How to make European pensions adequate and sustainable?

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Abstract

This special report presents the results of the research project on Adequacy and Sustainability of Old-Age Income in the EU (AIM). This collaborative effort of 13 research institutes from across the EU, led by the Centre for European Policy Studies (CEPS), was financed by the 6th Framework Programme and lasted three and half years. It concluded with a final conference in October 2008, featuring a keynote speech by Vladimir Spidla, EU Commissioner for Employment, Social Affairs and Equal Opportunities.

The project has been able to highlight the differences among EU member states when it comes to saving for retirement. While in some countries the working age population is able to sustain their consumption on retirement, in others there is a significant saving gap.

AIM also provided new, detailed statistics on the socio-economic situation of the elderly in the EU, developed scenarios for the future and described the key concepts and analytical tools available to policy-makers.


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Where does Europe stand today on pension benefits?

Europeans worry about their pension benefits. They also resist reforms. Attempts to raise the retirement age, in particular, are universally unpopular.

Still, in the 1990s, the policy arena fully awoke to the problem of demographic ageing. Governments started introducing parametric reforms aimed at improving the long-term sustainability of public finances. Some even managed to comprehensively overhaul their pension systems (Sweden and most of the new member states).

So, what new is there to say about pension reform design?

First, the recent reforms provide valuable material for policy learning. We can assess the results against the initial expectations, draw conclusions about the preparation and implementation of reforms. Secondly, academics have continued to develop analytical tools. Some of the approaches introduced in the 1990s, such as option value models, have been refined and new simulation techniques developed. And, thirdly, we have more data – on income positions, on attitudes to reform options, on health and productivity patterns – and we can therefore assess with greater accuracy the needs and demands of various stakeholder groups.

The European dimension

This study is based (comparatively and in term of generalisations) on the EU perspective. While social policy continues to be very much under the control of the individual member states, the EU dimension is increasingly important. Some regulation of pension investment is provided under the common market principle. Also, some aspects of the portability of pension rights are dealt with at the EU level.

And, finally, the European stage is also important for comparing practices, for mutual learning and for pooling resources. For instance, microsimulation models, arguably the key quantitative

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1 See European Commission (2008).
2 See Boeri (2004).
3 See Kohl (2003).
4 See Belloni (2008).
5 A typical example is Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision (IORPs), which was adopted in June 2003.
6 While the portability of pension rights accrued in publicly administered systems has been well provided for for some time, the recent attempts by the Commission to provide the same for occupational pensions, in the form of the directive proposed in October 2005 and amended in October 2007, have apparently somewhat stalled (the amended directive proposal can be retrieved at http://ec.europa.eu/employment_social/spsi/docs/social_protection/2007/com_2007_0603_en.pdf).
7 See Natali (2007).
tool needed to assess individual adequacy of pension provision, have traditionally been built at the national level. The European Commission has now organised a project, PENMICRO, that will list the key microsimulation models and their technical properties. Another example would be the SHARE project, which maps the health situation in the population above 50, and is thus crucial for assessing the productive capacities of the elderly, something we are now able to largely glean only from labour market data.

The European Commission has also funded some large-scale projects dealing comprehensively with the economics of ageing. The following text draws heavily on the project on Adequacy and Sustainability of Old-Age Income Maintenance (AIM).

**Key problem: Balancing sustainability and adequacy**

Age-related expenditure is bound to rise in the future, as populations become older. The effect will be compounded by the retirement of the baby-boom generation in roughly the years 2020-40. After 2020, increments to growth will have to come from productivity increases (unless the EU experiences massive inflows of migrants).

It is easy to see that this will influence provisions for retirement. But assessing the effect with any precision and comparing how different countries will be affected is no mean feat.

However, we now have projections that allow us to comprehensively assess the sustainability of the consumption of cohorts in certain countries, and compare it, on a methodologically robust basis, with the consumption in other countries.

