

CHAPTER 4

Sustainable pensions and populations

Introduction

The politics and economics of pensions are complex, but extremely important since the policies adopted by governments affect everyone – those drawing a pension now, those who will do so in the future, and those who bear the cost either now or in the years to come.

The policies selected today will have a major effect on future living standards, on the income available to those who have retired, and on the level and structure of taxes and social charges levied on those whose work pays for transfers to pensioners. Hence these policies potentially affect, not only the distribution of income between different sections of the community and between different generations, but also the growth of that income and the total amount available to distribute in the long-run.

In all European countries, pensions have become an increasing focus of public and government concern as the number of people above retirement age has risen and the projections of the future growth in numbers have escalated. These projections are often used, however, not only to justify the reform of existing pension systems in order to reduce future commitments and expand the funding available to pay for them, but as an argument for more general cutbacks in public spending.

This need to avoid an impending fiscal crisis implied by growing pensioner numbers has become a part of the justification for further ‘budgetary consolidation’ – either to cut public expenditure and raise taxes in order to reduce government borrowing, or to build up government reserves in order to meet possible future spending commitments. Either way this tends to lead to a restrictive economic policy stance and slower rates of economic growth.

This review seeks to examine the truth behind the claim that pension systems are in crisis, to disentangle the real issues from the scare stories

and propaganda, and to consider the appropriateness of different policy responses in the light of the fact that the European population is currently ageing. In doing so, it highlights the overall success of EU national pensions policies, despite their diversity, and the extent to which reforms are in progress. It questions, however, whether one of the underlying causes of the prospective difficulties – low birth rates – is not being exacerbated by family-unfriendly taxation policies.

The nature of the problem

Pensioner numbers are growing throughout Europe, and should continue to grow for many decades as life expectancy increases. It is also a fact that the number of people of working age who will need, in one way or another, to generate the income to support those in retirement is also forecast to decline as a result of past low birth rates, although this will not actually happen in the EU15 on present projections until after the year 2020.

Clearly the coincidence of these two tendencies demands a policy response. And while some governments are currently seeking to shift more of the responsibility for providing for old-age onto individual workers, they will never be able to escape their wider political responsibility to ensure, in one way or another, that those in retirement have an adequate income to live on. This inter-generational obligation extends across European societies, whatever their particular political philosophies or pension scheme arrangements. There is simply no getting away from the fundamental fact that the working population ultimately always has to generate the income needed to support the non-working population.

These realities are reflected in the fact that, while there is a common desire by EU governments to limit future spending commitments on pensions and to increase the funding available to meet them, they all signed up to a common set of principles regarding the future development of pensions policies within the EU at the Laeken European Council at the end of 2001.

These principles were:

- that everyone who retires should be assured an adequate level of income and standard of living;
- that pension systems should be sustainable in both financial and political terms – that the economy is capable of generating the funding required and that present and future generations are prepared to pay the taxes and social contributions involved;
- that systems are compatible with changing economic and social circumstances, that arrangements keep pace with labour market developments, that entitlement to pensions is not adversely affected by frequent movements between jobs, by people taking up non-standard forms of employment or self-employment, and that men and women are treated equally.

Some may see potential conflicts between some of these principles, but this is more apparent than real. Pensions systems are only likely to be sustainable, from a political perspective, if they provide acceptable levels of income for those in retirement. And people retiring can only be assured of an adequate income if the resources are there to provide this.

However, what an ‘adequate’ level of income means, and what level of pension provision is likely to be ‘sustainable’ in the long-run, are clearly issues open to debate. And it is evident that the interpretations put on these concepts differ from country to country, and, indeed, between governments of different political shades, which, in turn, lead to differing policy conclusions.

This is especially the case as regards the interpretation of the ‘adequacy’ of pensions, which can be defined in various ways – most commonly in terms of ensuring that the income they provide does not fall below a certain level or, alternatively, that they maintain living standards at a level related to that enjoyed before retirement. The financial implications of adopting the second interpretation rather than the first are clearly substantial.

EU pension systems

Even though governments ultimately act as a safety net for older people in all Member States of the EU – including the new Member States, whose pension systems will be examined in future issues of this report - the processes of political control, or governance, of pension schemes vary widely between them.

