

## **Chapter 2**

### **Pensions: the European debate**

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#### **2.1 Introduction**

Pensions are not an EU responsibility, and a chapter on this topic as such may seem out of place<sup>1</sup>. Recent analyses of national pension reforms (Bonoli 2000, Pierson 2001, Anderson 2002) only touch on the European influence on choices made at the national level. Nevertheless, few would claim that the European Union plays no role in the national processes of reform in pension systems. It is on this apparent contradiction that we will try to shed some light in this chapter, which serves to introduce the varied trajectories of pension reform discussed recently within EU institutions.

By ‘pension systems’ we refer to the totality of public and private resources drawn on to ensure a replacement income at the moment of retirement. So we will be referring to the three pillar structure of pensions: first pillar – public pay-as-you-go (PAYG) pensions; second pillar – private occupational pensions schemes; third pillar - private individual pensions; - developed by the World Bank. Many criticisms have been levelled at this division into three pillars, and the misinterpretations they can lead to. However, the division acts as a point of reference in the European debate, as much in the documentation of the Commission as in that of the principal economic and social players in the field.

The question of pensions has been approached at the European level in three phases. The first is linked to creating the internal market (Objective 92). This 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 limiting effective freedom of movement. From a normative point of view, privatisation is a key issue.

The second wave stems from the adoption of monetary union; here, two strands can be distinguished. First, the limit of 3 per cent of GDP imposed on public deficits, and the objectives of the Stability and Growth Pact, to maintain the balance or even a slight surplus in public finances. Since pensions are the costliest item of social expenditure, the pressure to stabilise or even reduce such costs will be reinforced. Elsewhere, fears have been expressed about the capacity to finance pensions in the medium term, and the risks involved for the sustainability of the European Monetary Union. Here, sustainability is central.

Finally, since 1999 social protection has become the object of more sustained attention from the European Commission (CEC 1999a) and from ministers for Social Affairs. Since the Lisbon summit in March 2000, the open method of coordination<sup>2</sup> had been applied first to poverty and social exclusion, then to pensions (Pochet 2002). This approach focuses on social perspectives such as redistribution and the reduction of poverty among old people.

In variance with other contributions to this book, this chapter will elaborate on how pension policy is currently formulated within the EU: on the policy contexts within

which it is located and on the identity of the main actors concerned with its development. As such, it complements the descriptions of national pension reforms in the selected European member states that follow in subsequent chapters. At the European level, the key questions under discussion take on a more normative air as the EU seeks to co-ordinate reforms under discussion at national level. The questions addressed at European level are:

- 1 How should EU member states deal with the demographic, financial and political pressures on current pension security?
- 2 To what extent should public and private responsibility for pension security be redrawn as a result?
- 3 What are the implications of new public-private partnerships for the financial organisation and infrastructure of European (and global) financial markets?

The object here is to analyse policy trajectories being developed within EU institutions. As we are examining an organisation without direct sovereign powers in this area, the main focus must remain on developing an understanding of the different factors shaping policy recommendations – prescriptions that are not necessarily acceptable to member states. In taking a European standpoint, we will approach these questions in three stages.

First of all, we need to reconstruct European debates, pointing out where they are consistent, but also identifying their dynamics and interactions. One of the key issues at European level is to define the nature of the problems linked to pensions. We will approach this question from a global perspective. In effect, there is a strong link between public pensions (their level and coverage) and the space thus made available

for, or left for, other systems. In other words, a reduction in public pensions is one condition for opening up wider possibilities for individual and private schemes (Palier and Bonoli 2000).

But it is not only this aspect which leads us to favour a more integrated approach. In effect, agreement on the part of ministers for Social Affairs to deal with the question of pensions at the European level has removed one of the main obstacles to a European approach. Insofar as European debates were driven by economic and financial players, by the Directorates General (DGs) for the Internal Market and by the Economic and Finance Council (Ecofin), their impact at national level was de facto relatively limited. Those primarily concerned, the ministers in charge of pensions, could argue at national level that Europe had no jurisdiction in these matters (subsidiarity). National political systems being less fragmented than the European system, European discussions that only tackled one aspect of the multidimensional problem of pensions, had, finally, very little impact on national politics (for a discussion of fragmentation/fusion of European politics, see Wessels 1997).

At this point, we need to understand the different ways in which the EU could intervene in national reforms. This forms the second phase of the analysis. Academic literature on the Europeanisation of national policy is now the dominant theme of European studies (Radaelli 2000). In order to be more specific about the area of analysis that concerns us, we will draw on the work of Dudek and Omtzigt (2002). They distinguish five means by which the EU influences the options available for pension reform.