A paper produced by the UK’s National Institute of Economic and Social Research (NIESR) shows that the consumption patterns of 20-year olds in some major EU economies are unsustainable. In the countries surveyed – France, Italy, Spain and the UK – this cohort needs to substantially increase its savings rate (ranging from an increase of 6% in France to 10% in Italy) to be able to finance itself through the life-cycle.

The picture is not quite as dramatic when one looks at the entire current working population, given the historically high savings in these countries. France and Spain are practically able to afford current spending. Italy, although a high saver in the past, cannot afford its current consumption and would need to decrease it by around 5%. The biggest savings gap of the countries surveyed is to be found in the UK, which has had low savings rates and which would need to decrease working population consumption by around 7%.

Even though simple fiscal projections in the past have drawn attention to ageing as a problem of pay-as-you-go (PAYG) systems, more comprehensive data as presented here allow us to see the effect of ageing irrespective of the pension system. In fact, as we have just seen, the UK, relying on a significant funded component, has been a major dis-saver.

At a microeconomic level, this partial shift of attention to comprehensive old-age income rather than relying solely on the standard labour income replacement rates has led to the construction of a new tool – comprehensive replacement rates (COREs). This measure defines disposable

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9 Project website: [www.share-project.org](http://www.share-project.org).

10 Project website: [www.enepri.org/Aim](http://www.enepri.org/Aim).

11 See Carone et al. (2005).

12 The Ageing Working Group (AWG) 2005 exercise mandated by the Economic Policy Committee has relied on individual national projections of pension expenditure.

13 This research was part of the AIM project (see Weale & Khoman, 2008).
income in a broad way, including pension income from public and private schemes, income from work, unemployment, disability, survivor, housing and other social benefits.\textsuperscript{14}

Such a measure allows us to better understand the income positions of various groups of the elderly. Efforts in recent years have also led to enhanced datasets that tell us how European pensioners live, by various subgroups.\textsuperscript{15}

We need such detailed datasets, particularly, to continue monitoring pension adequacy. While the main problem discussed in the policy sphere in the past decade or so has been sustainability, publics also insist that pensions remain adequate.

Adequacy is a controversial term - it is difficult to base on a single, universally accepted measurement. Also, public pension schemes, as components of larger welfare regimes, have sprung from different objectives. In some cases, the original aim was simply to prevent people from falling into poverty. In others, pension schemes were intended to help individuals maintain their lifestyle and social position.\textsuperscript{16}

However, it has come to be generally accepted in the policy sphere that adequate pensions should have both a poverty-preventing and a consumption-smoothing function, while maintaining a compact between generations.\textsuperscript{17}

While pensions that are overly generous are economically unsustainable, those that fail to provide for the three basic objectives are politically unsustainable.

Decision-makers should therefore be aware of the full range of options available to them when reforming pension systems. They should focus on objectives rather than on narrow, specific components of the pension systems. Also, being aware of the full range of options makes it possible to debate and implement a consensus-based pension mix that can provide long-term political and economic sustainability.

The basics of pension scheme design

Besides the retirement age, there are four main parameters of pension systems whose combination ultimately determines the pension payout:

- The pension formula/rules of accrual
- Portability (transferability) of pension rights
- Vesting (eligibility) rules
- Indexation of benefits