- Some pensions systems are organised mainly under the responsibility of the social partners – as is largely the case in Sweden, Denmark and the Netherlands.
- Others are managed by central governments, but on the basis of a non-party-political approach that seeks to ensure political acceptability, as in France or Germany.
- Others can be the product of a mixture of past political ‘clientalism’ and public debate and decision, including by referenda, as is partly the case in Greece and Italy.
- Or they can be much more under the control of the government currently in power – as seems to be the case in the UK.

The results are, perhaps, predictable:

- Greece and Italy have the most costly public commitment to pensions as a proportion of GDP. In Italy, expenditure now exceeds 15% of GDP. In Greece it is estimated to rise to 20% of GDP if nothing changes. Greece also has one of the least egalitarian systems, with the government having difficulty getting itself off the financial hook created by past policies.
- The Nordic countries and the Netherlands have managed, or seem to be managing, to modernise their systems, and reduce the public financial commitment, while still retaining relatively generous benefits, not least by encouraging older workers to stay in work, and by generally maintaining high employment rates.
- The French and German governments have stuck to the basic principles of their systems, but are trying to curtail their generosity with increases in contributions and reductions in

benefits in various ways (such as, in France, extending the number of years over which contributions need to be paid in order to qualify for a full pension) and introducing elements of individual diversity (e.g. voluntary supplementary contributions in Germany).

- And while the UK government can boast of a public financial commitment way below that of most others - at 4% of GDP a year - this actually reflects the failure of successive governments to develop a serious and lasting pensions policy, creating poverty for some groups of the aged, bringing growing pressure on social welfare spending elsewhere in the system, and encouraging a rash of, often unsatisfactory, private pension initiatives.

Despite this diversity of systems and performance, old-age state pensions remain one of the major success stories of European welfare systems, with significant economic as well as social benefits. In the process of bringing relief from poverty and creating economic independence to older generations, they have provided freedom and opportunity for those parents' children to develop independent lives.

Today, most working people in Europe have come to expect something that their grand-parents, or even parents, could not – namely that, as and when they retire from work, they will receive a public pension which will be sufficient to help keep them out of poverty, and help them maintain - to some degree at least - the lifestyle to which they had been accustomed during their working life.

In general, the evidence is clear. The average quality of life of those currently in retirement appears to be high, and to have risen in recent decades. Those aged 65 and over in the EU-15 now receive incomes estimated to be close to 90 per cent of those of people aged under 65. (We return to the issue of sustainability below.)

However, the situation is not so rosy for everybody. Some people, especially women and those working at the more 'flexible' or 'precarious' end of the labour market, still tend to miss out. And the risk of poverty in old age remains a serious concern in some parts of the Union.

Major reforms have been, and are, being made to bring national systems up to ensure their long-run future. And, on the whole, these reforms have so far been more sensible, and less draconian, than once seemed likely.

However, they still do not seem to fully reflect changes in the pattern of working life and society - especially as far as their treatment of those in the weakest positions are concerned. Moreover, there is the danger that the enthusiasm of some governments for more private provision could prove both risky and socially divisive, if the schemes are not properly managed, and if the social partners are not more directly involved.

Pensions account for over 10% of GDP and something like a quarter of public expenditure. And pressure for pension reforms have undoubtedly been driven primarily by fears that public budgets could not be expected to cope with the effects of growing demographic imbalances, with fewer young entrants to the workforce foreseen, and with pensioners living longer, and therefore costing more.

The first response of many governments, especially finance ministries, was to panic about how to pay the bills, and put the focus on raising contributions and cutting pension provision. Since then, though, economists and pension and labour market specialists have argued for more wide-ranging measures, including a better mix of pension arrangements, and the restoration of a better balance between periods of working life and retirement, in order to ensure a long-run social, as well as financial, equilibrium.

And while responsibilities for pension arrangements within the EU rest firmly with individual Member States – who finance their own national schemes with no EU-wide financial support - much work on policy reforms is now strongly influenced by coordinated discussions at EU level between the European Commission and the Council, with the emphasis on the development of indicators and exchange of information on policies adopted, following the European Employment Strategy model.

