (the effective spread of private schemes consequent to cuts in public provision) (Rein and Turner, 2004). On the other hand, the concept of ‘passive’ privatisation cannot be used in absolute terms, for the state never disappears completely from a policy field, since it always remains to some extent active through regulation (see Muller, 2002 for a critical review). According to Barr (2000), it is not possible to get the government out of the pension business. Yet, the contrast between passive and active privatisation can be used in relative terms, in order to shed light on the role of the state in the post-reform scenario (with evident effects on risk-pooling, social inclusion of pensioners, etc.).

With reference to the key dimensions mentioned above, recent reforms do not provide evidence of a ‘race to the bottom’ through ‘passive’ privatisation (Bridgen and Meyer, 2007). We see, by contrast, examples of an active privatisation of pension systems. This is related, first, to the introduction of mechanisms of participation in supplementary funds that goes beyond voluntarism (Orszag and Stiglitz, 2001). Some countries have introduced mandatory supplementary schemes, like Sweden, Estonia and Poland. And the countries that have not chosen mandatory pension funds (like the UK, and more recently Italy, as well as, to some extent, Belgium and Slovenia) are experiencing more encompassing participation as well. The option of pure voluntarism seems to have been abandoned. The case of the UK is extremely interesting. Stakeholder pensions have been the first attempt to improve regulation to protect individuals who invest in the pension market. This has then been recently followed by the proposed introduction of Personal accounts based on ‘auto-enrolment’. In Italy, the ‘silence-assent’ mechanism to use resources from severance pay schemes shares many aspects of the British automatic enrolment. And in other countries (e.g. Belgium and Slovenia), the coverage of supplementary pension funds has been extended through collective bargaining.

Moreover, in many countries, after a first period of light regulation and limited administrative role, the state has increased its intervention on the pensions market. Countries that introduced mandatory supplementary schemes (like Sweden, Estonia and Poland) show complex forms of governance based on public-private partnership. The ‘clearing house’ model is a typical example of public/private interplay in the supervision and management of funds, insofar as public bodies exert some administrative functions (e.g. collection of contributions). In other cases, public pension funds compete with private funds and/or represent the ‘default’ option. Such a complex interplay is expected to

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5. Leisering (2003) has proposed the term ‘coordinated’ regulation to define the public aim, typical of some countries, including Germany, of coordinating the different parts of a pension system.
lower administrative costs and risks of mis-selling and mis-management (SPC, 2005).

To sum up, the state still has considerable authority over important parameters with respect to supplementary schemes. It can influence the development of occupational and individual pension schemes by using regulatory frameworks, providing financial protection against investment risks, etc.
Social partners may find opportunities to influence pensions policy through their role in self-administration. In several countries, social partners perform self-regulatory functions in relation to occupational pensions (Ebbinghaus, 2006), involving, through the collective bargaining process, not only employers but also unions. Cross-national differences in social partner involvement reflect historical variations in the development of welfare states, commonly exemplified by the Bismarckian social insurance and the Beveridge-type welfare state models.

While in many European countries social partners play a direct role in public social insurance schemes, it is in the negotiated supplementary funds that they have traditionally had the most say. Accordingly, following recent reforms that foster a ‘second pillar’ of private pensions, unions may be able to further enhance their bargaining role in the sphere of occupational pensions (Rein and Turner, 2004). In the following pages we refer, in the main, to the governance of supplementary (especially occupational) schemes and to the role of social partners in relation to the key problem of information management.

In nearly all European countries, the members of occupational pension fund governing boards must be selected by sponsoring employers and employees, often in equal numbers (Stewart and Yermo, 2008). Pension fund governance is structured in different ways in different countries. All autonomous pension funds have a governing body or board, which is the group of persons (or in some cases a single person) responsible for operating and overseeing the pension fund. The governing body may be internal or external to the pension fund, it may have a single or dual board structure, and it may delegate certain functions to professionals. The nature of these features depends on the legal form of the fund and the regulation in place and these aspects constitute the starting point for understanding differences in the quality of pension fund governance across countries. The structure of the governing body is determined by the legal form of the pension fund. There exist only a handful of types of autonomous pension fund (Table 3).