First, through the forums for discussion created by the EU, ideas are spread, awareness raised, and policy networks created. It is in the realm of ideas, their circulation, and their legitimacy that influence makes itself felt. At the European level, different documents mobilise these policy networks. Reform of capital markets are subject to the Cardiff process; matters concerning Economic and Monetary Union (EMU), are shaped by the Broad Economic Policy Guidelines (BEPG) and matters of employment, by the Luxembourg process. (For a description of these, see CEC 2002a).

Second, economic integration and monetary union is making all member states more conscious of the policies pursued by their neighbours. In this context, it becomes more legitimate to hold each of them to account. This has led, for example, to the Dutch employers seeking reforms to the French and Italian pension systems, because they ran the risk, according to the Dutch, of skewing capital markets and the returns obtained via the Dutch pension funds.

Third, the EU has become an agenda setter for member states. The Commission has the power to impose issues that are not necessarily on national agendas, or not on the agenda at a given moment. The fact that the Commission has taken up the issue, and might have received several explicit but different mandates from the European Councils, gives it the capacity, if not the obligation, to maintain the issue as a priority on national agendas.

Fourth, some political leaders use the EU as a pretext. . As a recent study by the Commission stated: ‘... besides economic arguments, coordination can also play a

useful role from a political-economy viewpoint by helping to implement unpopular but necessary policy actions at national level' (CEC 2002b: 4). European level agreements offer a resource for those who are in tune with the European line of argument, at least in those countries where European integration is considered to be of positive value.

Fifth, the configuration of groups mobilised at the European level is different to that within member states. Lobbying practices or organisational forecasts at the European level do not cover national plans.

Besides these different mechanisms which, collectively, have their impact primarily in the realm of ideas, the impact of the Court of Justice must also be mentioned, particularly in its role as guardian of competition law<sup>3</sup>. In defining what is the responsibility of national collective provision and what is legitimately a function of the market, the Court has had a decisive influence.

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 schemes of supplementary retirement income (the second pillar), the situation is less clear. The Court of Justice 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. Since the Albany judgement (C-67/96 Albany International BV v Stichting Bedrijfspensioenfonds Textielindustrie) it seems that the Court may have struck a balance in how it interprets

what is and what is not a collective ‘second pillar’ pension scheme, excluded from competition law (Bosco 2000). It should also be noted that the reform of the treaties adopted at Nice (2000) had added a phrase to article 137 which reads: ‘... *shall not affect the right of Member States to define the fundamental principles of their social security systems and must not significantly affect the financial equilibrium thereof*’. This implies that the Court could not overturn the fundamental balance within each national system, nor the financial aspects which are evidently a central to pensions. Finally, the Charter of Fundamental Rights adopted at the European Council at Nice (2000) changed the balance between the economic mission of the EU and other, more general – notably social - objectives. Its inclusion in the agreements issued by the Convention on the Future of Europe, and the intergovernmental conference it anticipated, should reinforce the attitude of the Court of Justice in its concern not to destabilise the national equilibrium of member states. Nevertheless, some uncertainty remains.

Having outlined the development of European discussion on how pension reform should be shaped, and considered various mechanisms for communicating these between the national and European levels, the effects at national level need to be considered. This is the key concern, and it is less a matter of anticipating outcomes than of underlining the absence of direct effects, or simple mechanisms of cause and effect on the public – private divide which lies at the heart of this chapter. The argument we propose is that the more complex the discussions at European level are, the more weight they carry, and the more options they offer for dealing with the challenges of ageing. This being the case, radical proposals become marginal.

However, the incremental impact of Europe on the redefinitions of the division between private and public needs to be reinforced.

For purposes of clarity, we have chosen a chronological, thematic presentation. The first section (2.2) underlines the issues linked to labour mobility, and the creation of an integrated financial space. The second section (2.3) shows how this debate has become linked with that of monetary union, and the sustainability of non-prefunded public pensions. Finally the third section (2.4) shows how social issues have moved centre stage in this debate since 2000. This has promoted a new set of interconnections between areas of debate, which previously had tended to remain compartmentalised.