In particular there is an on-going, if sometimes uneasy, EU level cooperation between the Social Protection Committee (representing the Social Affairs Ministries) and the Economic Policy Committee (representing Finance Ministries), supported by the European

Commission. The OECD is also playing an important role, not least in assessing the likely outcomes of actual and proposed reforms

In this uncertain environment, however, the actual, or expected, financial difficulties of governments have been seized upon by those who dislike the collective ethos and provisions of European welfare states. They have sought to use the current confusion to undermine such systems, to promote more individualistic arrangements, and to ‘sell’ private pensions as an end in themselves – not least in accession countries.

In a number of Member States, these ideologues seem to have shaken public confidence in state pensions. As a consequence public expectations regarding pensions, as expressed in recent opinion polls, are more pessimistic than would seem to be justified by the evidence on the actual situation of pensioners.

And while there is no question that the growing demographic imbalances in Europe have to be actively addressed in various ways, it is not clear that the much vaunted financial pension ‘crisis’ is as inherently serious, or imminent, as some would claim, especially given the scale of the reforms underway or planned.

The risk is, nevertheless, that governments will start to panic again if the economic prospects in Europe do not improve quickly, thereby undermining further public confidence in pensions – both private and public. Indeed, there is a distinct possibility of initiating a vicious circle in this respect, with a misplaced concern to leave room for future government borrowing to fund pension commitments being used to justify restrictive fiscal policies at present, which then constrains the pace of recovery, leading to widening budget deficits and even more restrictive policies. Likewise, concern about future pensions might be one factor behind the current weakness of consumer spending in a number of (large) EU countries.

Reforms of many detailed aspects of current pension systems, as well as improvements in the work-retirement balance, are central to a successful response to population ageing, but it is important to recognise that a satisfactory outcome requires the effectiveness of other policies to be improved too. Above all, it is vitally important that economic growth is

sustained and employment rates increased, and that policies are directed at achieving this.

A point to note in this respect is that attempts to promote ‘active ageing’ will not succeed if they focus only on older age groups. Policies in all areas need to be based on the assumption that all women and men are likely to live a long and full working lives, with support provided from an early age to ensure that they can do so. This means ensuring that there are appropriate social and labour market facilities in place, including financial support for child care, care of the elderly and training provisions that are accessible to all workers so that they can extend and update their skills as they progress through their careers.

It should be recognised, too, that the current focus on the financing of pensions is not a balanced, or lasting, way of addressing the demographic ‘problem’. The other major cause of demographic change – low birth rates – reflects the difficulties still faced by women (and, to a much lesser extent, men) seeking to combine careers and families, and the high cost of raising children today, to which government tax and benefit schemes have failed to adjust. Yet this issue is barely mentioned in the debate on demographic ageing, and certainly not with the urgency that is required.

And it should go without saying – but it is necessary to do so because it is so often forgotten – that the ability of older workers to be part of the solution and to stay longer in the labour market does not depend on them alone. It depends as much, if not more, on the attitudes and actions of employers towards them and on the availability of jobs for them to do, which depends, in turn, on the state of the economy in which they work – for which responsibility lies elsewhere, as addressed in chapters 2 and 3.

The current situation of pensioners

An indication of the income of pensioners in relation to other sections of the community – or, in reality, their income in the recent past, given the time-lag in obtaining relevant data – can be gained from a number of studies undertaken by academics, the OECD, the EU, the World Bank and others, using household survey data.

These studies commonly compare:

- the income of older age groups relative to that of those under retirement age
- the degree of equality, or inequality, in the levels of pensions received – typically relative to the degree of equality in income of those under retirement age.

These comparisons, although of interest, tend to leave out of the account a number of factors that affect the living standards of pensioners which are not captured by data on household income alone. Accordingly, the results need to be treated with some caution. For example, while surveys of household incomes take account of the effects of taxes and other financial benefits, they do not measure the capital wealth of households, which can significantly affect living standards.

Moreover, such household surveys typically exclude benefits in kind such as free or reduced price health, social, transport or other services, for which pensioners are eligible in some countries. On the other hand, they do not take account of the fact that pensioners' outgoings – on transport or clothing, for example - may be less than those who are still working.

