Pensions in turmoil owing to the crisis: key messages from the EU

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The global financial and economic crisis declared in 2008 has affected social protection schemes in Europe in three major ways. Firstly, they have been used as ‘automatic stabilisers’ to mitigate the potential social consequences of the negative economic situation, which is expected to significantly increase social spending in many EU countries. Secondly, the economic downturn has coincided with new challenges to the financial sustainability of social protection: growing unemployment and negative Gross domestic product (GDP) growth represent a loss of revenue for welfare programmes and thus may lead to a deterioration in public budgets. Thirdly, the financial shock has had a huge impact on private fully-funded schemes such as pension funds. And public reserve funds risk being hit too.

All these challenges are affecting pension systems too. While it is still too early to predict the precise consequences of the crisis for pensions, some initial impacts can be assessed. As for first pillar pension schemes, short-term effects have been limited. PAYGO (pay-as-you-go) schemes are largely immune from short-term financial crises¹. But the long-term effects may be considerable and lead to further adjustments to secure their financial viability. As for second and third pillar schemes, fully-funded schemes have seen more direct effects. Investment losses and negative rates of return have been massive, and pension funds are bound to suffer from this trend. The latter dimension of the crisis is the most evident.

¹. In pay-as-you-go (PAYGO) schemes, current contributions paid by both employers and employees (or revenue coming from current taxation) are not accumulated but rather immediately used for financing current benefits.
What is more, the crisis has influenced the EU debate on pension reforms. The struggle between advocates of the development of private pension schemes and supporters of the ongoing role of public pension systems has been revived. Decision-makers, experts and stakeholders have intervened in the debate in line with different understandings of the economic recession and its impact on old-age risks.

As argued elsewhere (Pochet and Natali, 2005), the question of pensions has traditionally been approached at the European level from three perspectives, each related to a specific network of actors. The first is linked to the development of the internal market: it centres on promoting labour mobility and on the creation of an integrated financial market. The question of pensions is seen, from this point of view, as a factor related to completion of the single market and effective freedom of movement. The second approach stems from the adoption of Economic and Monetary Union (EMU). Here, the focus is on the limit imposed by the Stability and Growth Pact so as to maintain a balance or even a slight surplus in public finances. Since pensions are the costliest item of social expenditure, the pressures to stabilise or even reduce such costs have redoubled. Thirdly, social protection is the object of more sustained attention from the European Commission and from the Ministers for Social Affairs. Since the Lisbon summit in 2000, the Open Method of Coordination (OMC) has been applied first to poverty and social exclusion, then to pensions (Pochet, 2003). This approach focuses mainly on social perspectives, such as redistribution and the reduction of poverty among the elderly, and provides a broader interpretation on the problem of financial sustainability.

This chapter provides a summary of the most recent ‘messages’ from EU institutions and EU-level stakeholders on the economic crisis and its impact on pension policy. We look at official documents, reports and communications, and assesses the shift (if any) in the way key players have addressed the ‘pension challenge’ in this time of crisis.

Section 1 sheds light on some indicators of the impact of the financial crisis and economic recession on pension policy across Europe, as well as in the broader international context. Section 2 briefly summarises the different ways in which the European Union has intervened in the pension debate; while Section 3 underlines the most recent key messages from EU institutions – and stakeholders – on the present and
future impact of the recent financial and economic downturn. We refer more specifically to the debate linked with the completion of the single European market in supplementary pension schemes; the intervention of EU institutions in the mutual interaction between pensions policy and economic and monetary stability, and the sustainability of public pensions; and the debate on the social consequences of the economic crisis and the role of social protection in facing up to them. Section 4 draws some preliminary conclusions while showing how social and economic/financial issues have moved to the core of the EU debate on pensions. This has promoted a new set of interconnections between areas of debate which had previously tended to remain compartmentalised.

1. The financial and economic crisis and its impact on pensions

In the literature on pension policy, there is a large consensus on the fact that pension programmes, be they public or private, are not immune from the consequences of economic recession and financial crisis. International organisations and experts agree that the economic and financial context has a major effect on every component of a pension system. Yet, the impact differs markedly if we consider first, second and third pillar schemes.

Supplementary pension schemes with a fully-funded logic of financing are the ones worst affected by negative economic and financial trends. Recent data from the OECD (2009) clearly shows huge negative effects in 2008 and a limited recovery in 2009 (Figure 1).

In 2008, supplementary pension funds – both defined benefit (DB) and defined contribution (DC) plans – were hit hard by the crisis². The impact of the crisis on investment returns was greatest among pension funds in countries where equities represent over a third of total assets invested.

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² The terms ‘defined-benefit’ (DB) and ‘defined-contribution’ (DC) are used to describe the type of benefits and the logic of their calculation: in the former, the ‘resources/benefits’ balance is adjusted by modifying contribution rates while keeping benefits ‘defined’. In 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.
with Ireland the worst hit at -30% in nominal terms, followed by Belgium, Hungary and the United Kingdom. Irish pension funds were the most exposed to equities, at 66% of total assets on average (ibid., 3-5).

Figure 1 Pension funds’ nominal investment rate return in selected OECD countries

Funding levels in DB plans were down by more than 10% on average. As the rate of company insolvency increases, benefits may be cut. Members of DC schemes have been those most at risk of losses, in that these pension schemes leave the investment risk entirely with the scheme member so the impact will be felt directly. Older workers close to
retirement are particularly affected by investment losses, and their overall pension income will mean that they face a less well paid or later retirement (CEC, 2009a: 2). Younger workers, on the other hand, could benefit in the long term as future pension contributions will be invested at much lower prices, hence raising the potential rate of return on investments and future benefits.

