Original Article

Can the EU achieve adequate, sustainable and safe pensions for all in the coming decades?

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ABSTRACT The latest financial and economic crisis has shown that European economies are all interdependent and no Member State can any longer guarantee on its own the adequacy, sustainability and safety of its pension system. In March 2011, all European Union (EU) leaders agreed that new EU rules are needed to address financial markets' erratic behaviours and to ensure the long-term sustainability of social protection systems across the EU. The new fiscal consolidation rules should help bring more coherence in the EU economic policy coordination and should enable Member States to make better-informed decisions when reforming their pension systems. In doing so, policy makers should, however, not only be concerned with ensuring economic recovery, but also with protecting Europe's social cohesion. It is and should remain the duty of public authorities to ensure that their national pension systems, regardless of how they are organised, deliver adequate incomes in old age to guarantee a decent life to all. The objective of adequacy of pensions systems should receive equal attention to the objective of sustainability and safety, and the impact of proposed reforms on vulnerable groups, such as women with career breaks, should be addressed.

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INTRODUCTION

With its Green Paper on pensions,¹ the European Commission launched a huge debate in July 2010 to gather views from a wide range of stakeholders on what could be done at the European Union (EU) level to help Member States ensure adequate, sustainable and safe pensions, despite today's context of demographic

change and fiscal consolidation. The Commission is now analysing the numerous responses they received and is preparing a White Paper with concrete proposals, which is expected to be released by the end of 2011. But how far they will go, and whether their proposals receive the support of national governments and of the European Parliament is too early to say; however, one thing is sure: the latest financial and economic crisis has shown that European economies are all interdependent and that no Member State can any longer guarantee on its own the adequacy, sustainability and safety of its pension system.

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NEW EU GOVERNANCE RULES

Up until a year ago, national policy makers were pulling out the red card of subsidiarity² whenever the European Commission dared to suggest more harmonisation between national pension systems or stricter supervision of financial markets. However, the potential impact of the Irish abysmal debt and of the Portuguese political crisis on their own economies provoked a few worried EU heads of state and governments to set aside their usual diplomatic cautiousness and to demand conditions to be imposed to those countries going through financial turbulences, which would call on the solidarity and support from the other Member States to bail them out. Those demands included a harmonisation of pension age at the EU level, longer working lives linked to life expectancy and sharp reductions in the public pension promise, all issues on which – up until now – Member States had vigorously recalled EU policy makers that only national authorities were competent to take any decision. After lengthy and heated debates, the European Council did not support these drastic requests, but all national leaders agreed that new EU rules are needed to address financial markets' erratic behaviours and to ensure the long-term sustainability of social protection systems across the EU. They also recognised that action is needed at the EU level to ensure that all Member States apply sound governance rules to manage their public finances and they decided to endorse a package of measures to strengthen the economic governance of the EU and to ensure more stability of the eurozone. With these measures, Member States acknowledged that they operate in a new legal and economic context that requires common rules and an enforcement mechanism at the EU level. These led them to agree to reform the Stability and Growth Pact³ in order to enhance the surveillance at the EU level of national fiscal policies and to apply enforcement measures to prevent further macroeconomic imbalances.

The new fiscal consolidation rules agreed in March 2011 as part of the European Semester⁴ should help bring more coherence in the EU economic policy coordination and should enable Member States to make better-informed decisions

when reforming their pension systems. In doing so, policy makers should, however, not only be concerned with ensuring economic recovery, but also with protecting Europe's social cohesion.

With the reforms introduced recently, older people are facing increasing difficulties in their daily lives as a result of cuts in pension benefits and reduced welfare support. The social cost of today's crisis is dramatic and will get worse in the future, particularly for some vulnerable groups, and governments should not sweep these social realities under the table in their efforts to restore economic growth. It is and should remain the duty of public authorities to ensure that their national pension systems, regardless of how they are organised, deliver adequate incomes in old age to guarantee a decent life to all. The objective of adequacy of pensions systems should receive equal attention to the objective of sustainability and safety, and the impact of proposed reforms on vulnerable groups, such as women with career breaks, should be addressed.

ADEQUACY CHALLENGES

In most EU Member States, older people are often pictured as being 'privileged', with a higher than average home ownership rate and purchasing power. Older consumers have become a key target group for many industries eager to reap the benefits of the so-called silver economy. Yet in many countries poverty rates among older people, particularly older women and the very old, are higher than among younger generations because older women often only have limited and/or derived pension rights and 'very old' pensions have often eroded over time and are no longer sufficient to enable elderly dependent people to live in dignity.