## **2.2 Towards a single market**

European action in the area of complementary pensions is based on two aspects of the EU treaty. First, free movement of people, goods, services, and capital, and second, competition policy. In both these areas, authority to act at the European level is powerful, and has been validated by innumerable rulings by the European Court of Justice. There are two strands to this debate: on the one hand, showing the ways in which freedom of movement is hindered where (second and third pillar)<sup>4</sup> pensions are concerned; and on the other, how free competition between economic agents is unduly constrained. As Math (2001b) noted, various economic actors are pushing for complementary social protection systems - that are currently very much embedded at national level, are often compulsory and monopolistic, benefiting from protective fiscal arrangements - to be subject to European competition policy, and to competition from other sectors (insurance companies, pension funds). It is clearly no coincidence

that European discussion developed under the auspices of liberal European Commissioners.

This has happened in several stages, during which argument has become more focussed. The first attempts failed miserably. In the context of creating the single market (Objective 92), a new directive on institutions for retirement provision had to be withdrawn under pressure from several member states. In 1996, the European Federation for Retirement Pensions (EFRP) regretted this failure to accomplish the three objectives it had identified as priorities (DeRyck 1996): freedom of cross-border investment management, of cross-border investment, of cross-border membership.

The Green Paper on complementary pensions (CEC 1997) revived this initiative. This aimed to establish a community framework of 'prudential regulation', and fiscal regulation and to reduce the obstacles to labour mobility. This Green Paper is to play a crucial role. Mindful of previous failure, the tone adopted on institutional questions is very cautious. It specifies that: each state is free to choose how it divides its pension system between the three pillars - the first pillar is and will remain dominant, subsidiarity will apply in this area and so on. The objective is evidently modest – to encourage diversification within a framework dominated by state pensions: *'State pensions (pillar 1) account for the bulk of pension payments (88per cent), but the need to maintain levels of income in retirement is likely to result in greater reliance being placed on the other main sources of supplementary retirement income'*. The different lines of argument developed in the Green Paper will provide the backbone for future action and proposals. The problems of an ageing population, and the

demographic trends which form the point of departure for these documents are not dealt with here (see particularly CEC 2000a) and are well documented elsewhere.

One of the arguments in the Green Paper is that wage overheads would be less burdensome if the rate of return obtained on financial markets was higher. It gives the following example, subsequently used in various documents: *'Assume that the target is a fixed supplementary pension of 35per cent of salary on the basis of a 40 year working life. If the real rate of return on assets is 6per cent, the cost is 5per cent of salary: all other things being equal, if the real rate of return is 4per cent, the cost is 10per cent of salary, and if the real state of return is only 2per cent, the cost is 19per cent of salary.'* The market needs to be as integrated as possible, so that returns will rise. However, behind this argument lies another argument, that is not explicit but nevertheless evident: as the rate of return from a PAYG system is fairly weak, a partial switch to a private system would be as beneficial for employers as it would be for workers.

Hard on the heels of the Green Paper, in May 1998 the Commission deposited a Financial Services Action Plan, which was endorsed at the Cologne European Council in June 1999. One of the strategic objectives of this Plan is to establish a genuine single market for wholesale financial transactions. The adoption of legislative provisions on investments by the Institutions for Occupational Retirement Provision (IORPs) is presented in the Plan as a prerequisite for attaining this objective. Later, the Lisbon European Council placed strong emphasis on the need to integrate financial services and markets within the European Union. A single financial market is seen as a key factor in promoting the competitiveness of the European economy,

the development of the new economy, and social cohesion. In its conclusions, the Presidency stresses that priority must be given to removing the remaining barriers to investment in the field of pension funds and has called for the Plan to be implemented by 2005. The Lamfalussy report of 15 February 2001 on the regulation of the European security market goes back to the usual arguments favouring the development of private pensions and pension funds.

A second line of argument is that of mobility. Even though inter-state labour mobility is still very weak, supporters of pension policy development will reverse the argument. Movement of workers is weak because a number of obstacles prevent workers from exercising their right to freedom of movement in full. This will lead the Commission to present a Communication on a new labour market, open to all, with access for all. This is followed by a plan of action to promote mobility. Following the recommendations of the Veil report on freedom of movement, the Commission set up a Pension Forum (formally established by the JOCE L196 decision, 20.07.2001) which met for the first time in 2000. Its role is to help the Commission resolve problems linked with cross-border movement. It has indicated that the Commission is willing to increase the number of participants. It represents states and social partners, as well as retirement funds, insurance companies and investment societies. The aim is to depoliticise the discussion and neutralise the ideology surrounding the issue, to turn it into a technical matter. This led to a consultation in June 2002 of the social partners (ETUC, UNICE and CEEP) on the portability of private pension rights. The trade unions have responded comparatively positively to this consultation.