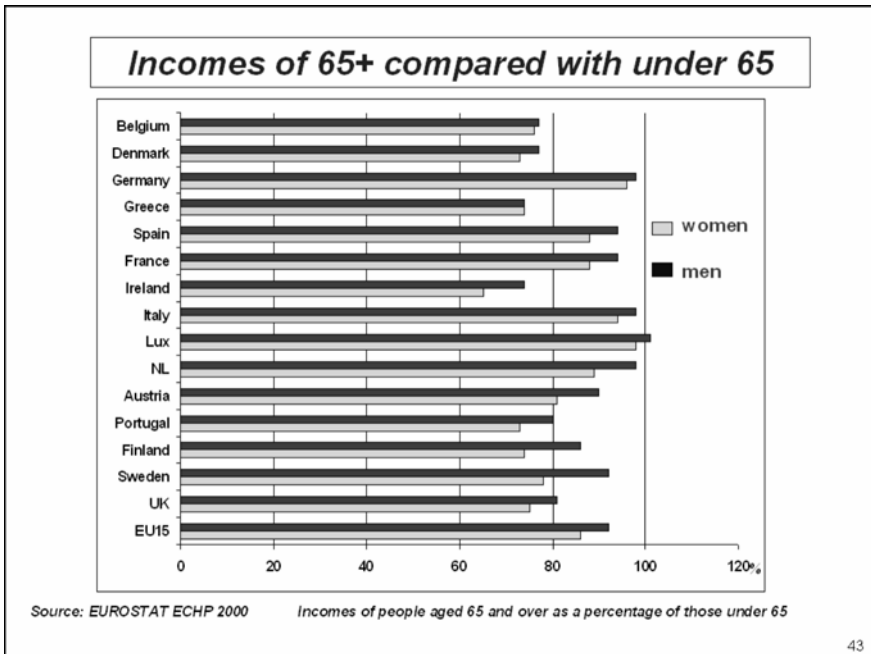
Likewise, such surveys do not give any indication either of the extent to which pensioners have to use their own resources to meet the kinds of health or care needs that tend to come with growing older, if public provisions prove inadequate. Since there are large variations between Member States in this respect, as well as in the extent of social services which pensioners can draw upon, comparisons of the relative position of those in retirement between countries are particularly difficult.

Leaving the above considerations to one side, all recent analyses suggest that the income of people aged 65 and over, virtually all of whom are likely to be retired from economic activity, is, on average, either similar to, or not much lower than that of people of working age in most EU15 countries.

In 2002, Disney and Whitehouse, reviewing the results of a series of studies based on data for the 1990s, concluded that, on average, the income of older people in the EU countries covered (most of the then 15

Member States) were something over 80% of the income of the population as a whole.

The latest results from the European Community Household Panel, released at the end of 2003, show, in practice, that income of people aged 65 and over in the EU15 in 2002 were closer to 90% of that of those aged under 65.