During the first half of 2009, pension funds regained a fraction of the investment losses made in 2008. In June 2009 pension fund assets were 14% below their December 2007 levels. The recovery in pension fund performance has continued through the whole year on the back of strong equity returns, but it will take some time before the 2008 losses are fully recouped.

But the crisis has affected public schemes too. Through the most recent round of reforms, funding has become increasingly important within publicly managed pension systems. Many countries have established
public pension reserve funds (PPRFs) to provide financial support to what are otherwise pay-as-you-go systems. This is the case in Sweden, where buffer funds were set up in the second part of the 20th century, and more recently in Ireland, Poland and France. Even though to a much lesser extent than private pension schemes, public buffer funds have been hit by negative investment returns (Figure 2).

As argued above, the crisis has had another effect. Social protection schemes have been heavily used to confront the initial social consequences of the recession. EU countries have thus increased public social spending to limit the effects of the financial crisis on individuals and families. According to the Commission’s autumn economic forecast, as a result of automatic stabilisers and discretionary measures to enhance social benefits, social expenditure in the EU is expected to increase by 3.2 percentage points of GDP between 2007 and 2010 (Figure 3). The projected increase varies from less than 1% in Bulgaria, Hungary and Slovakia to 6% or more in Estonia, Ireland, Latvia and Lithuania.

Figure 3 Expected increase in social expenditures between 2007 and 2010

Spending on unemployment benefits has increased the most. While it is too early to assess the trend as regards pensions, there is some evidence of an upward trend. In some countries like Poland and Greece the number of older workers taking early retirement has grown. In other Member States, the indexation of pension benefits has been revised in a more favourable manner (e.g. Portugal), and in others minimum pension benefits have been improved (e.g. Finland) (SPC, 2009).

To sum up, public pension benefits (first pillar) seem in the main to be isolated from the short-term impact of the crisis. And in some cases they have been increased to act as automatic stabilisers. Yet the long-
term prospects of PAYGO systems are more difficult to predict. Persistent economic stagnation if not recession, rising unemployment rates and the consequent reduction in revenues may lead to future financial tension. Lower investment returns for public reserve funds contribute to these more negative prospects. Private (second and third pillar) pensions have been hit much harder by the crisis. The short-term effects on funded schemes have been enormous. Despite the partial recovery of 2009, the decline in investment rates of return has put pension fund members – and especially older workers – at risk of huge income losses.

2. EU networks on pensions

In order to fully understand EU reactions to the crisis and its potential impact on pension policy, we shall now summarise the key networks of institutions and stakeholders traditionally involved in the pensions debate (see Pochet, 2003). Evolving EU competence has been characterised by an initial desire to promote the free movement of workers and services, and to boost competition between financial institutions. This was later combined with the goal of improving the European Union’s economic and monetary stability, and finally that of coordinating its social dimension. This ‘step by step’ process has been consistent with the co-existence of different sets of actors, each based on the mutual interaction of players and institutions. This section summarises the three main networks, represented by institutions, social partners, lobbies, and officials, activated in the last few years (for a more detailed analysis see Pochet and Natali, 2005). These groups are not mutually exclusive but tend to overlap partially. They interact with each other through different processes (legislation, soft coordination, etc.). Section 3 will focus on the most recent debate within the three networks.

2.1 The single market in supplementary pensions

EU regulation has led to direct, and negative, integration in order to grant freedom of movement for workers and provision of services through the market-building process. On the one hand, the aim of the EU has been to ease intra-European migration and thus reduce restrictions on labour mobility. On the other, completion of the single
market for private insurance has been the strategy consistent with indirect pressures that do not legally require, but nonetheless encourage, the adaptation of national pension programmes. Here again the legal and normative foundations have been based on a liberal understanding of economic integration: market liberalisation and promotion of competition. In both these areas, authority to act at the European level is substantial and has been validated by innumerable rulings of the European Court of Justice.

Various economic actors have traditionally advocated the development of supplementary pension funds and full implementation of European competition policy in this area. This has happened in several stages, during which the argument has become more focused (Pochet, 2003). In the 1990s, heated debate arose over freedom of cross-border investment management, cross-border investment and cross-border membership. The 1997 Green Paper on supplementary pensions and the 1998 Financial Services Action Plan converged on the supposed need for a genuine single market in wholesale financial transactions. The adoption of legislative provisions on investments by Institutions for Occupational Retirement Provision (IORPs) was presented in the Plan as a prerequisite for attaining this objective by removing the remaining barriers to investment in the field of pension funds. The Lamfalussy report of 15 February 2001 on the regulation of European securities markets went back to the usual arguments favouring the development of private pensions and pension funds.

A second line of argument was that of mobility. As argued by Pochet and Natali (2005), even though inter-state labour mobility is still very weak, supporters of pension policy development have reversed the argument. Movement of workers is low because a number of obstacles prevent workers from exercising their right to freedom of movement in full. In keeping with the recommendations of the Veil report on freedom of movement, the Commission set up the Pensions Forum which met for the first time in 2000. In May 2003, the Council of Ministers adopted Directive 2003/41/EC on institutions for occupational retirement provision (IORPs). The directive aimed to facilitate a pan-European market for occupational retirement provision and create a framework for the efficient operation of pension institutions and the defence of their members’ interests. But this has not led to full liberalisation. Member States with more restrictions on
investments largely succeeded in defending their domestic rules, especially in the case of solidarity-based occupational schemes.