As reiterated by the EU leaders at the last Spring Summit⁵ on 25 March 2011, most reforms introduced recently aim to strengthen the link between contributions made by the individual beneficiary and the pension benefits s/he will be entitled to. Such measures are presented as incentives to work longer and to save more for one's old age. However, they will have a detrimental impact on women, long-term unemployed, young people in precarious jobs,

migrants, disabled persons and so on – who will all face increasing difficulties in achieving the required contributions to build adequate pension rights if they are not accompanied by measures to compensate for legitimate career breaks or other valid reasons for lower contributions. This problem needs to be addressed both in public and private schemes through the introduction of solidarity and equity elements.

In addition, the increasing trend to rely more and more on supplementary pensions for an adequate replacement rate will lead to greater risk of poverty among today's young people when they retire in 30–40 years' time if nothing is done to address the negative impact of long vesting periods on short-term contract workers. Today, many young workers have to wait for 10–15 years in short-term contracts before getting a stable job and therefore the investment they meanwhile make in supplementary occupational pensions with long vesting periods is lost.

If EU leaders are serious about promoting workers' cross-border mobility, the lack of portability of supplementary pension rights should be adequately tackled. Not only long vesting periods, but also minimum ages in supplementary pension schemes should be forbidden in order to enable short-term workers – mainly young workers – to build adequate pension rights from the beginning of their working career. The EU should relaunch the debate on minimum standards for the acquisition, preservation and transferability of supplementary pension rights and should tackle differences in taxation regimes applied across the EU on savings and payouts, to make portability of pensions rights between employers, occupational sectors and across EU countries a reality.

To improve workers' mobility, the European Commission would like to explore the feasibility of a 28th regime for supplementary pensions. The question is interesting, but should be explored in more detail as it will raise difficult issues. For example, in his report Mr Monti proposes to limit access to this envisaged new EU scheme to workers taking up their first job. Although we can understand that it might be difficult for such a system to be fully operational and open

to all from the very beginning, such limitation would soon lead to discrimination against workers within the same company and could be challenged on the principle of equal treatment in employment. The EU rules on the acquisition, preservation and transferability of supplementary pension rights should apply to all pension schemes, including the 28th regime.

Finally, to help Member States develop a better understanding of what an adequate pension means and to enable policy makers to make better-informed decisions when reforming their pension systems, the EU should develop an adaptable 'basket of goods and services' that older women and men of different age groups need to live a decent life. Similar to the basket of goods and services that is used to calculate the cash needs of an average household and monitor inflation at the national level, a special consumer basket for older people would enable policy makers to get a better assessment of the costs of goods and services one needs to live a decent life in old age, including when dependency arises, as most of these needs become more expensive with age because they require more labour-intensive services.

SUSTAINABILITY ISSUES

The impact of the pension promise on the economy of some Member States and the consequences this has on the overall economic stability of the EU demonstrate that an increased role for the EU in the pension field is more than ever legitimate to ensure that all Member States apply sound governance rules and do their utmost to balance their public budgets. Today, sound public national finances matter not only to the workers and pensioners in that specific country, but to everyone living in the EU, as was demonstrated by the recent crises in Greece, Ireland and Portugal.

One crucial objective of the Europe 2020 Strategy,⁶ the new EU policy framework for this decade, is to reach full employment (75 per cent) by 2020 in order to support economy recovery and ensure the long-term sustainability of public budgets across the EU. This will require efforts to raise the effective retirement

ages and to improve youth and female employment through the promotion of an age- and gender-friendly labour market. So far, the rhetoric on active ageing has not been translated into comprehensive age management strategies at the national and company levels, and older workers are still pushed out of the labour well before statutory retirement age while employers at the same time deplore the shortage of skilled workers. Pressure on older workers to clear the way to open up jobs for younger people has come up again with the crisis, although the past experience has shown that this is a fallacy.

During the last decade, the European Commission and Member States failed to assess the reasons why the Lisbon Strategy did not succeed in raising employment among all age groups. It is crucial to rethink the way in which work is managed within companies and within society. The Europe 2020 strategy should promote intergenerational solidarity and cooperation to create an age- and gender-friendly labour market. Innovative measures need to be adopted to support older workers wishing to remain in or re-enter the labour market, and youth employment needs to be promoted much more vigorously.