The risk of poverty

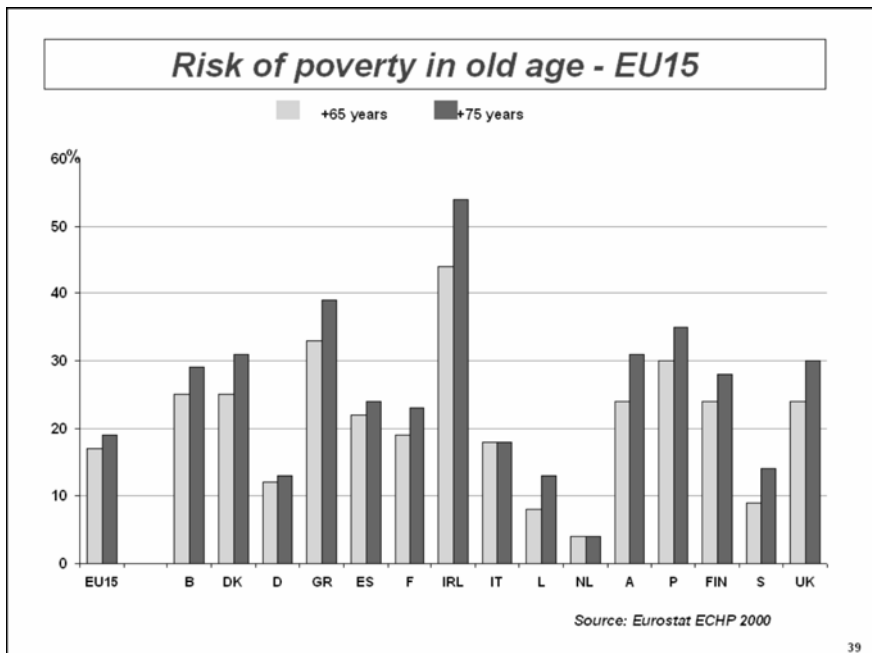
However this still means that the average risk of older people being in poverty – defined in the conventional EU way as 60% of average national income levels – is likely to be higher for those aged over 65 than for those aged under 65 (the usual *caveats* regarding ‘qualitative’ factors note above apply here, too, of course). According to the latest EC estimates, 19 per cent of those who are 65 or over are at risk of poverty, as compared to a

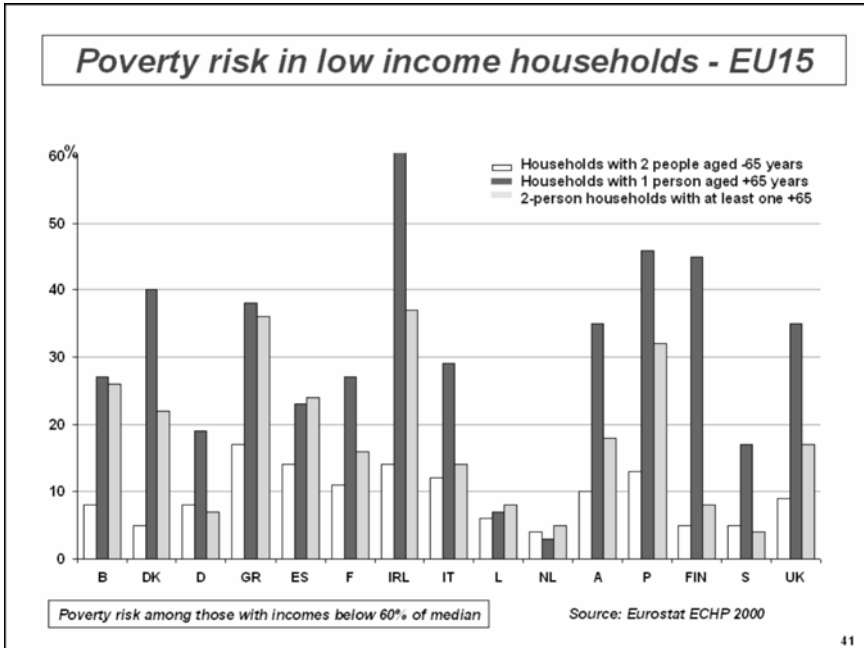
risk of just under 13% for those under 65 – again defined in the conventional EU way.

The risk, moreover, varies appreciably between men and women, with women of 65 and over much more vulnerable than men. In the EU as a whole, some 21% of women in this age group had poverty levels of income, as compared with 16% of men of the same age, and only 13% of women aged under 65.

These averages mask significant differences between Member States. While the average risk of being in poverty for the population below age 65 ranges only from 7% in Denmark to 16% in Italy and Ireland, the spread for those aged 65 and over is much larger.

One in every four pensioners are at risk of poverty in five EU countries (Spain, Austria, the UK, Denmark and Belgium), and one in every three in Greece and Portugal, while in Ireland, the figure is closer to one in every two.