As concerns the main institutions and actors in the debate on the completion of the single market for supplementary pensions, the European Parliament, the Commission (Directorate of Internal Market and Services), the Economic and Social Committee, and the financial services sector have been pressing for several years for the establishment of a European framework for IORPs. Whereas some Member States have been (very) reticent, others have, however, shown their support for the Commission’s initiatives. At the parliamentary level, the European Parliamentary Pension Forum (EPPF) was established in 2003, at the initiative of Dutch MEPs.

More recently, under the so-called Lamfalussy process, technical committees have been set up within the broad context of the financial services committees. On the basis of Directive 2005/01/EC, the European Insurance and Occupational Pensions Committee (EIOPC) has replaced the former Insurance Committee to assist the Commission in adopting and implementing measures for EU directives in the field.\(^3\) And the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) is a committee representing the insurance and occupational pensions sectors. CEIOPS is involved in both level 2 and 3 activities by providing advice to the European Commission on the drafting of implementation measures for framework directives and regulations on insurance and occupational pensions, and to facilitate cooperation between national supervisors.

The European Court of Justice (ECJ) has played an important role in this area. Basic public pensions, like other social security mechanisms, are not subject to competition policy. Third pillar provision, however, is bound by competition rules. For other supplementary retirement

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3. EIOPC members are appointed from the insurance supervisory and regulatory authorities of the 27 Member States. Each Member State may appoint up to two members to the committee. Representatives from Norway, Iceland and Liechtenstein have also been admitted into the EIOPC meetings as observers.

4. CEIOPS is composed of high level representatives from the insurance and occupational pension supervisory authorities of the European Union Member States. The authorities of the other Member States of the European Economic Area (Norway, Iceland and Liechtenstein) and the European Commission participate in CEIOPS’ activities as observers.
income schemes (the second pillar), the situation is less clear. The ECJ is increasingly inclined to pronounce on this subject, and in the absence of clear-cut norms exempting complementary forms of social protection from European competition law, it tends to override the liberal economic logic which stems from the texts of the Rome Treaty (Pochet, 2003).

Numerous private actors act as lobbies to obtain amendments and advance their interests. The CEA (European Insurance and Re-insurance Federation) brings together insurance companies from all Member States and non-EU countries. The European Federation of Retirement Provision (EFRP) represents pension funds that are responsible for occupational pension provision. BusinessEurope has pointed out clearly that “there is no single European model of pension system. A “one size fits all” solution is neither desirable, nor appropriate or feasible across the EU’. The EU should, therefore, play a fairly modest role, and the only justification for the EU to pursue national pension reforms is to maintain the stability of the Eurozone (Arcq and Pochet, 2002).

Not all participants share the same view: some of them (e.g. DG Internal Market, pension fund managers, and other economic interest groups) have pushed for a more integrated market in supplementary pensions facilitating the free movement of workers and the growth of capital markets, while others (trade unions and European civil society) have been more concerned about the defence of workers’ and citizens’ social rights. While the former group has a central role, orbiting around the Ecofin Council, the latter has more marginal access and resources. What is more, the network is highly permeable to a variety of interest groups5.

2.2 Economic and monetary stability through sustainable pensions

The second strand of discussion stems from the Ministries of Finance and their advisory committees, particularly the Economic Policy

5. Pochet and Natali (2005) clearly illustrate the active role of the representatives of insurance institutions: the European Federation of Fund Managers, FEFSI; the European Insurance and Reinsurance Federation, CEA; and the European Association of Paritarian Institutions of Social Protection, AEIP, as well as other groups such as the European Round Table of Industrialists.
Committee (EPC) and the Economic and Financial Committee (EFC). The issue is mainly about the stability of monetary union. The long-term viability of public non-funded pensions is the main preoccupation.

The European fiscal framework was designed in 1991 and subsequently included in the Maastricht Treaty, which entered into force two years later. It was then revised in 1997 with the creation of the Stability and Growth Pact (SGP), in force since 1999, and eventually reformed in 2005. While the Pact agreed on in Amsterdam did not concern pension policy, the Ecofin Council and related technical committees have specifically monitored the long-term sustainability of pension programmes (Pochet and Natali, 2005). The guiding philosophy here has been that pension reform needs to be adapted to the circumstances of an ageing population while at the same time ensuring durable fiscal consolidation and improving the condition of European labour markets. The principal recommendations have been to curb benefits, as the main instrument for guaranteeing the solvency of PAYGO schemes; to delay the age of retirement, to move towards pension system based on individual contributions, and to gradually increase the role of funded schemes (de la Porte and Pochet, 2002; Pochet, 2003). As argued by Pochet and Natali (2005), contrary to the ideologically inspired debates related to the internal market, the EPC studies did not, as an a priori position, support a greater role for private pensions. The Ageing Working Group (a technical body of the EPC) has been particularly active in stressing the need to postpone the retirement age, because, according to its calculations, this measure not only has a positive effect in terms of global cost, but – most importantly – does not cause a reduction in the relative level of pensions. The AWG is keen to provide evidence of the present and future impact of demographic trends, not only on pensions but also on other key policy sectors such as health care, long-term care and unemployment.

