Political and Corporate Ramifications of an Aging Europe

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The European Pension Crisis

• In the European Union’s (EU) six largest countries (France, Germany, Italy, Poland, Spain, and the UK) *four people of working age support each pensioner*

• By 2050, only two workers will be paying for each pensioner (proportion will halve). In Spain, Italy, and Poland = somewhat worse; in France and the UK = somewhat better
• Longer life expectancy together with falling birthrates has created a problematic “double aging process” in EU countries

• Plus: early withdrawal from labor market of older workers (especially since the early 1980s) “early retirement” (<60)

• High retirement income (replacement rates) from public (compulsory) pension plans (>60% in most EU countries) with full contribution record (35 to 45 years)
• Reliance in many EU countries on Pay As You Go (PAYG) funding (unsustainable)
• Exceptions: UK, Netherlands, Sweden, Denmark, Poland, Hungary, with only modest public PAYG; emphasis on DC private occupational pension plans
• High percentage of GDP spent on pensions in PAYG countries
• Contribution rates (in many countries >25%) have reached unsustainable levels
The EU’s Three Pension Pillars

1. *Public earnings-related plans:*
   the most important source of retirement income in most EU countries (e.g. 85% in Germany; 65% in the UK; 50% in the Netherlands)
2. **Private occupational plans:**
e.g. 5% in Germany; 25% in the UK; and 40% in the Netherlands

3. **Individual retirement provision:**
e.g. 10% in Germany, the UK, and the Netherlands
EU Pension Reforms

• Current pension reform activities in the six largest EU countries suggest:
  there will be a reduction in future state pension income -- as a % of average earnings (e.g. Poland, Germany, Spain) leading to increased participation in private occupational or private personal pensions
• New private pensions will look similar to those in the UK, i.e. based on Defined Contribution (rather than Defined Benefit). (Poland has introduced compulsory personal pensions requiring all employees to contribute 7% of their salaries)

• Private occupational pension plans are expected to grow and become more innovative (e.g. first collective agreement on establishing a TIAA/CREF-style pension fund in German chemical sector)
• People will need to work longer (five years) to receive a full state pension (France, Italy);

• Polish workers will have to work five years longer for a 20% reduction of benefits (from 61% to 49%)

• In Germany, reforms of state PAYG system will reduce, by 2030, pensions from 70% to 45% of previous salary (with full, i.e. 45-year, contribution record)
• Previous pension reform in the UK will likely result in a fall of state PAYG pensions from 38% of average earnings in 2000 to 23% in 2050.

• Spain has not yet pursued serious reforms of the state pension system as aging will not make its current PAYG system unaffordable until approximately 2015.
• Many EU countries have already created, or are about to introduce, the legal and fiscal basis for voluntary occupational and personal pension saving
• Typically, the new pension plans are/will be based on Defined Contribution rather than Defined Benefit
• All EU governments are trying to remove fiscal incentives for early retirement so as to increase the employment rate
Pan-European Pensions in 2005

• By September 23, 2005 EU member states will have to have implemented the “Directive on the Activities of Institutions for Occupational Retirement Provision”

• The directive provides a general framework for the operation of pan-European pension plans
• Theoretically, the directive will enable employees to transfer their pension funds between any of the 25 EU countries

• The directive will mutually recognize the current supervisory regimes that exist in each EU country

• To establish a pan-European plan, either a totally new plan is constructed, or an existing plan is adapted to meet the new rules
• All pan-European plans must have sufficient assets to cover their liabilities, or to have in place an adequate plan to make good any deficits over a reasonable time period.

• The directive sets a limit of up to 5% of all of a company’s assets to fund this type of plan.
• The directive will have a significant impact on the work of HR professionals in multinational corporations as they will now have a legal template to create pan-European pension plans

• At present, most occupational pension plans can operate only in the country in which they are established, forcing firms with multiple EU locations to use several different providers to manage these plans
• The EU Commission estimates that multiple plans could cost a multinational as much as euro 40 million a year and believes that substantial economies of scale will be achieved by managing one pan-European plan.

• In general, industry is in favor of this directive.

• But a major problem is the EU’s lack of a harmonized tax structure.
Without tax harmonization companies will have little incentive to establish a pan-European pension plan.

The EU Commission is trying to remove tax obstacles by launching infringement proceedings against member states before the European Court of Justice (e.g. against Belgium, France, Spain, Italy, Portugal, the UK, Ireland).
The ECJ has recently ruled (Danner and Skandia cases) against countries that allowed tax discrimination, concluding that contributions were tax deductible when made to pension plans based in other member states.

France and Spain have now agreed to change their legislation and stop tax discrimination against pension funds based elsewhere in the EU.
• Not only do EU member states have to implement the pan-European pension directive by September 2005, they must also ensure that their tax regulations harmonize with the new provision.

• The Commission believes that the directive will boost the EU’s occupational pension segment, improve labor mobility and the general workings of the internal market.
The importance of later retirement

• All EU governments want to increase the employment rate in the population as a whole by removing fiscal incentives for early retirement.
• But the Commission fears that members will miss the targets of an employment rate of 50% for older workers and a 5-year increase in the effective retirement age by 2010 (part of Lisbon strategy to make EU economy “the most dynamic and competitive in the world by 2010”).
• To help solve the EU’s pension crisis, the OECD supports a retirement age of 70 and believes that an “element of compulsion” is needed to achieve this.

• The OECD also believes that introducing age discrimination legislation could increase the percentage of older workers by at least 10% in some countries.
Combating age discrimination

- The EU “Employment Guidelines” call on member states to develop policies aimed at “enhancing the capacity of and incentives for older workers to remain in the labor force as long as possible … and raising employers’ awareness of the potential of older workers”
The EU Commission pushed through a directive establishing a general framework for equal treatment in employment and occupation, which prohibits various forms of discrimination, including on grounds of age.

The implementation deadline for this directive was December 2, 2003.

The 10 new member states were expected to implement the directive prior to their May 2004 accession to the EU.
Concerning the directive’s provisions on age and disability, member states were allowed to request an additional 3-year implementation period.

Several countries have made use of this option: Belgium, Germany, the Netherlands, Sweden, the UK (3 years) and Denmark (one year)

Once fully implemented, the directive will have a profound impact on the employment of older workers in the EU and on corporate HR policies.
Unions versus Employers

• In general, EU unions favor early retirement as many of them believe that it represents a significant tool of job creation for younger people.

• In addition, while most unions may share concerns about the aging workforce, they cannot ignore their members’ persistent demand for retirement opportunities as early as possible.
• Employers’ organizations in the EU are in favor of making the pension system less expensive and more sustainable and tend to support the employment and employability of older workers in order to be able to retain “core” and qualified workers and better manage capacity and skills within organizations

• EU retirement reforms are not optional – without them Europe’s social model will crumble