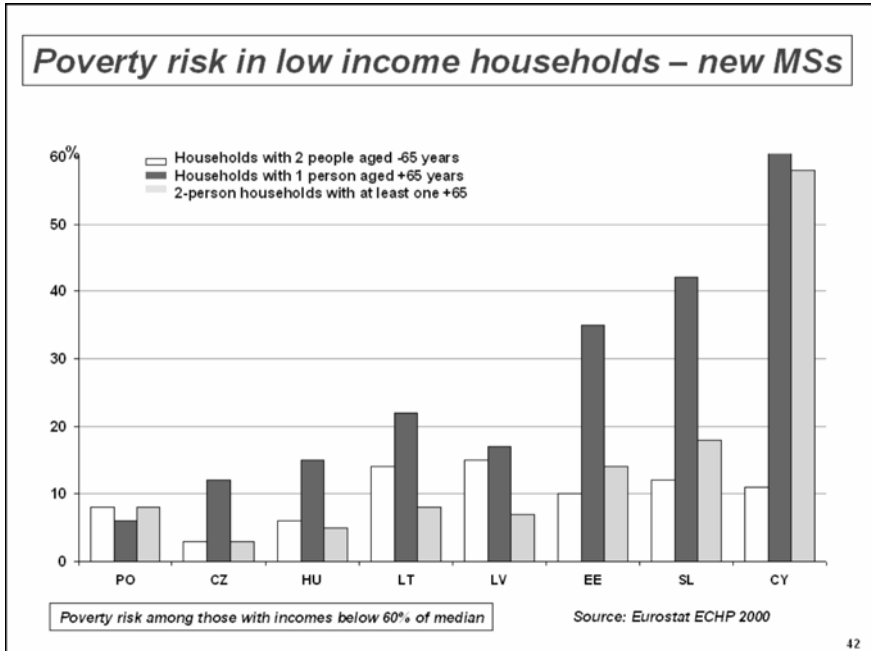


In general, the risk for pensioners also increases with age, in part reflecting the improvement of pension arrangements over time, in part the tendency for more people to live alone, and to have to rely on one source of income, as they get older. As a result, some 21% of those aged 75 and over had poverty levels of income in 2000, as opposed to 19% of those aged 65 and older.

Inequalities of incomes between pensioners

There are various ways of measuring inequalities between groups in the population. One common method is to calculate the ratio of the incomes of the poorest 20% of the population to the incomes of the richest 20%.

Such an analysis shows a relatively encouraging picture for pensioners in that, across the EU as a whole, income inequalities are somewhat lower for those aged 65 and above compared with those below 65 – a ratio of 4.1 compared with 4.6.



The exceptions are Greece – where inequalities across the whole population are quite large and the differences even larger for older persons - and, perhaps surprisingly, Austria, Belgium, Denmark and Germany. However, inequalities in general are at, or below average, the EU average, and the differences for those over 65 are rather small.

Other research evidence suggests, not altogether surprisingly, that although income differentials are lower for retired people than they are for working age people, those who had higher incomes when they were in work will tend to have higher incomes in retirement. The extent to which this is the case, however, varies according to the pension system in place (see below).

Those living alone are much more vulnerable to the risk of poverty than those living in a household with someone else or several other people, such as sons or daughters. In 2000 in the EU as a whole, almost one in three of those aged 65 and over and living alone, had poverty levels of income – twice the level of those living as a couple. The latter figure,

however, was still well above the proportion of couples under 65 at risk of poverty – only 10%.

Most people of pensionable age who are living alone are women. This is because they tend to live longer than men, and marry younger, and therefore have a much greater likelihood of being without a husband or partner, as they get older. These facts also help to explain the higher risk of poverty among women pensioners than among men.

Longer life expectancy is reinforced in the current retiree generation by the effects of the Second World War, which resulted in the deaths of many more men than women. As a result of both factors, men make up only around 40% of the total population of 65 and over, and only 36% of those of 75 and over.

Pensioners and poverty in the accession countries

In a number of the countries joining the Union in May 2004, the risk of poverty among pensioners (in the sense of them having an income below 60% of the national median), seems to be less prevalent than in existing Member States. Indeed, in 2000, according to the data available, the proportion of pensioners at risk of poverty was less than it was for people aged under 65 in Poland, the Czech Republic, Hungary, Latvia and Lithuania. Only in Slovenia was the risk substantially greater for those of pensionable age. Again, though, it is women who are more likely to be in poverty than men.