Together with the Council and its technical bodies, the Commission and the European Central Bank play a key role. The Lisbon Council (2000) mandated the Commission to prepare a study on ‘the contribution of public finances to growth and employment: improving quality and sustainability’ (for the most recent state of play see CEC, 2009a; 2009b). Several reports have dealt with the question of retirement pensions, emphasising the question of the ‘quality’ of public expenditure. Pensions have been put at the forefront of the category of
‘bad’ expenditure. The ECB has, in various documents, shown its concern for the budgetary stability of public (non-funded) pensions, and recommends lowering the ratios of public debt, the establishment of financial reserves, and pursuing social security reform with ‘even greater determination’. More specifically, the ECB is interested in the effects of ageing on decisions to consume or save, and, through this, on interest rates and the state of public finances.

As stated by Navarro (2004), the role of social partners in macro-economic policy-making is particularly limited, especially as concerns the Cologne Process aimed at introducing a permanent dialogue between social partners, governments, and the ECB.

The revision of the Stability and Growth Pact represents further intervention in the field of old-age programmes. The Ecofin Council report of March 2005, subsequently adopted by the European Council, dedicates two out of nineteen pages to structural reforms to be adopted in order to enhance the ‘growth oriented nature of the Pact’ (Natali, 2008). In the second paragraph of the report, respect for the budgetary targets is related to encouragement for reforms improving the long-term sustainability of public finances. Particular attention is thus paid to pension innovations introducing multi-pillar systems that include a mandatory fully-funded pillar. In line with a more flexible understanding of stability, and despite the potential for a short-term deterioration in public finances, such reforms are favoured because of the resulting improvement in the long-term equilibrium of the public budget. The third paragraph clarifies how to implement that general statement. The Council has agreed that an excessive deficit reflecting the adoption of pension reforms introducing the above-mentioned multi-pillar system ‘should be considered carefully’. In other words, the Commission and the Council will assess the development of budgetary policies while considering the net cost of the pension reform for the initial five years of its implementation, or after 2004 for the countries that already introduced such a system. The revised Pact is, on the one hand, consistent with the traditional point of view of the economic network centred on the Ecofin Council. Pension reforms are part of the efforts (structural reforms) directed at reducing the long-term impact of demographic ageing on budgetary policies. On the other hand, a new emphasis is put on a particular type of pension systems – the multi-
pillar model – that is favoured and judged to be a contribution to the long-term sustainability of public finances.

As argued by Pochet and Natali (2005), the ‘economically oriented’ network shows some specificities if compared to the ‘single market’ one. First, the number of participants is more restricted and coherent. The Ecofin Council (and its technical bodies, the Economic and Financial Committee – EFC – and the Economic Policy Committee – EPC) are its lynchpin, providing the overall network strategy in line with the ‘stability and growth’ argument. The other core actors are the Directorate General for Economic and Financial Affairs and the European Central Bank. They share the same values: the sustainability of public finances, which are jeopardised by ageing, and the need for more pronounced economic growth. As regards old-age programmes, the need for more diversified systems with some role for occupational and individual schemes is related to the above-mentioned aims and the need to reduce financial strains on (public) old-age protection.

2.3 The social dimension of pensions and the OMC

The creation of a network around the Social Affairs Ministers has been designed to analyse pension reform from a more social angle and thus to balance the economically oriented action. The first step by the Council of Ministers of Social Affairs was the creation of the Social Protection Committee (SPC). This was immediately given the task of producing a report setting out the evidence on the social aspects of pensions. Socially oriented actors thus began to use a new mode of governance: the Open Method of Coordination (OMC) (de la Porte and Pochet, 2002). In its first report, the SPC viewed the interlink age of different areas (social protection, employment and public finance) as crucial. The main message was that financial sustainability cannot be achieved at the expense of the ability of pension systems to meet their social goals. Only one paragraph was devoted to the reasons for dealing with the issue at European level. This meant that a positive definition of common social objectives was problematic and came about partly because some Social Affairs Ministers share the objective of reforming their national pension system with their Finance colleagues (see de la Porte and Pochet, 2002).
The Stockholm Council in 2001 officially launched the ‘soft’ governance on pensions on a three-year basis. The process involved defining some broad policy guidelines, then adopting a more precise set of policy objectives, adopting National Strategy Reports by the Member States, and the Joint Report on safe and sustainable pensions by the Commission and the Council. The formulation of common objectives aimed to achieve greater policy convergence between EU Member States in line with both economic and social goals. Eleven objectives for pension reform were agreed around three ‘pillars’: social adequacy, financial sustainability, and modernisation (e.g. responding to changing socio-economic needs). They offered a structure for future EU work in this area. That said, the tensions between the different approaches have not disappeared, but have but have been put into perspective by the document.

The need for a more effective strategy to confront these problems has led the European institutions to update the various OMCs (on pensions, social inclusion, and health and long-term care). In 2003, the Commission proposed to simplify the coordination between social protection and the existing processes established by the Treaty. The principal aim was to launch simultaneously, in 2006, the second three-year cycle of economic and employment policy coordination as well as the new streamlined objectives for the three pillars of social protection (Natali, 2005). At the end of 2004, the outline draft of the first Joint Report on Social Protection and Social Inclusion was put forward by the Commission for discussion by the SPC.