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6. The main exception is Ireland where there is no requirement for employee or member representation in single employer plans. In some other countries like Austria, and the United Kingdom, member representation is required but not necessarily in equal numbers to sponsor representation.
Table 3 Number of sections within GWU and UHM, 1946–2007

<table>
<thead>
<tr>
<th>Institutional type</th>
<th>Contractual type</th>
<th>Trust type</th>
</tr>
</thead>
<tbody>
<tr>
<td>Independent legal entity</td>
<td>No independent legal entity</td>
<td>Independent legal entity</td>
</tr>
<tr>
<td>Bipartite governing board</td>
<td>Separate governing body</td>
<td>Trustees’ management</td>
</tr>
<tr>
<td>Key role of social partners</td>
<td>Limited role of social partners</td>
<td>Limited role of social partners</td>
</tr>
<tr>
<td>Mainly applied in Scandinavian, Continental and southern European countries</td>
<td>Mainly applied in Central-Eastern European countries</td>
<td>Mainly applied in Anglo-Saxon countries</td>
</tr>
</tbody>
</table>

Source: Stewart and Yermo (2008)

There is an **institutional type** where the fund is an independent entity with legal personality and capacity and hence has its own internal governing board. Examples of pension funds of the institutional type include pension foundations and associations as these exist in countries such as Denmark, Finland, Hungary, Italy, and the Netherlands, and Switzerland, as well as corporations in Austria and Germany. In most of these countries pension funds have a single governing board, the members of which are typically chosen by sponsoring employers and employees (or their representatives). In some countries, like Germany and the Netherlands, there is a dual-board structure. In Germany, a supervisory board is responsible for selecting and monitoring the management board which is, in turn, responsible for all strategic decisions (ibidem, 6).

By contrast, a pension fund of the **contractual type** consists of a segregated pool of assets without legal personality and governed by a separate entity, typically a financial institution (bank, insurance company or a pension fund management company). The governing body of a fund set up in the contractual form is usually the board of directors of the management entity, though in some countries some key responsibilities are shared with a separate oversight committee. Examples of pension funds set up in the contractual form include those in the Czech Republic, Portugal and the open funds found in Italy and Poland.

Under the **trust type**, which is the legal form used by pension funds in countries with an Anglo-Saxon legal tradition, it is the trustees who legally own the pension fund assets. Trustees must administer the trust assets in the sole interest of the plan participants, who are the beneficiaries from the investment of those assets according to the trust deed. While this feature of trusts is similar to that of foundations, the trustees are not legally part of the trust. Indeed, a trustee may be of the corporate type (as is sometimes the case in Ireland) which makes the pension fund resemble a contractual arrangement (Blome et al. 2007). This governance thus incorporates features of both the institutional and the contractual type.

Over and above the governing modes described above, European countries have shown social partners play a key role in this and adjacent policy areas. In France, for instance, employee savings plans (épargne salariale) – part of what
the French call ‘participation sociale’ (social partnership) – play a role in the development of pension funds (Gournac and Maillard, 2007). Salary savings plans – related to company performance (dispositifs d’intérêts au bénéfice de l’entreprise) – and profit-sharing schemes (dispositifs de participation aux résultats de l’entreprise) are increasingly allocated to pension funds. By June 2007, 45,000 firms had provided the possibility for their employees to contribute to retirement savings schemes. At the beginning of 2007, Partnership employees’ retirement schemes (Plans d’épargne retraite collectives, PERCO) – being one of the instruments to which contributions may be sent – had assets under management worth 1.21 billion euros. Supplementary pension schemes are expected to play a key role among the alternative modes of allocation of the resources collected through social partnership schemes. And social partners have a say in the management of these resources. In Italy, social partners play a similarly important role in managing the shift of resources from the severance pay scheme (TFR – End of Service Allowance) to pension funds (Natali, 2008).