National social partners should agree to age management strategies in the workplace, including flexible working conditions towards later stages of career, professional reorientation for workers carrying out heavy tasks and so on, to motivate older workers to continue working up to the statutory retirement age and remove barriers such as mandatory retirement ages to enable those who wish or need to continue to work to remain active in the labour market. To succeed, the EU active ageing policy must take on board the needs of all age groups and women, and develop new forms of work–life balance provisions adapted to the specific needs of the 50+, particularly women, who care for dependent relatives. Older women are the group with the lowest employment rate, and most often the reasons that prevent them from remaining in employment are linked to family care duties. Facilitating the reconciliation of work

and family life for older workers who care for elderly dependant relatives should be supported at the EU level by a Directive on carer's leave, which should not only offer the possibility to take career breaks, but should also ensure that informal carers keep building their pensions rights during those breaks.

Prolonging work lives is an avenue explored in almost all Member States, and heated discussions are going on in several countries on the objective to increase the official retirement age. Achieving longer contributing years will require more quality jobs for both younger and older female and male workers. Rather than forcing people to stay at work for longer, incentives are needed to encourage people to work longer and employers to offer better working conditions and training to young and older workers, and to support age and gender diversity in their workforce.

Better occupational health should be promoted at the EU level. We may live longer but we do so in poor health. When looking at the Healthy Life Years (HLY) expectancy in the EU,⁷ the current statutory retirement ages no longer seem overly generous, as HLYs are often lower. Ensuring that people live longer in good health is a precondition to longer working lives. If automatic adjustment mechanisms based on demographic change are used, national policy makers should link statutory retirement ages to their HLY indicator rather than to life expectancy. This would encourage Member States to devote enough effort to the promotion of healthy and active ageing, an objective that the European Commission is proposing to support through the European Innovation Partnership to Active and Healthy Ageing. Their target is to improve HLY by 2 years by 2020.

However, in order to achieve a healthier and more active ageing population, we need a supportive environment. Mainstream goods and services are developed for younger people rather than designed for an ageing population. This creates a dependency that is very costly to society in terms of loss of labour market participation and need to support dependent

people. A proposal for a directive on equal treatment in access to goods and services was tabled in 2008 by the European Commission. This new legislation is needed to remove environmental obstacles that prevent older and disabled people from participating in employment. This would benefit EU economies through higher employment rates of older workers, women and persons with disabilities and would lead to the creation of an EU-wide market for the industry.

HOW TO ACHIEVE SAFE PENSIONS

As pointed out by the European Commission in their Green Paper, recent reforms have introduced major changes in the pension systems across the EU and there is a general trend to re-individualise old-age risks through a move from public to private occupational pension schemes and from defined benefits (DB) to defined contributions (DC). As the move from DB to DC shifts the financial risk to the scheme members, this trend increases the need for EU regulation to reduce the risk of employer's insolvency and irrational behaviours of the financial institutions in order to avoid a detrimental impact on adequacy of future pension promise. Drawing lessons from the financial crisis, EU supervision and better investment and governance rules for pension funds should be adopted quickly to protect workers' pension rights and to build public confidence in DC systems. As long as funded schemes do not offer adequate protection against capital market risks, labour market risks (unemployment and part-time) and biometric risks (longevity, disability and work-life balance), citizens will continue to prefer PAYG systems as these are built on solidarity and have proved more reliable in terms of pension outcome in periods of financial market turbulences.

Over the last years, boundaries between pension schemes have become blurred and public authorities struggle to build public support for these changes because they cannot prove that they will be safe in the long term. Much more effort will be needed to raise awareness and inform citizens about the consequences of these

reforms and enable them to plan adequately for their old age. Much more needs to be done to ensure safer and more transparent pensions. Stronger EU regulation and supervision of financial markets and institutions is needed, as well as clarification about the exact nature of these new products and which rules apply to them. What matters for pension scheme members is not so much to be adequately informed about the risk, but rather to be sure that their pension savings will be safe regardless of the scheme they are involved in.

With regard to protection against employer's insolvency, the European case law on the existing Insolvency Directive⁸ shows that the main objective of the Directive – that is, to force Member States to guarantee workers pension promises in case of their employer's insolvency – is not respected in the way in which national authorities are interpreting the Directive. Following the 2007 ECJ ruling on the Allied Steel and Wire and United Engineering Forgings cases, 140 000 workers lost not only their jobs, but also all or part of their pension savings after their employers collapsed. The protection against employer's insolvency offered by the current EU legislation is therefore not sufficient and needs to be reinforced to secure pension promises in employer's pension schemes. This debate should be part of the discussion on the solvency regime for IORPs and should explore the possibility of merging the Insolvency Directive with the revised Directive on IORPs to develop a more coherent and more efficient EU legal framework to protect workers against insolvency of the pension provider. If Member States pursue their shift towards pension funds, it is their responsibility to set up guarantee funds to ensure that beneficiaries will not suffer any loss of their pension promise in case their employer closes down. Individual workers cannot be made responsible for the unpredictability of economic and financial performance of the business sector.