From the outset, the ‘social’ network has been more heterogeneous than its economic counterpart based on the EPC. The pivotal role is played by the Council of Ministers of Social Affairs, supported by the SPC. As stated above, the Social Protection Committee is to cooperate with more economic bodies, such as the EPC. The EPC and the SPC, in fact, have been asked to develop common approaches with regard to indicators in order to underpin the Open Method of Coordination relating to the future of pensions. This cooperation has covered the preparation of projections relating to the medium and long-term prospects and implications of pension policies. The SPC’s Indicators Sub-Group has published a series of interim reports dealing with this challenge. They have mainly centred on statistics on the adequacy and financial sustainability of public programmes (first pillar) and supplementary schemes (second and third pillars) (Natali, 2008 and 2009).
As to the social partners and their role in the OMC, it is particularly limited, especially if compared to the Social Inclusion OMC and the European Employment Strategy. Their influence operates mainly through consultation by the SPC. Hence, it is more a case of lobbying (informal consultation in non-formalised, open and fluent communities) than of networking (active promotion of interest groups). At the European level, transnational non-profit civil society organisations, such as the European Older People’s Platform (AGE), have proved to be active but still on the margins of the policy-making process. In the first stage of implementation of the process, meetings between the SPC and social partners have been few in number. They have concerned both specific problems, e.g. the functioning of privately managed pension schemes and the strategy to ‘make work pay’, and broader issues such as the streamlining of social OMC processes. As for the European Trade Union Confederation (ETUC), it created a working group on social protection and an ad hoc working group on pension funds. The European trade unions have also tried to strengthen their cooperation with social NGOs (Natali, 2005). As well as participating in the ‘single market’ network, AGE has been particularly active in lobbying European institutions for the defence of ‘social goals’ related to pension systems through the OMC. However, social NGOs have an even more marginal role than the social partners: they are not part of a formal consultation. They merely have informal contacts with members of the Social Protection Committee. A further means of improving the participation of interest groups in the OMC on pensions is to reduce tension between and within social actors.

To sum up, the ‘socially oriented’ network has a particularly restricted membership. National civil servants and political decision-makers from the Member States interact with the Commission’s Directorate General for Employment and Social Affairs through the SPC, with a particular role being played by the Indicators Sub-Group. That community shares some core values but with strategic differences.

3. **Key messages from the EU on the crisis and its impact on pensions**

After the recent financial and economic crisis, all three networks have been working hard to re-frame their understanding of the pensions issue. This section describes the key messages conveyed by each group, in terms of
their diagnosis of the crisis and possible solutions. As for the network for the completion of the single market in pensions, reference is made mainly to CEIOPS and to the reaction of the pension funds lobby (EFRP and BusinessEurope). For the group focused on economic and monetary stability, reports from the Ageing Working Group of the Economic Policy Committee will be analysed. Finally, the role of the Social Protection Committee and the action of the social partners (ETUC) and social NGOs (AGE) within the ‘socially oriented’ network is summarised.

3.1 European pension markets: demands for better regulation and governance

The network focused on the completion of the single market in supplementary pensions has interpreted the global financial crisis as the result of inefficient regulation of financial markets and ineffective governance. Two different arguments have been put forward. On the one hand, the Commission and its technical committees have proposed new measures to increase regulation and supervision. Here the issues debated have been whether solvency regulations so far provided for financial markets should be applied to private pension funds, and the scope for harmonisation of national legislation in the field. On the other hand, the EU institutions – and especially the supervisory bodies such as CEIOPS – have stressed that occupational pension funds are much more stable than other financial institutions, in that they are partly immune from investment risks. Quite paradoxically, the specific social aims of pension funds have been identified as the main source of their greater security. The key issue at stake here has consisted in the identification of more precise measures to improve pension fund governance.

In 2008, President of the European Commission Barroso set up the so-called Larosière Group to give advice on the future of European financial regulation. This high-level group has reported on its main goals for increasing financial market stability. The crisis is assumed to have been the result of a twin failure, namely regulation and excessive financial liquidity due to historically low interest rates. The report recommended tightening the prudential rules on capital and banks’ reserve funds, and
liquidity management, and reinforcing the control rules through some regulatory reforms: a fundamental review of Basel II, stricter supervision of credit rating agencies, hedge funds and investment funds.

After the publication of the report, the Commission formulated its initial reaction in March 2009 in its Communication ‘Driving European Recovery’, which was a contribution to the Spring European Council. The Commission furthermore staged a wide consultation exercise in September 2008 which generated 60 reactions, including one from the ETUC. It summarised these reactions in March 2009, and then on 27 May held a public hearing attended by the ETUC among others (CEC, 2009b). The central underlying question in the debate was to establish whether these control rules apply to pension schemes. Most of the occupational funds’ representatives agreed on the fact that pension funds have particular characteristics and thus should not be concerned by solvency rules designed for other financial actors.

As far as stakeholders are concerned, many of them proved sceptical about the application of new regulations on financial services to pension funds. While the European Federation for Retirement Provision (EFRP) has recognised the need to restore trust in financial institutions, it has also stressed its concerns about the proposed changes to the structure of EU-wide ‘micro-prudential’ supervision proposed by the de Larosière report and endorsed by the Commission. Implementing the proposals could prove to be an inappropriate knee-jerk response to the current crisis (EFRP, 2009). In this context, the EFRP has consistently called for shifting capital into long-term investments overseen by institutions with clear fiduciary responsibilities to their members. Greater social partners’ involvement has been proposed to reduce volatility and increase trust in financial markets. The EFRP has also shown itself to be sceptical about the harmonisation of national rules. In recognition of national competence over these systems, the IORP Directive is restricted to the minimum standards

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6. Basel II is an international business standard that requires financial institutions to maintain sufficient cash reserves to cover the risks incurred by their operations. The Basel Accords are a series of recommendations on banking laws and regulations issued by the Basel Committee on Banking Supervision (BCBS).
needed to permit a single market that protects members, rather than setting out detailed specifications of prudential standards.