\textsuperscript{14} See Borella & Fornero (2009).
\textsuperscript{15} The AIM project featured two such extensive studies. One is Jehoel-Gijsbers & Vrooman (2008). The other, focusing in more detail on the New Member States, is Vrooman et al. (2008).
\textsuperscript{16} It is a fairly well-established fact that when pension saving is not obligatory, people are do not save enough. Or, if they have the option to opt out or even avoid contributions, they do so. In justifying mandatory pension systems, the literature generally focuses on the inability of individuals to predict their needs or to take multiple decisions leading to the preparation for retirement. A less dictatorial, game-theoretic explanation is also possible. Individuals are competing to achieve a certain standard of living. If, given the very long horizons and uncertainty involved, only a few save and most do not, the dis-savers may suppose to be at the end assisted through some collective action (or simply ignore the individual preparation due to too much uncertainty).
\textsuperscript{17} The AIM project produced a paper on constructing quantifiers of adequacy (see Abatemarco, 2009).
A typical distinction made is between defined-benefit (DB) and defined-contribution (DC) pension formulas. A DB-type formula sets pensions at some contractually pre-determined level, either as a concrete amount or, more likely, as a ratio to salary. Typically this is to the final salary or as an average of salaries in the final years of employment (for the so-called ‘final-pay benefit schemes’). In contrast, the schemes that are defined-contribution provide benefits that are directly related to the amount of contributions made to the scheme – multiplied by the rate of return (in funded schemes, i.e. schemes where assets are invested in the financial market) or by an index linked to economic growth (in non-funded schemes). There are many variations of either the DB and or the DC formula. For example, an average-pay scheme links benefits to average pay throughout the whole career, and is thus a combination of the DB and DC principles.

The portability of pension rights is a particular problem for occupational pensions. Indeed, one of the original aims of occupational pensions has been to ensure the loyalty of employees to the employer/plan sponsor. This becomes a problem in modern economies where individuals change jobs more frequently than in the past. Particularly in the UK, which has a plethora of occupational schemes (as contrasted to the situation in the Netherlands, where several sector-based schemes dominate), savers can still lose a substantial portion of pension rights transferring from one scheme to another.\(^\text{18}\) The problem of portability is, of course, compounded by the existence of national boundaries and is conceivably affecting labour force mobility in the common market.

A pension scheme typically requires a certain minimum vesting period (a period after which one becomes eligible for benefits). Variations include phased vesting, where one first becomes entitled to only a part of the benefit and then in stages earns the full-entitlement.

Of course, benefit indexation also plays a role. It is still not uncommon for indexation to be decided purely through a vote in the parliament every year or every few years. Pensions can be indexed to wages or prices level. Long-term wage-indexation is considered risky for public finances – once baby boomers start exiting the labour market, the relative scarcity of labour should cause a sharp rise in wage levels. A compromise between price-indexation (a good measure of cost of living but not of relative income position) and wage indexation is found in the so-called ‘Swiss indexation’: 50% wages and 50% prices.\(^\text{19}\)

Of course, other factors can directly influence pension income, for example the way countries treat taxation of old-age benefits (in some cases, these are taxed, in others, not). But in terms of the basics of the pension scheme itself, the list just presented sums up the dimensions along which policy-makers are able to move in terms of determining payout.

The other side of the coin, of course, is how pensions are financed. The typical dichotomy used is between pay-as-you-go (PAYG) systems (where current pensions are financed through continuous redistribution of current contributions) and funded systems (where assets are invested in the financial markets). This dichotomy, it needs to be said, is probably exaggerated in public debates. The choice is not between PAYG and funded systems, but between various types of PAYG and funded schemes. The Swedish notional defined contribution system (NDC) combines PAYG financing (that is, financing from current contributions) with the principle of individual defined-contribution accounts. On the other hand, while funded schemes are often associated with individual accounts, this is by no means the only option. Assets can be pooled,

\(^{18}\) A detailed overview of the UK pension system is provided by Blake (2003).

\(^{19}\) A further technical detail concerns the question of whether to index to the average wage or to the total wage bill.
and payout adjusted to long-term returns. This provides a smoothing mechanism and takes away some of the risk of exposure of the individual to sudden downturns in the stock market.