Two other aspects are also addressed in the Green Paper. Tax systems: *‘Taxation plays an important role in pension provision and scheme design, providing privileged treatment at the level of contributions, fund income and capital gains, and benefit payments. There are regulations in place to control how these fiscal privileges are used.’* (Chapter V). Following from this, on the 19 April 2001, the Commission adopted a Communication on the elimination of tax obstacles to the cross-border provision of occupational pensions. (Difficulties arising from differences in taxation systems are subject to other EU initiatives and are not dealt with in any detail here. For a recent analysis, see Radaelli, 2002). ‘Prudential regulations’ (Chapter III) are also discussed. The strategy of issuing the Green Paper has proved to be a smart move, as in this way the Commission has managed to keep the upper hand, and use the responses to the Green Paper as a basis for setting out new proposals.

These different elements allowed the Commission to set out a proposal in October 2000 for a Directive on institutions for occupational retirement provision (pension funds, superannuation schemes, etc). The aim is to create a prudential framework at the European Union level strong enough to protect the rights of future pensioners and to increase the affordability of occupational pensions. The draft Directive also seeks to enable an institution in one member state to manage company pension schemes in other member states. Once again, this proposal gave rise to numerous debates, but finally the Ecofin Council agreed to it in June 2002, opening the way for this Directive to be adopted (although the European Parliament has still to give it a second reading). One aspect remains uncovered – tax systems.

Having outlined the main documents and their underlying logic, we now turn to the agencies and institutions who contribute to this section of EU discussion. Amongst these, the European Parliament<sup>5</sup>, 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. If some member states have been (very) reticent, others have, however, shown their support for the Commission's initiatives.

There are numerous private actors in the field. They act as a classic lobby (the European Federation of Fund Managers (FEFSI), the European Committee of Assurance (CEA) and the European Federation of Retirement Pensions (EFRP)) to obtain amendments and advance their interests - which are not always identical, as can be seen by the tension between the CEA and the EFRP (see Math, 2001c) over the Commission's proposal on the activities of occupational retirement funds

One of the strategies is to legitimise their demands by producing, or referring to, academic studies in the field. In this context, the role of the European Round Table of Industrialists (ERT), a group of about forty senior industrialists<sup>6</sup>, is significant. The ERT set up a working party chaired by De Benedetti which produced a document entitled : « *European pensions, an appeal for reform – Pensions schemes that Europe can really afford* » published by the De Benedetti Foundation (ERT 2002) and widely publicised in the media. As Math (2001b) describes it '*The Foundation has links with leading edge researchers and university personnel, in which one party may not know, or may not seek to know, the close working links between this research centre and the ERT. Its work is presented as independent research, brings a scientific legitimacy to*

*political recommendations, and is widely disseminated notably within a sympathetic financial press'.*

This stance adopted by one sector of European employers is in strong contrast to UNICE, which brings together national employers' federations, and has kept a very low profile on this issue. It was only in November 2001 that UNICE adopted a 'Strategy Paper on Sustainability of Pensions'. UNICE points 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).

In the field of private pensions, Europe has a particular role to play in bringing together an asymmetrical group of interested parties. The Commission, through two commissioners with strong personalities, Brittan in the late 80s/early 90s, and Bolkenstein in the early 2000s, has been an important catalyst for putting this subject onto the EU's agenda. The demand for a radical change has been vocal: 'Defusing Europe's pensions timebomb' was the title of a speech by Bolkenstein (2001). For all that, it is hard to make the interests they defend a priority for the Commission as a whole, or to win them support from the wider group of member states. For the time being, various elements have been brought together to develop a more sustained approach. Beyond the general issue of an ageing population, that of the mobility of workers has become more central. Faced with a failure to force the issue, the argument has become more neutral – a pragmatic resolution must be found to the practical problems of labour mobility. Networks favourable to pension funds, and a

greater role for private pensions are using the ‘Annual Report on Structural Reforms’, published in the framework of the Cardiff process (which focussed on the market reforms for goods and capital) to support their ideas. Nevertheless, this process is subordinate to the Broad Economic Policy Guidelines (BEPG) which are controlled by the Ministers of Finance (see below) (CEC 2001a).

### **2.3 The economic and monetary stability of the European Union**

The second line of discussion developing at European level, stems from the ministries of Finance and their advisory committees, particularly the Economic Policy Committee (EPC), and the Economic and Financial Committee (EFC). The issue is less freedom of movement and competition policy, than the stability of the monetary union. Public, non-prefunded pensions are the focus here. This issue will come to a head in the medium to long term, 2020-2040. The declarations of the Ecofin Councils, and the various statements from the European Councils are not addressed here (for a detailed description, see de la Porte 2002b, de la Porte and Pochet 2002a). Here the focus is on the normative descriptions presented in the various documents, and their progressive consolidation.