BusinessEurope has sent out ambivalent signals. On the one hand, its traditional pro-integration stance has been confirmed. The single market must be further integrated and existing barriers removed (BusinessEurope, 2009). For Business Europe, the expected benefits of integrated EU financial markets in terms of increased competition, reduced costs of raising capital and lower trading costs will only be realised if confidence in financial markets is restored and legislation is implemented and enforced consistently. This, in turn, requires increased cooperation between national supervisors and regulators and convergence of national regulators’ day-to-day application of legal provisions. Yet European employers’ representatives have clearly stressed that financial services and supplementary pension funds do not compete with each other and so there is ‘no need to have the same rules for insurers and IORPs’ (CEC, 2009c). For the European Trade Union Confederation (ETUC), we are witnessing the failure of the existing regulations (ETUC, 2009a).

As far as the more technical debate is concerned, in December 2009 CEIOPS published its Financial Stability Report. This stressed that the financial turmoil has hit Institutions for Occupational Retirement Provisions (IORPs) primarily in their role as institutional investors. But the impact has not been as severe as in other financial sectors. The long-term nature of the liabilities has helped to give some protection in this respect and IORPs have not experienced the liquidity problems seen elsewhere, e.g. in the banking sector (CEIOPS, 2009a: 3). IORPs have a number of safety mechanisms available in the event of under-funding. No Member States have reported material exposure to ‘toxic assets’: this is seen as immaterial in relation to the fall in asset values and has had a limited impact on the funding levels of European pension schemes.

In terms of the policy responses to be implemented, CEIOPS firstly emphasised the complex set of challenges to the financial sustainability of funds: defined benefit (DB) occupational pension funds are under increased pressure, partly because of low interest rates and the prevailing longevity risk. The crisis has also been challenging for defined contribution (DC) plans, making plain that careful investment
strategies, such as suitable default options and lifecycle mechanisms, are important elements in mitigating the effect of market downturns on plan members. What is more, financial education and awareness is increasingly felt to be crucial, in order to empower people to make sensible and informed choices regarding their pension provision. As a result of the crisis supervisors reacted differently, depending on the nature of pension funds, by for example closer monitoring of riskier funds, increasing the frequency of reporting, performing stress tests, using the flexibility in their funding frameworks and increasing disclosure requirements (CEIOPS, 2009b).

Thus last year saw a shift in the way the network on the single market in pension funds has approached the pension challenge. Traditional support for the widening of pension funds has weakened. Two main criticisms have appeared: the first concerns the weakness of the EU regulatory framework for financial markets. Secondly, the need for better governance of pension funds has been emphasised. Stricter control over the investment strategies of pension fund managers has been demanded. Stakeholders have agreed on that but stressed the need to consider the specificity of pension funds (especially IORPs) and their improved performance, if compared to that of other insurers, in recent years. In that respect, attempts to establish common supervision of financial institutions have largely been rejected.

3.2 Financial sustainability of pensions in view of population ageing and the economic downturn

The European network on the sustainability of pension systems has engaged in more in-depth reasoning about the crisis, its impact and the way to deal with it. In the short term, increased deficits have been allowed to limit the consequences of the crisis. Yet in the long term, structural reforms have been assumed to be decisive. The Economic Policy Committee has pointed out that ‘successful fiscal expansion to counter recession and longer-term fiscal sustainability are not incompatible’. But fiscal measures to increase confidence and support demand are only successful if they are perceived by the markets and public opinion as temporary and consistent with long-term sustainability (EPC, 2009).
In a context of severe economic recession, discretionary fiscal stimulus and automatic stabilisers have been assumed to help limit negative social consequences. They have provided a cushion for economic activity and contributed to the recent signs of improvement, but have led to a substantial deterioration in government accounts. From a deficit of 0.8% of GDP in 2007 – the best result for thirty years – government deficits in the EU are forecasted to average 6% of GDP in 2009 and around 7% in 2010. In the three years to 2010, the gross debt ratio for the EU as a whole is increasing by more than 20 points (ibid.).

The economically oriented actors have stressed that the main problems are related to the combined effect of the crisis and of ongoing population ageing. The fiscal costs of the crisis and of projected demographic developments combined make fiscal sustainability an acute challenge. Again, the need for structural cutbacks has been stressed: ‘in the absence of ambitious efforts to implement structural reforms and consolidate government accounts, there would be very large increases in expenditure on debt interest and public pensions, as well as on healthcare and long-term care during the coming decades’ (CEC, 2009d).

The message from the EPC and its Ageing Working Group has been that there is no defined upper limit to sustainable debt levels. Limits to sustainability differ across countries and time. The capacity to run high debts depends on the degree of development of financial markets, perceived risks, and trust in the capacity of a government to implement structural reforms and consolidate deficits. Countries with high debt ratios – as well as large external imbalances or contingent liabilities – are particularly exposed to market turbulences, such as changes in interest rates and spreads during times of evolving economic perspectives. Fiscal expansion in a crisis context is not detrimental for sustainability as long as the measures adopted by governments are temporary. But concerns arise when high deficits are structural (EPC, 2009).

The EPC has drawn attention to the fact that strains on the long-term sustainability of the public finances are affecting all Member States. However, there are major variations across the Member States. A first group of countries (Bulgaria, Denmark, Estonia, Finland and Sweden) has comparatively strong budgetary positions and undertaken important reforms in the last few years. Though the crisis is expected to lead to a deterioration in government accounts and a substantial increase in
government debt in each of these countries, their structural fiscal positions remain sounder than in most other EU countries and present, therefore, a low long-term risk.