Lastly, pension systems can be privately or publicly managed, voluntary or mandatory.\(^{20}\)

The taxonomy of pension systems, incidentally, can be quite confusing. Central and Eastern Europe, which has relied on World Bank expertise, uses the World Bank three-pillar classification: the first pillar being the public PAYG schemes, second pillar compulsory funded schemes and the third pillar voluntary funded schemes. This classification is often used in other countries too and now clashes with the previously widespread OECD classification, which has traditionally also been used in EU documents.\(^{21}\)

Apart from adjusting the above-mentioned economic parameters, governments can improve the fiscal sustainability of pension systems, particularly of the defined-benefit ones, by manipulating the effective retirement age. Evidence shows that people react strongly to financial incentives.\(^{22}\) Apart from raising the statutory retirement age, effective retirement age can be increased by discouraging early retirement by

- applying actuarial reductions to pensions for those who retire early, and premiums in the case of those who continue working beyond the statutory age,
- restricting (or completely abolishing) access to early retirement schemes and
- restricting access to various incapacity schemes.

In fact, as we will see in the next section, closing off pathways to early retirement has been one of the main reform movements in the EU.

**The labour market matters too**

Of course, pension income is a function of both the pension system and the conditions in the labour market. The conditions that affect the pension benefit include:

- overall labour market income of a person over his lifetime,
- the income profile of an individual over her life-cycle in the labour market,
- continuity and discontinuity of labour market participation (i.e. gaps between spells of work, which can have a dramatic impact on DC systems),
- labour market demand (also in a narrow sense, for example employability of older workers)
  and
- regulation of the right to be employed and active labour market policies.

The many issues related to the performance of the labour market and its impact on old-age income include the need to provide unisex mortality tables, which prove to be the most effective tool for making up for the scattered career profile of women, due to their child-bearing and caring responsibilities.\(^{23}\)

\(^{20}\) The AIM project provided an overview or EU pension regimes in Soede & Vrooman (2008). For an earlier discussion on classifying pension regimes, see Rhodes & Natali (2003).

\(^{21}\) These taxonomic questions are extensively discussed in Yermo (2002).

\(^{22}\) See Gruber & Wise (2004). The AIM project surveyed the reaction of workers to incentives comprehensively in Piekkola (2009). Other studies in the project looked in more detail at specific countries, and can be found through the project’s website (www.enepri.org/Aim).

\(^{23}\) The AIM project looked at the effect of defined-contribution and defined-benefit pensions for women, and the impact of unisex tables in Belloni & Fornero (2008). The AIM research also confirmed that the
Pension income is thus the result of a variety of factors in pension system design and labour market conditions. Recent reform efforts have featured comprehensive approaches to pension income, going beyond microeconomic issues to draw attention to the regulation of the labour market. A good example is the report of the UK Pensions Commission24 (the so-called ‘Turner Report’, after the Commission’s chairman, Lord Turner), which recommended:

- Implementing and enforcing anti-age discrimination legislation. The legislation that came into force in the UK in October 2006 (following a European Commission directive) makes age discrimination punishable if it affects workers before the statutory retirement age. However, beyond this mark it is possible to fire employees on the grounds of age. The Commission has proposed to make age discrimination completely universal.
- Ensuring good incentives for older workers to remain in the workforce. At present, UK retirees do not have the option of drawing on a part-time public pension while continuing working.
- Ensuring good financial incentives for employers to employ older workers. Here, the Commission proposed to consider reducing employers’ National Insurance contributions for old-age workers.
- Putting more emphasis on occupational health.

Putting more emphasis on the education and re-training of older workers.

Indeed, in the fight against the results of population ageing, the broader issues of old-age worker productivity,25 relating to their health status and human capital, may be just as, if not more, important as reforms related to pensions.

**What reforms are taking place in the EU?**

Two trends are generally observable: the movement towards more defined-contribution (DC) formulas, and various parametric adjustments aimed at raising the effective retirement age.

Throughout the post-war period, many pension schemes, public or private, offered defined-benefit (DB) pensions.

In public pension schemes, the most notable example of the shift has been the adoption of the notional defined contribution (NDC) formula in Sweden, which forms the backbone of the new Swedish system. In an NDC scheme,26 individual accounts are credited with notional assets, which are given a rate of return linked to the overall economic performance of the economy. This principle is also used in the first pillars of the Polish and Latvian mandatory systems, and is being phased in (albeit over a very long period27) in Italy.