Social partners’ involvement in pension funds may lead to both problems and opportunities. Major problems in the governance of occupational pension funds are related to the lack of expertise and competence of governing boards and to the ineffective management of information. In relation to the former of these problems, the responsibilities of board members may not be clearly defined, for instance, the board may lack a clear mission statement and may engage in operational duties which should be left to internal management staff or external service providers (Stewart and Yemo, 2008). In many countries board members are often selected on the basis of their status in a trade union or employer organisation, rather than their specific knowledge or experience of pension issues. Governing boards rarely subject themselves to a thorough self-assessment review, to evaluate the extent to which their objectives are being met and to propose improvements in their decision-making methods. Moreover, small funds are likely to be backed by small employers, which may lack workers and even executives with the types of skills and experience required to sit on the governing board (ibidem, 13-14)7.

Opportunities are very much related to the dissemination of information as a result of the involvement of social partners. According to the OECD (2008), social partners may in fact contribute to financial education programmes, given their important role in negotiating pension plans and contracts, by means, for instance, of surveys of their workers or members to ascertain their level and needs with respect to financial education and to find out in what form they would prefer to receive such information. Social partners can provide financial information or training, and inform members about where they can receive

7. Anglo-Saxon countries tend to apply few ‘fitness’ criteria on trustees. In the United Kingdom, the 2004 Pensions Act required trustees to have the necessary knowledge and understanding of relevant legislation (including trust law), scheme rules, funding and investment matters. The Pensions Regulator has introduced a framework for trustee knowledge and understanding (the TKU regime), promoting trustee training.
help. They have a role in making sure that members know what pension and/or retirement savings arrangements are available to them. Trade unions, in particular, frequently sponsor materials for public education programmes, alone or in cooperation with other social partners, in order to promote, develop and deliver quality education on financial issues that are relevant to the interests and well-being of the plan members and the workforce in general.

To sum up, the governance of supplementary pensions provides both opportunities and challenges for social partners. The most problematic aspects include fund managers’ lack of knowledge, experience and training; conflicts both within boards and in relation to independent trustees; and problems of how to ensure funds’ suitable governance.
Conclusion

The paper set out to shed light on the key features of recent pension reforms across Europe, on the present and future challenges facing pension systems and on the complex and changing interplay between state, market and social partners in relation to supplementary pension schemes.

In the area of pension reform, recent innovations have been consistent with a new balance between public and private pillars. The responsibility of the state to protect against the risk of old age is increasingly shared with other actors (social partners and market institutions), and the role of fully-funded schemes is increasing across Europe. Supplementary schemes have taken on a growing role in all European countries.

These common trends have led to three pension clusters: the first generation of multi-pillar systems (where public spending is limited and earnings-related pensions are mainly private); the second generation of multi-pillar systems (where recent innovations have led to the partial privatisation of the system and earnings-related schemes are both public and private); and social insurance countries in transition (where the first pillar is still the backbone of the system but with an expected reduction in benefit levels).

Though the increased role of supplementary pension funds and the recent economic and financial downturn have led to new challenges in relation to both the future financial sustainability and the adequacy of pensions, pension reforms have not entailed a ‘residualisation’ of the state role in the field or the passive privatisation of pension policy. On the contrary, both state and social partners have a key role to play in the management and regulation of pension funds. The paper has stressed key dimensions of the complex public/private mix in pensions policy and has drawn attention to aspects such as the rules affecting the setting up of private pensions; the supervision and monitoring functions; the tax rules; investment and information; participation/contribution to the funds; their management; the participation to financial costs and guarantees; and the competition between funds, all of which represent dimensions where new form of public/private interaction may be implemented.

Recent tensions in pension funds’ investments and assets are evidence of the important role that both public authorities and social partner representatives may play in mitigating market failures. But major improvements in governance are needed.
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