A second group of countries (Belgium, Germany, France, Italy, Hungary, Luxembourg, Austria, Poland and Portugal) reveals very different characteristics in relation to their initial budgetary position and age-related expenditure. Belgium, Germany and Austria are projected to bear costs of ageing that are close to, or above, the EU average, but their initial budgetary positions are relatively sound, provided that the crisis-related deterioration in government accounts does not become structural. For France, Italy, Hungary, Poland and Portugal, the long-term costs of ageing are not projected to be particularly high. However, their initial budgetary positions imply that the countries’ fiscal policy is unsustainable, even without considering any increase in age-related expenditure. In all these countries, the crisis and the support for recovery are leading to a very fast increase in debt ratios. In general, for this group the long-term sustainability risk is medium.

For a third group of countries, the sustainability gaps are the result of a very large projected increase in age-related expenditure, compounded in most cases by large initial imbalances, and hence they are exposed to a higher long-term risk. The sustainability gaps in the Czech Republic, Cyprus, Ireland, Greece, Spain, Latvia, Lithuania, Malta, the Netherlands, Romania, Slovenia, Slovakia and the United Kingdom are all above 6% of GDP. The possible continuing effects of the crisis on the budgetary position and on medium-term growth are a serious concern for most of these high-risk countries (ibid., 27-29).

What is important here is that the three groups of countries do not overlap with traditional classifications of pension models in Europe. Some of the countries with high-level public protection against old-age risks (e.g. Finland, Sweden and even Italy) are not assumed to be more at risk than countries with multi-pillar pension systems (Ireland and the UK being among those most at risk).

What is more, while traditional demands for structural reforms persist, the perception of private pension funds is not so positive. As pointed out by the Commission, future pensioners have been encouraged to top up their public pensions with their own savings and funded old-age
income. Yet developments in financial markets during the crisis have illustrated the risks associated with the shifting of a large share of pension provision to privately-managed funded schemes, and has reduced the political and social support to implement reforms that leave a large proportion of pensions subject to market fluctuations. In that respect the Commission has said that it will continue to work with the Council and Member States to identify lessons for the design of funded schemes and target beneficiaries in order to secure adequate and sustainable private pension provision (CEC, 2009e; 2009f; 2009g).

At the same time, the assessment of recent pension reforms is largely positive. The EPC has made the point that EU countries have tried reducing the generosity of public pension schemes so as to make these programmes financially more sustainable in view of demographic trends. They have raised the statutory retirement age in a gradually phased way over the long-term for old-age pensions and restricted access to early retirement schemes and strengthened the incentives to prolong working lives, which leads to a containment of the increase in old-age and early retirement spending. By contrast, prospects for the short-term sustainability of supplementary pension funds are assumed to be more negative. The Ageing Report does refer to the few countries where pension funds already play a big role in the determination of pensioners’ income (ibid.). For all of them, Sweden included, the prospects are worrying.

The network on the sustainability of pension systems has thus put particular emphasis on the sustainability of private pensions, with accompanying demands for a revision of the broad strategy for privatisation. Long-term financial viability of pension systems have been approached through complex sets of measures based on structural reforms, debt and deficit reduction, and especially an increase of employment rates. After the crisis the network has recognised the tensions affecting supplementary pension funds and the need for more cautious strategies.

3.3 The enhanced focus on social adequacy and pensions

As for those in the camp of the EU institutions (the SPC and its Indicators Sub-Group ISG) and stakeholders, who are more keen to
defend the adequacy of present and future pensions, they have reinforced their critical attitude towards the progressively increased role of supplementary pension funds. And they have stressed the important role of public pensions to protect against economic risks. As argued by the Social Protection Committee (SPC, 2009a), strong policy intervention, focused on recovery and social protection systems acting as automatic stabilisers, played a major role in mitigating the social consequences of the crisis.

Regarding the longer-term impact of the crisis on pension schemes and social security schemes in general, the SPC has emphasised that pensions in payment are mainly delivered by public PAYGO schemes on which the crisis in financial markets has no direct effect. By contrast the book value of the assets of pensions funds have been significantly reduced, and real issues of solvency could emerge if markets take a long time to recover. But apart from in a few Member States, this would primarily affect the incomes of future pensioners in the medium to long term. Therefore most Member States perceive their pension systems as quite resilient. However, if the crisis deepens and continues for several years, even PAYGO systems will be affected, as unemployment and lower growth will reduce revenue from taxes and social contributions and will weaken public finances. Despite the severity of recent market turbulence, European pensions have not experienced problems to the same degree as other types of financial institutions, nor those of pension systems in some other countries outside the EU. So clearly the system is relatively robust, at least over the short term for those retiring today (SPC, 2009b).

The Open Method of Coordination (OMC) process has provided a tool for the European Commission to explore with Member States where there may be weaknesses in pension systems that could need addressing in the future. For instance, one critical point has been the importance of ensuring that investment frameworks for DC pension schemes are designed to encourage the right choices and that the 'lifecycling' of asset allocation is the mainstream option for everyone. Another is that 'a careful monitoring and an in-depth and open discussion about pension systems in Europe, and in particular a critical review of the relative role, design and performance of the private pillar will be necessary' (CEC, 2009c).
The Commission and Council have noted in the Joint Report on Social Protection and Social Inclusion (CEC, 2009d) the need to mitigate risk in defined contribution pensions, particularly for those people approaching retirement, and have called for appropriate solutions for the pay-out phase which are still missing in a number of countries with mandatory schemes (Fischer, 2009).