These figures need to be treated with caution however since, unlike the data for the EU15 countries, they are based on surveys of household expenditure rather than income, which itself will tend to narrow disparities. (In other words, people on low income tend to spend proportionately more than those on higher income.)

State pensions

A key issue is the extent to which poorer and richer pensioners depend on state pensions for their incomes. An analysis covering five EU countries has shown - perhaps not surprisingly - that almost 85 per cent of the

poorer pensioners in the countries covered (France, Italy, Germany, the UK and the Netherlands) obtained all their income from the state.

However, this research also showed that, even the most well off pensioners in France, Italy and Germany still received 60-75% of their retirement incomes from public pensions and other state benefits, compared with around 35% in the UK and the Netherlands.

Thus, in most countries, public pensions remain by far the most important source of pension income, especially – but by no means only – for the poor.

The wealth factor

As suggested earlier, income data does not tell the whole story regarding pensioner well-being. Personal wealth also matters. Work by Disney has suggested that financial wealth increases substantially as people age. Similar work by the OECD in 2001, using mid-1990s data, confirms the same for property wealth - suggesting that, in the six EU Member States for which data were available, housing wealth for those over retirement age was some 50 per cent higher than for those under retirement age.

This property ‘wealth’ only translates into ‘income’ if pensioners can release the equity – for example by ‘downsizing’ and moving to a cheaper home, or entering into various kinds of rental-agreements with new buyers - and many pensioners are reluctant to do so, particularly if they are concerned to pass on an inheritance to children and grandchildren, to a charity, or to the local cats home. Nevertheless, it does imply the opportunity for a significant reduction in the cost of living as a considerable proportion of the income of young people living away from home tends to go on rent or mortgage payments.

Higher income pensioner households are obviously likely to own more expensive properties than lower income families. On the other hand, differences in rates of home ownership between income groups vary across the EU. They are limited in France and Germany, non-existent in Italy, but large in the UK – with a 50% difference between the top and bottom 20% of income groups. Thus those with lower pension income may also face higher living costs.

The effect of irregular work history

A more difficult group to identify, and to address, are people with irregular work histories because they have held relatively temporary or insecure jobs, or changed employer frequently. Given the number of workers now in temporary jobs, the extent of part-time working and the increasing need – and apparent willingness – of workers to move between jobs, this may well be a growing rather than diminishing problem. There is a real risk that the relative disadvantages that such workers face in their years of employment is likely to be carried over into retirement.

Also, despite European initiatives, there is a particular problem for people moving between different European countries to work during their careers. Many systems have minimum contribution periods so that workers who change location frequently may find their pension entitlements significantly reduced as a result.

Cost of health services

Another important concern for many pensioners, apart from their income, is access to relevant social services and health services support. On this, comparable data is not easily available, although the Danish case, where pensioners have excellent support facilities but apparently relatively low income as compared with other sections of the population, is illustrative of how comparisons based purely on statistics of household income may give a misleading impression of their real position.

The key concern here is that pensioners, even if their income can be stabilised, could suffer greatly if, as a result of so-called ‘structural reforms’ in health and social security systems, they find themselves called upon to contribute a higher proportion of their treatment costs.

The structure of different national pension systems

The historical distinction between the Bismarkian approach to the provision of pensions – focused on maintaining living standards in retirement of those who are employed – and the Beveridge approach – to

ensure a minimum income in retirement for everybody – remains important. However all national pension systems are, by now, complex hybrids of these and other objectives, with different systems in place to achieve these goals.

The complexity of national systems is such as to make simple comparisons impossible – as a reading of the EU Joint Report on Pensions, or OECD documents, will quickly confirm. Nevertheless, it is possible in principle to broadly categorise pension systems, and to try to compare the likely outcomes for pensioners of current reforms.

The World Bank has sought to distinguish between:

- Mandatory public systems – where the state provides directly
- Mandatory systems, managed privately – where the state ensures that people invest in pensions, but leaves the delivery of pensions to the private sector
- Voluntary private systems - where people choose whether or not to save more for future pensions than they are required to by the above

This strong distinction between public and private is not as water-tight as it might appear, however, especially when you look in detail at earnings-related benefits, where both public and private elements are commonly present. Moreover, such a classification does not help much in evaluating success in achieving social objectives such as the overall adequacy of pensions, or the degree to which they fairly shared.