The battle between the ministries of Economic Affairs, and Social Affairs over who should have the last word has acted as a dynamic in this area. The first initiative to address the issue of pension reform came in 1997 from the EPC, without having a specific mandate to deal with this issue. Its guiding philosophy was that pension reform needed to be adapted to the circumstances of an ageing population, while ensuring durable fiscal consolidation and improving the condition of European labour markets. The arguments put forward to reform the pension scheme - the demographic

argument, the fiscal burden argument, and the labour market efficiency argument – have become permanent features in the architecture of European pension debates. The principal recommendation was containing benefits, as the main instrument for guaranteeing the solvency of PAYG pension systems. The principal means prescribed to achieve this aim was by delaying the age of retirement. A second recommendation was to move away from a solidarity-based system to a pension system based on individual contributions. A third recommendation was gradually to increase the role of funded schemes.

Following this first exercise, a work schedule for validating these propositions by means of various reports will be produced (de la Porte and Pochet 2002b). In 2000 the EPC submitted a new, more substantial report which tried, on the basis of shared national assumptions (in particular about demographic projections), to evaluate the burden of public pensions in terms of percentage of GDP up to 2050 (for a critical view of these baseline hypotheses see Math 2001a, Math and Pochet 2001; for quite different projections, see Fitoussi and Le Cacheux 2002). According to conclusions based on two different future scenarios, one that could be described as normal, the other based on the Lisbon objectives (ie raising the employment rate progressively to 70per cent), pension expenditures as a percentage of GDP are on the rise. The effects on public debt, in particular, were emphasised. The EPC put forward four recommendations:

1. Reforms should primarily aim at delaying retirement;
2. Fiscal policy should be rendered more sound and public debt should progressively be reduced;

3. The link between social contributions and benefits at the individual level should be strengthened, in accordance with the equity principle;
4. The role of funded schemes should be progressively increased.

These recommendations will be quickly taken up in economic and financial circles (see Mantel 2001). A second report was presented on the question of long term financing, and consideration of the effects of ageing was to be to the costs linked to healthcare (EPC 2001). A working group was set up (Ageing Working Group, AWG) which analysed the effects of parametric reforms (EPC 2002). Three aspects were measured: indexation, postponing the age of retirement, and a retirement more closely linked to life expectancy. The report concluded that, with variations between countries and systems, these three variables should be applied. It mounts an energetic plea for postponing 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 (as would any change in the rules of indexation). Note that this conforms to the central objective of the European Strategy, to raise the employment rate to 70per cent, and the employment rate for people over 55 to 50per cent.

One related aspect should be stressed. 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'* (CEC, 2000). This study also deals with the question of retirement pensions. This question of the quality of public expenditure is important because it gives direction to a number of players in the heart of the Commission .The argument runs as follows: 'good' public expenditure has to

be distinguished from other public expenditure. For example, investment, education, active measures to stimulate employment are all 'good' areas of expenditure. In this context, and assuming budgets need to be reduced, pensions are in the front line of the category of 'bad' expenditure. This is a strategy for the medium term. Rather than a direct intervention in the pension debate, what we see here is an attempt to reach a common definition about what is or is not acceptable in terms of public expenditure.

The European Central Bank is one of the most important players in this debate. It has, in various documents, shown its concern for the budgetary stability of public (non-prefinanced) pensions, and recommends lowering the ratios of public debt, the establishment of financial reserves, and pursuing with 'even greater determination' social security reform. 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.

The Broad Economic Policy Guidelines (BEPG) is the key document structuring the networks surrounding the ministers of Finance. In 2001 the Ecofin Council proposed that in future one part of the BEPG should be devoted to ageing and its financial implications. Member states should develop strategies for addressing the longer-term demographic challenge and present them in conjunction with their Stability and Convergence Programmes. The strategies should be examined in the context of multilateral surveillance). This proposal was accepted by the European Council<sup>7</sup>.

The emergence of the EMU as central to the economic debate on pensions has brought about an important change. Here we find ourselves at the heart of the

European project, and current debates on governance: how to make monetary union work when economic controls are, essentially, decentralised. The national actors who carry forward these discussions – including the sustainability of pensions – are central to the architecture of Europe (the Ecofin Council). Ecofin is supported by committees which benefit equally from the strength of their members' national institutions (numerous econometric studies are similarly coordinated). Contrary to the debates linked to the internal market, which are very ideological, the EPC studies do not support, as an a priori position, a greater role for private pensions. In numerous documents, the risks linked to second and third pillar pensions are underlined<sup>8</sup>. Nevertheless, if the analyses are more subtle, the political conclusions are the same (and sometimes seem disconnected from the analysis). The central argument employed by the EPC to justify a greater role for private initiatives is, classically, that of the diversification of risk. One might note here that the EPC studies move away from econometric calculations as such, to engage more substantially, and in a more normative way, with the performance of the various national systems.