The trade union movement and social NGOs have largely supported a broad revision of the pension reform agenda of recent decades. As stated in the ETUC commentary on the Joint Report on Social Protection and Social Inclusion, in the opinion of the ETUC the crisis requires certain existing policies to be modified, particularly concerning the privatisation of pension systems; the Union should be aiming higher and ploughing more resources into social policies (ETUC, 2009a; 2009b). The ETUC reaction to the Joint Report was critical in many respects. The report failed to deliver any answers that matched the challenges with regard to the social inclusion of certain disadvantaged groups, such as migrants for example. The ETUC examined the case of pensions, stressing that the income of employees currently retiring is heavily dependent on the role played by private pension schemes, notably ‘defined contribution’ schemes, in the constitution of their pensions (ETUC, 2009b). Certain financial assets, such as shares and high-risk investments, have lost up to 30% of their value; it has emerged that while all systems are affected by the crisis, they are not all affected in the same way. For example, pay-as-you-go schemes are performing less badly than those where the engine is essentially ‘financial’, in other words where the amount of the pension depends on investment performance.

According to a study conducted by the European Federation of Retired and Older Persons (FERPA) (see ETUC, 2009c), over the past five years the income of retired people has suffered a drop in purchasing power of between 15 and 20%, with women and older retirees bearing the brunt. It is the people currently embarking on retirement, and whose pensions include a large share of ‘capitalisation’, who are being hardest hit by the effects of the financial crisis. Conversely, in those countries where the amount of the pension is largely covered by the public system, retired people are faring better; the importance placed on or argued in favour of capitalisation pensions boils down to passing the risk on to the worker. To put it another way, pensions are slipping from the collective
dimension into an individual dimension; managers lack a long-term vision in their investment strategies and are intent on immediate profitability, focusing too often on high-risk investments.

In the social camp, AGE (the European older people’s platform) has strongly reaffirmed the need to focus on ensuring adequate pensions for the elderly. Here the focus is more on the need to modernise pension policies to deal with broad societal challenges. AGE members have reiterated the demand for balanced pension systems with adequate and reliable statutory schemes (first pillar). Enhanced security for individual entitlements in funded pension schemes should be secured through measures to facilitate the retention of older workers in their jobs and access to quality employment for those seeking work, measures to address gender inequalities in old-age income and avoid creating new sources of inequalities for future cohorts, and measures to support individuals with shorter or atypical employment careers to help them build sufficient pension rights (AGE, 2009).

This network has thus stepped up the criticism of pension privatisation and the development of supplementary funded schemes to protect old-age risks. The effect of the crisis is assumed to have been exacerbated by recent developments as concerns pension funds. Yet it is still questionable whether the network may change the EU agenda in the field.

Conclusions

This article has shed light on the three dimensions of the EU debate on pension policy. The financial and economic crisis has affected all three related networks and consequently the debate about pension reforms and the role each pillar is expected to play. The crisis has largely shaped the key messages proposed at EU level.

The first network is related to the aim of completing the single market. The DG responsible for the internal market took up the issue while, during the 1990s, various actors, especially economic and financial players, became increasingly involved. The network, centred on the internal market directorate, consists of numerous lobbying groups sustained – willingly or not – by academic networks that are influential in their field. These institutions shared the same guidelines and policy
goals, while other non-state actors advanced more differentiated arguments. The last year has seen a shift in the way the network on the single market for pension funds has approached the pension challenge. Competent European institutions have stressed the need to revise EU regulation and supervision of financial markets. Stricter control over the investment strategies of pension fund managers has been demanded. Stakeholders have agreed on that but stressed the need to consider the specificities of pension funds (especially IORPs) and their improved performance in the last years.

The second circle consists of macroeconomists orbiting around the EPC. Here, the groups involved are asymmetrical, and the unions are poorly represented. Although the Member States control the agenda with precise mandates determined by the Heads of State and national governments, the Commission now has the task of keeping this agenda, and its associated reforms, open at national level. Discussion has had to take on board different interests and become less fragmented than previously. National reforms undertaken under the auspices of qualifying for monetary union have stimulated debate on more significant and radical innovation. The network on the sustainability of pension systems has put particular emphasis on the sustainability of private pensions, with accompanying demands for a revision of the broad strategy for privatisation. Long-term financial viability of pension systems has been approached through complex sets of measures based on structural reforms, debt and deficit reduction, and especially the raising of employment rates.

The Ministers of Social Affairs, and the related network, have succeeded in placing other aspects on the agenda, going beyond financial matters. They have also managed, thanks to the support of the Social Protection Committee, to develop the common understanding necessary for further discussion. This third and much more fragmented network surrounds the SPC, which aims to place greater emphasis on the social purpose of pensions. Here, non-state actors participate merely through consultation by the SPC, formal in the case of social partners, informal in that of NGOs. This network has stepped up the criticism of pension privatisation and the development of supplementary funded schemes to protect old-age risks. The effect of the crisis is assumed to have been exacerbated by recent developments as concerns pension funds.
Recent developments in the way the three networks have framed the main challenges to pension systems prove that the crisis may lead to wider debate on the role of each type of pension programme belonging to the first, second and third pillars. Consideration of the social adequacy of present and especially future benefits has gained momentum in the social network, as well as in the more economic and financial ones. In parallel, disagreements about the role of the market have become more evident. All this may destabilise the previous interplay between the three networks mentioned above and has a direct influence on the struggle between advocates of the development of private pension schemes and supporters of the ongoing role of public pension systems.

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