To build citizens' and market confidence, the objective underpinning Solvency II must be the starting point, but the solvency rules applicable to IORPs must be adapted to the specificities of the various types of pension products (book

reserve, pension fund or insurance contract) and must ensure that the insolvency risk is not too heavily shifted to the beneficiaries. More convergence in terms of supervision and calculation of technical provisions will promote fairer competition and should help deliver safer and more transparent funded pension schemes.

National and EU authorities should agree on common rules to prevent pension beneficiaries from suffering again from highly volatile global financial markets. Measures such as minimum return guarantees, life-styling and life annuities are useful, but will not be sufficient to ensure adequate and safe pension systems. The EU needs to adopt common economic and public finance rules and binding guiding principles for investment practice to minimise risks and improve safety and affordability for both schemes members and providers.

PENSION REFORMS WILL DEEPEN THE GENDER INCOME GAP IN OLD AGE

Most reforms introduced or proposed recently, both in public and private occupational pension schemes, will have an aggravated detrimental impact on women if no compensation mechanisms are introduced to tackle the structural causes of gender inequalities. On average, women earn 18 per cent less than men and have less access to supplementary pension schemes owing to labour market segmentation. The gender income gap in employment will deepen in old age in the coming decades. The decision to strengthen the link between contributions and benefits will affect women more because they face barriers that prevent them from contributing equally to men. Part-time employment is mainly a female phenomenon. On average, in the EU 31.5 per cent of women and only 8.3 per cent of men work part-time. This gap will increase in the future as a result of social services cuts, which will put back the duty to care for young children and elderly dependent relatives on the shoulders of informal carers, that is women and particularly women aged 45 +.

There are also legal barriers, such as legal provisions, allowing for differences of treatments

to be applied on the ground of sex. For the moment, Article 5.2 of the Gender equality directive 2004/113/EC allows annuity providers to treat women and men differently and to offer significantly lower annuities to women because they have a longer life expectancy. On 1 March 2001, the European Court of Justice ruled in the C-236/09⁹ Test-Achats case that the exception in Article 5.2 is deemed to be transitional and insurers will need to apply unisex premiums and benefits to all insurance products as from 21 December 2012. This means that all insurance contracts signed after 21 December 2012 will need to offer the same premiums and benefits to women and men, and as a consequence it is expected that women's annuities will rise by about 8 per cent. As the ruling will apply to all insurance products, including life insurance-type pensions and complementary health insurance, this is excellent news for women and a big step forward towards gender equality.

SHOULD THE EU COORDINATION IN THE PENSION FIELD BE STRENGTHENED?

At present, EU coordination is limited to the coordination of statutory and occupational pension schemes in which rights are based on legislation. Given the increased impact of EU economic, fiscal and single-market legislation on Member States pension systems, EU coordination should be extended to cover all pension schemes in an integrated way to support Member States' efforts towards adequate, sustainable and safe pensions. Events in recent years have proved that Member States' economies are interdependent, and EU and peer supervision and coordination are needed to ensure no one rocks the boat. Such holistic approach is also necessary to overcome challenges raised by increasingly blurred boundaries between pension schemes and by the ongoing shift from the PAYG to funded schemes.

To facilitate such integrated coordination, a European Pension Platform should be set up to create a common space where EU institutions, Member States' representatives, social partners

and relevant stakeholders will debate pension reforms, exchange practices and develop common guidelines. This advisory body should seek to support Member States in their reforms and to inform debates in related fields (employment, social inclusion and long-term care policies). The Platform should become a key instrument to strengthen and feed the work of the Open Method of Coordination on pensions into the Europe 2020 Strategy. Semestrial meetings of the Platform should be complemented by peer reviews and thematic focuses to enable in-depth discussions on specific issues, as is currently done within the European Pension Forum on supplementary pensions issues.

In March 2011, the Heads of state and governments agreed to coordinate and harmonise much more their fiscal policies. The next logical step is to set up a European Pensions

Platform to improve the coordination and convergence process in the field of pensions.

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