#### **2.4 Pensions: a social question?**

If free movement and the impact of EMU have contributed to the shaping of the community discussions, this has happened without the national ministers in charge of pensions pronouncing on the subject. On the one hand, there is no clear legal responsibility in the Treaty, and on the other, there is such a wide diversity of national systems, and of reforms already implemented or under way. The issues in terms of medium term financing play a greater or lesser role from country to country. However, in the end, a negative reason has forced them, with reluctance, to address the question: the risk that the problematic nature of pension reform could be shaped

by actors other than themselves. As Chassard (2001:317) notes *'It is important that the "social experts" should make their voices heard in this concert, so as not to leave the field open to those who view social protection from an exclusively financial angle'*. It is worth noting here an immediate reaction on the part of the Council of ministers of Social Affairs: a Social Protection Committee (SPC) was created as an initial step. This was immediately given the task of producing a report setting out the evidence on the social aspects of pensions.

In the draft report, the Social Protection Committee views the inter-linkage of different areas (social protection, employment and public finance) as crucial. The main message is *'it will be important to bear in mind that financial sustainability cannot be achieved at the expense of the ability of pension systems to meet their social goals'*. Only one paragraph is devoted to the reasons for dealing with the issue at European level. This is the weak point of the social approach: if a purely financial definition of the problem is to be resisted, a positive definition of common social objectives is required and this is always problematic<sup>9</sup>. This partly because some Social Affairs ministers share the objective of reforming their national pension system with their Finance ministers (see de la Porte and Pochet 2002a).

The creation of a new network around the SPC is designed to analyse pension reform from a more social angle. From the outset, this group is more heterogeneous than its economic counterpart (the EPC), and needs to establish its own legitimacy as much from the analyses it produces as from its political and ideological dealings with the EPC. Nevertheless, the institutional development gives an indication of the dynamic nature of the issue being studied. In this context, the Belgian Minister of Social

Affairs and Pensions, Frank Vandebroucke, played a key role particularly during the Belgian Presidency in convincing his colleagues to adopt common objectives, and then in developing indicators to enable the open method of coordination to be applied. He also commissioned a report during the Belgian Presidency, edited by Esping-Anderson (2001) that set out the reasons for a common social approach to pensions. Following this, and the EPC report (see previous section), the European Council approved three major overall objectives as well as the application of the open method of coordination. These are to

- 1 Maintain social cohesion and social solidarity, notably reducing the risk of poverty;
- 2 Safeguard the financial sustainability of pension systems, in particular by improving employment performance, by adapting the structure and the parameters of pensions systems, and by increasing the budgetary room for manoeuvre;
- 3 Adapt pension systems to a changing society and labour markets.

To make these very general principles more concrete, the EPC and the SPC were given the task of producing a joint paper. They finally agreed on eleven objectives (SPC and EPC 2001). Over and above the specific content of these objectives, discussion centred on two wider elements: control over the decision-making process and the role of the Broad Economic Policy Guidelines (BEPGs) as a key document. The eleven objectives eventually endorsed (each one the subject of detailed negotiation by the two committees) are presented in detail in the annex to this chapter. Nevertheless, even if the wording is hazy and ambiguous, some considerations merit attention: first, the hierarchy of objectives that places social considerations to the fore; second, the minimum priority accorded to questions of the internal market and labour

mobility (only Objective 8 refers to this); third, the priority given to macroeconomic issues – five objectives mention these. These eleven objectives offer a structure for future EU work in this area and discussions will be shaped by this matrix. That said, the tensions between the different approaches have not disappeared, but have gained a framework from the document.

The working agenda for pensions has been defined. In September 2002 member states presented their first national strategy reports for pensions (available on the Commission's website) following the 11 principles defined at European level. These reports are explicit about the need to negotiate changes to pension systems, particularly with the trades unions, and several were drafted jointly by different ministers, which will strengthen their legitimacy. The Commission will analyse the national strategy reports and identify good practice and innovative approaches of common interest to the member states. By spring 2003, the Council and the Commission should provide a joint report to assess national pension strategies and identify good practice. For 2004, they will assess the objectives and working methods established and will decide upon the objectives, methods and timetable for the future of the pension strategy (SPC and EPC 2001).