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26 The World Bank has recently been using the term ‘non-financial defined contribution schemes’ and has published a book on the advantages of this approach (see Holzmann & Palmer, 2006).
Other examples of a system close to the NDC principle include ‘wage points’, as known, for example, in Germany and France.\textsuperscript{28}

The shift to DC schemes is particularly notable among private pension plan sponsors, in the countries where private occupational pensions form an important tier of overall pension provision – the typical case in the EU is the UK.\textsuperscript{29} DB schemes are being phased out fast.\textsuperscript{30} In Holland, the one continental country with a really significant tier of occupational pensions, plan sponsors are moving towards average-pay rather than final-pay schemes.\textsuperscript{31}

The general shift to DC schemes, in public and private plans, has been driven by two policy objectives. First, the need to achieve better sustainability: schemes are in principle actuarially neutral, so it is not possible to pay out more than what one contributed. Secondly, a consensus has been building over the past years that pension systems should provide consumption smoothing and a basic minimum income, but should be neutral with respect to other objectives. Targeted assistance to vulnerable population groups should be provided via specific instruments.\textsuperscript{32}

In addition, the move to DC schemes has been made possible due to technical advances. Countries have collected records for a sufficiently long period of time and can store and transfer data quickly and efficiently to make it possible to compute a pension payout based on an entire career, spanning several decades.

Besides pension schemes, both public and private, moving towards being defined-contribution, the major shift happening in the past few years has been that governments have been busy closing off pathways to early retirement. Early retirement was widely instituted in the 1970s and 1980s, when governments started to use public pension systems as a more palatable alternative to unemployment benefits by opening up early retirement options. Something similar happened in some post-communist countries (Poland being the most glaring example) in the early stages of economic transition.

Over time, the danger of exposing public finances to long-term accumulation of pension obligations became apparent. Recently, Germany lowered the availability of early pensions and limited access (for example restricting it to the unemployed). Slovakia applies reductions to the statutory pensions of those who had taken up early retirement, and in the Netherlands the early pension is no longer tax-deductible.

In addition, countries have set stricter preconditions on the contributing period (France, Greece), and many now apply pension premia for every year worked beyond the statutory retirement age (Czech Republic, Estonia, Germany, Hungary, Luxembourg, Portugal, Slovenia and the UK).\textsuperscript{33} Very recently (December 2008) Poland has significantly curtailed, practically discontinued, early retirement.

There have been other reforms, most notably in Finland (2005 - deep parametric reforms to improve sustainability),\textsuperscript{34} Germany (most significantly in 2001 – small parametric adjustments

\textsuperscript{28} Legros (2006).

\textsuperscript{29} Andrew Hill, „Farewell, defined benefits”, \textit{The Financial Times}, 24 January 2009. For an early analysis of impact, see Ross & Wills (2002).

\textsuperscript{30} There exists the view, however, that DB schemes are being primarily closed due to government overregulation and that they can be saved through better insurance policies (see Keating, 2008).

\textsuperscript{31} See van Ewijk(2005).

\textsuperscript{32} See Gora (2008).

\textsuperscript{33} In the AIM project, the summary was provided in Labeaga (2006).

\textsuperscript{34} For the analysis of economic impact, see Lassila & Valkonen (2007).
and stronger role for individual private pensions), Austria (2003 reform - little in way of novel mechanisms but relatively strong cuts to benefits).\footnote{For a comparison of the German and Austrian reform, see Busemeyer (2005).} We have already mentioned Italy, where an NDC system is being reluctantly introduced. These are the most publicised cases, but practically all governments have been making some incremental changes to improve the long-term sustainability of public pension systems.

All of the post-communist member states of the EU have opted (save the Czech Republic and Slovenia) for very comprehensive reforms, aided by World Bank financing and technical advice. Public systems were split into two pillars, one remaining publicly administered, the other privately managed. The World Bank recipe envisioned a third pillar of voluntary, funded schemes, but these are very thin on the ground. Only the Czech Republic has significant coverage, but with low contributions and recently very low returns (with Slovakia also having a thin individual voluntary tier dating back to mid-1990s and Slovenia having some occupational schemes).\footnote{Private schemes in the EU are the topic of a recent EC paper from the European Commission (2008).}

The reforms in Central and Eastern Europe are such a peculiar case of a fairly uniform reform option with a strong regional concentration that they deserve a detailed description.

**A special case: ‘Multi-pillar reforms’ in Central and Eastern Europe**

The 1994 World Bank report *Averting the Old-Age Crisis* proved to be an attractive blueprint for introducing pension reforms in Central and Eastern Europe. As of 2009, all of the post-communist EU members except for the Czech Republic and Slovenia have the World Bank-recommended multi-pillar pension system (with Hungary and Poland being the first reformers, in 1998 and 1999 respectively, and Romania the latest, in 2007).

The arguments in favour of carving out of the public systems a pillar with individual, privately managed accounts included: 1) fewer distortions to labour market incentives, 2) improved economic efficiency due to the fact that assets are allocated through financial markets and 3) insulation of the system from political meddling.

These arguments are not entirely convincing. As for labour market incentives, the argument is true to any DC system, funded or not. Regarding improvement of the performance of the stock market due to the inflow of pension assets and improved economic efficiency: it has to be said that only the Warsaw bourse has significantly benefited, due to the fact that the reform restricted investments out of the country to 5% of assets. Elsewhere, the pension funds started investing heavily in government securities. And regarding the argument that the privately managed pillar is automatically more stable due to the absence of government meddling, well, governments can actually very easily influence funds’ strategies through regulation – and if the publics become disenchanted with returns, they certainly will react accordingly.

Nevertheless, for the time being, there seems to be still quite a lot of backing for the ‘second pillars’.\footnote{Second pillar faith not withered yet, IPE.com, 21 January 2009 (retrieved at http://www.ipe.com/news/Second_pillar_faith_not_withered_yet_30339.php).} The advantage of this type of reform is that rather than having the inexperienced local political elites promoting it, it was the fund managers themselves who invested in slick, Western-style marketing. Also, it seems that the feeling that in the second pillar people actually keep owning their money rather than giving it to the government contributes to the success of the reform (particularly since actual payouts are still a long way off).
The strength of faith in the funded schemes will soon be tested in Slovakia, however, where the government has allowed those already enrolled to opt out in the first half of 2009, ostensibly to allow people to reflect on their options during the financial crisis. This is the second time in the space of a few months that the government, has ‘re-opened’ the pillar, the previous period (the first half of 2008) in which an opt-out was allowed brought about an outflow of 90,000 people, with 1.49 million remaining in the funded pillar.38

Looking ahead – Myths and real policy options

The European landscape is dominated by public PAYG systems. Even in the two European Union countries with traditionally strong occupational, funded pension schemes, the UK and the Netherlands, the PAYG component provides a substantial bulk of the pension payout in their basic pension tiers.

PAYG systems sprang up everywhere throughout the 20th century, particularly gathering strength after World War II, following unpleasant experiences with funded occupational pensions. PAYG schemes offered cheap, centralised administration and they were (and are) naturally insured against devastating fraud or mismanagement by the simple fact that they do not accumulate long-term contributions. Powered by positive demographics and steady productivity gains, PAYG systems became the mainstay of the post-war welfare state construction.

However, the favourable productivity and demographic patterns have changed. Gradually, the danger of exposing public finances to long-term accumulation of pension obligations became apparent.

The first reaction in the face of the looming change in the composition of the population has been to draw attention to the effect on public finances. This has been probably due to two reasons. First, it is easier to grasp the simple arithmetic represented by the ratio of contributors to claimants than to understand how demographics affect funded systems. Secondly, as we just said, PAYG systems are simply more prevalent and therefore a more obvious target.