*At the same time the EPC and the SPC were asked to 'develop common approaches and comparability with regard to indicators in order to underpin the open method of coordination relating to the future of pensions. This cooperation should cover the preparation of simulations and projections relating to the medium and long-term prospects and implications of pension policies'. An interim report of the Indicators Sub-group of the SPC notes: 'difficulty arises from the need to define common*

*indicators that are comparable with the wide diversity of pension systems found across the Member States. The common objectives agreed in Laeken can be achieved by very different pension systems and different combinations of public and private provision. Common indicators will have to be neutral to the architecture of a country's pension system' (SPC 2002).*

## **2.5 Conclusions**

The question of pensions emerged as an issue to address at European level with the decision to complete the single market. At this point, in the absence of any legal alternative, the DG responsible for the internal market took up the issue, not the DG responsible for social affairs. This strategy did not meet with success. Nevertheless, during the 90s various actors, especially economic and financial players, have become increasingly involved. The issue was revived by the Green Paper on supplementary pensions, and also as a consequence of the single currency. This last required more integrated financial markets. National reforms undertaken under the auspices of qualifying for monetary union (France and Italy are examples of this) have stimulated debate on more significant and radical reforms (see Boeri, Siebert etc). Even though calls for reform have been strident and relayed by one pressure group or another (see the De Benedetti Foundation), their impact on the on-going development of European discussion has been marginal. At the same time, the ministers of Social Affairs have succeeded in placing other aspects, going beyond the financial, on the agenda. They have also managed, thanks to the support of the SPC, to develop the common understanding necessary for further discussion. One other aspect has also emerged: the sustainability of public finances. Here, the main focus is on unfunded schemes.

However, the outline of the problem developed within this framework does not entirely marry up with the concerns of those inclined to favour private pensions.

Rather than radical reform, the discussions taking place at European level propose incremental change, touching on a range of issues, where efforts are made to reconcile apparently contradictory objectives (collective solidarity and market forces). This in turn touches on the close link between the problem of pensions and employment strategies (raising the employment rate and the age of retirement). Radical proposals have had little effect, as the less publicised second, rather disillusioned report by De Benedetti notes, with reference to the impact of the first report (2002).

The weakness of the radical approach can be illustrated by a recent publication by one of its better known and more subtle advocates, Martin Feldstein (2002). As a transitional measure towards a fully investment based system, he proposes the establishment of a *'notional defined contribution system within the broader framework of a PAYG system'* (p6) on the Swedish model. The advantage of this is that *'they provide an individual account framework within which an investment-based system could later be introduced or expanded'* (p7). There are several points to consider. The first is a matter of conjecture: it is far from certain that Swedish workers who have lost 30per cent of the market value of their savings since the new system came on stream are fully convinced by these arguments. But more fundamentally, what Feldstein overlooks is the part played by institutions, particularly in Bismarkian countries. His proposal is addressed to an individual entrepreneur, dealing directly with a worker, each party wanting to gain maximum profit. It is very likely, as Barr (2002) suggests, that workers will prove to be risk averse, but most importantly, as all

the reforms adopted indicate, the agreement of the unions (and at least some employers) is essential. To date, trade unions have only accepted reforms that develop existing systems, and not those that are designed to achieve radical transformation. To resolve the question of collective solidarity, it is not enough to ask '*What does national solidarity for employees mean in a single Europe-wide labor market?*' (p4) because the single labour market is so far from being a reality. Even when disguised beneath proposals that are apparently purely pragmatic, Feldstein's arguments highlight is the tension between the market and social solidarity. What the short history of European discussion demonstrates is that proposals based solely on the economic arguments of market forces do not offer a constructive way forward.

If we refer back to the five sources of influence outlined in the introduction, a range of developments can be identified. First of all, there are now at least three policy networks. The first, centred around the internal market directorate, consists of numerous lobbying groups sustained – willingly or not – by academic networks that are influential in their field. The second, much more fragmented, surrounds the SPC, which aims to place greater emphasis on the social purpose of pensions. The third consists of the macro-economists around the EPC. Here, the groups involved are always asymmetrical, and the unions are always 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 mission 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. Given the scenario that the interests represented are wider, and documents show greater agreement, Europe can become a resource for those who want to initiate or pursue

reforms drawing on a range of approaches: parametric reforms, public prefinanced reforms (thanks to budgetary surpluses), or recipes for privatisation, under the auspices of the second pillar. What is clear is that the way forward will be based more on continuity than change at national level.