Some of the earlier policy documents have been blamed for unreasonably extolling the virtues of funded schemes, particularly the 1994 World Bank report *Averting the Old-Age Crisis*,39 which laid foundations for the reforms in the post-communist EU members, as described in the previous section.

The arguments in favour of the ‘multi-pillar reforms’ have been criticised as not relying on robust economics.40 These reforms entail other risks. For example losing parts of accrued rights when switching to the new systems: in the case of Hungary, those who switched to the system directly lost part of their rights.41 Elsewhere, the need for comparatively long periods of saving in this system, which depended on cumulative interest, might have escaped the attention of

39 See a critical appraisal in Orszag & Stiglitz (1999). The strong promotion of funded schemes was criticised by the World Bank’s own evaluation group (see World Bank, 2006). For an early discussion of reform trends in the CEECs, see Fultz (2003).
40 Besides the critical reports of Stiglitz & Orszag, op. cit., the issue of pension myths and policy choices is widely discussed in Barr (2000), and revisited in Barr (2006). A defense of public systems is made in Diamond (1998).
41 See Augusztinovics (2007).
those who signed up, even though they had very short periods to retirement. One might also consider wider political economy risks of having, in some cases, very few funds accumulating a substantial share of GDP. And, last but not least, the governance risks: in general the reformers have been careful to introduce comprehensive safeguards, such as the separation of the fund’s assets from the management firm’s assets, oversight requirements for account custodians (banks) and penalties for funds significantly deviating from average market returns. However, funded schemes still carry some governance risks, which should be analysed and appropriately regulated.

The example of the Central and Eastern European states illustrates the need to tread carefully. The bold reforms may turn out to have been, in general, a good step, but there are many problem points, aside from the fact that in these states, crucial pieces of legislation (e.g. details on annuitisation of contributions) are still missing.

The post-communist countries’ and the Swedish example show, nevertheless, that ‘reform bundling’ rather than parametric adjustment is often the more viable reform strategy. Single, headline adjustments often lead to resistance, while reform packages make it possible to address the concerns of a large spectrum of stakeholders. Successful reforms thus need careful mapping of attitudes to reform options and detailed designs to spread the cost of reforms in a politically expedient way, preferably evenly over cohorts.

Conclusion

The demands of voters to be taken care of in the later stages of life will not go away. Neither will the promises of politicians to provide or mandate such care. What economists must do is continue pointing out where adjustments are needed. They also need to chart out, whenever possible, a range of reform options. Politicians must be provided with a choice, so that they can opt for the solution best suited to a particular constellation of stakeholders.

Furthermore, while a sound economic analysis of sustainability and adequacy is a key condition, other issues need to be taken into consideration, particularly management risks related to pension funds.

Europe does not have to face a pension crisis. Reforms are clearly possible, as several examples in the EU have shown. Governments must act quickly – but also effectively. If a pension system does not work, the voters will demand change. No publicly mandated system, whether it is PAYG or funded, publicly or privately managed, is immune to political meddling. Policy-makers should therefore strive for solutions that are sustainable both economically and politically. Academia has certainly provided them with a lot of tools to assist their deliberations.

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42 The need to help those with such extremely short saving periods to re-think decisions was one of the main arguments given by the Slovak government when it allowed opt-outs in 2008 and the outflow was, indeed, mostly in the category of older workers, see Druhý pilier opustilo viac ľudí, ako sa očakávalo, SME daily, 13 May 2008 (retrieved at http://ekonomika.sme.sk/c/3873955/Druhy-pilier-opustilo-viac-ludi-ako-sa-ocakavalo.html).

43 For a summary of regulatory issues, see Yermo (2005). See also Besley & Prat (2003) for differences in governance of DB and DC schemes.

44 On ‘reform bundling’ and multi-pillar reforms, see Müller (2003).

45 For a detailed analysis, see the following AIM study: Janky & Gal (2008).

References


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