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ANNEX: 11 objectives agreed

### **Adequacy of pensions**

**Member States should safeguard the capacity of pension systems to meet their social objectives. (...)**

1. Ensure that older people are not placed at risk of poverty and can enjoy a decent standard of living; that they share in the economic well-being of their country and can accordingly participate actively in public, social and cultural life<sup>10</sup>;
2. Provide access for all individuals to appropriate pension arrangements, public and/or private, which allow them to earn pension entitlements enabling them to maintain, to a reasonable degree, their living standard after retirement; and
3. Promote solidarity within and between generations.

• **Financial sustainability of pension systems (...)**

4. Achieve a high level of employment through, where necessary, comprehensive labour market reforms,(...);
5. Ensure that, alongside labour market and economic policies, all relevant branches of social protection, in particular pension systems, offer effective incentives for the participation of older workers; (...)
6. (...) tak(e) into account the overall objective of maintaining the sustainability of public finances. At the same time sustainability of pension systems needs to be accompanied by sound fiscal policies, including, where necessary, a reduction of debt<sup>11</sup>. Strategies adopted to meet this objective may also include setting up dedicated pension reserve funds;

7. Ensure that pension provisions and reforms maintain a fair balance between the active and the retired by not overburdening the former and by maintaining adequate pensions for the latter; and
  8. Ensure, through appropriate regulatory frameworks and through sound management, that private and public funded pension schemes can provide pensions with the required efficiency, affordability, portability and security.
- **Modernisation of pension systems in response to changing needs of the economy, society and individuals**
9. Ensure that pension systems are compatible with the requirements of flexibility and security on the labour market; that, without prejudice to the coherence of Member States' tax systems, labour market mobility within Member States and across borders and non-standard employment forms do not penalise people's pension entitlements and that self-employment is not discouraged by pension systems;
  10. (...) ensur(e) the principle of equal treatment between women and men, (...),
  11. Make pension systems more transparent and adaptable to changing circumstances, so that citizens can continue to have confidence in them. (...) Promote the broadest possible consensus regarding pension policies and reforms. Improve the methodological basis for efficient monitoring of pension reforms and policies.

## ENDNOTES

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<sup>1</sup> Note Article 44 and Article 137. The first aims at the coordination of public pensions, and the second requires unanimity.

<sup>2</sup> Open method of coordination consists of:

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- ❑ fixing guidelines for the Union combined with specific timetables for achieving the goals that they set in the short, medium and long terms;
  - ❑ establishing, where appropriate, quantitative and qualitative indicators and benchmarks against the best in the world and tailored to the needs of different Member States and sectors as a means of comparing best practice;
  - ❑ translating these European guidelines into national and regional policies by setting specific targets and adopting measures, taking into account national and regional differences
  - ❑ periodic monitoring, evaluation and peer review, organised as mutual learning processes.

<sup>3</sup> The EU has also had a significant impact on pensions through its policy of equality between men and women – not dealt with in this chapter.

<sup>4</sup> Public pensions are regulated by Rule 1408/71.

<sup>5</sup> On 13 April 2000, the European Parliament adopted a Resolution which welcomes the Commission's intention to propose a Directive on supplementary pensions.

<sup>6</sup> The ERT played an important role in the dynamic of the internal market and the White Paper of 1985, as well as later in the transeuropean networks outlined in Delors' 1993 White Paper. This is one of the most influential groups in Brussels.

<sup>7</sup> On the subject of the market for goods (Cardiff), the Annual Report on Structural Reforms is prepared each year by the Economic Policy Committee. It includes a section which covers aspects of 'Ageing, pensions and fiscal sustainability'. This process is later integrated into the Broad Economic Policy Guidelines (see EPC 2002).

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<sup>8</sup> The report on structural reforms published by the EPC (see note 7) notes on p30 *‘These efforts (additional fiscal incentives) will promote the accumulation of private pension assets, but could also imply deadweight costs and, through the diversion of assets into tax-favoured or subsidised forms, lead to negative long-run influence on the government budget balance. The overall consequences of such incentive schemes for fiscal sustainability are therefore uncertain’.*

<sup>9</sup> For example, how to draw on the notion of solidarity when the majority of national reforms are designed to link what an individual pays with what they receive in the future.

<sup>10</sup> In this respect, benefits and tax advantages other than pensions should also be taken into account where appropriate.

<sup>11</sup> Member States’ strategies to ensure sound and sustainable public finances are reported and assessed in the framework of the BEPGs and the Stability and Growth Pact and should be in accordance with these.