Here the OECD and the European Commission have sought to develop more integrated approaches, in order to measure the performance of public pension schemes in terms of:

- Ensuring some minimum, absolute, standard of living for pensioners – which the OECD calls a redistributive criteria, but which in practice relates to the Beveridge objective
- Ensuring a standard of living in retirement comparable to that achieved when working – which the OECD calls an insurance criteria, but which could be described as Bismarkian.

Within each of these areas, different national systems can then be classified in terms of:

- Their reliance on public or private provision, mandatory or otherwise
- The extent to which the income that the pensioner can expect to receive is already known and determined in advance – the ‘defined benefit’ system – or whether the level of pension will depend on the amount of contributions which a person makes during the working life and the success with which these savings are invested – the ‘defined contribution’ approach.

However systems are described conceptually, public pensions have to be paid for – from general taxation or specific contributions – and then provided in various forms, namely:

- Basic, flat rate, state benefits available to everybody who has worked or is a resident in the country concerned
- Means tested state benefits – the level of which will depend, in some degree or other, on income from other sources, accumulated wealth and essential expenditure (on housing in particular)
- Earnings related state benefits – the level of which generally depends on previous earnings over a defined period or the contributions paid out of those earnings

In addition, state pensions can be supplemented by:

- Occupational pensions provided by employers – whose content will depend on the particular schemes and national legislation in place
- Private pensions taken out by individuals – usually based on what has been paid in over the years, plus returns from investing these savings.

These are at present of relatively minor importance in most EU Member States, but are significant in a few, especially the UK, where, as noted above, there has been a deliberate policy of limiting the amount provided in public pensions and encouraging people to make their own

arrangements. Nevertheless, in other countries, there is a tendency for their importance to increase.

The impact of reforms

The extent to which these different elements can be combined, and the degree to which they are complementary, mutually exclusive, or genuine alternatives, across Member States will depend on all aspects of the different arrangements in place, and the impact of the wide-ranging current reforms in progress.

Whatever the details of the national reforms – and we await the on-going reports from both the EU and the OECD - there is a widespread tendency for governments to try to reduce the public financial commitment to pensions by encouraging more private provision, and to shift the emphasis from ‘defined benefits’ to ‘defined contributions’. This ensures that the pension received bears a close relationship to the income earned during a person’s working life and so avoids, for pension providers, the element of uncertainty about the extent of future liabilities inherent in a defined benefit system.

It does so, however, by transferring the uncertainty to future pensioners, in the sense that they no longer know how much income they can expect to receive when they retire, which will depend not only on the contributions they make, but the returns from the financial and other assets which their contributions have purchased over the years. As recent experience demonstrates, this return can change considerably, and rapidly, if equities make up a significant proportion of the assets concerned.

At the same time, though, governments are, to varying extents, making serious efforts to ensure that the most basic objective of pensions – namely to avoid poverty in old age – is still met, and that the encouragement of private provision and defined contributions does not result in increased inequalities in old age.

In this respect some reforms are going much further than others. The Swedish and Danish reforms are - somewhat surprisingly to some - moving down the private ‘defined contribution’ road to some extent. However, this process is balanced by other elements in these countries’

social systems – not least an egalitarian and re-distributive tax system, and guaranteed access to health and other benefits. Moreover, these new policy directions are very much negotiated by, and under the control of worker representatives.

At the present time, the OECD is seeking to calculate, on the basis of current pension arrangements, what pension a person with a full working career is likely to receive in different countries from both basic and earning-related pensions, given their earnings from employment. Such hypothetical calculations always need to be treated with care, however, given the importance of the assumptions commonly made – not least the assumption that everyone has had a full working career, which may not be the case for a variety of reasons. It is, therefore, just as important to consider cases where people have interrupted their working career to take care of children or elderly parents, to resume their education or training, because of spells of unemployment and so on, and the effect this has on pension entitlement.

The extent to which systems tend to redistribute income across groups from the same generation – as opposed to re-distributing over time between generations -depends both on the importance of basic pension provision compared with earnings related systems, and the way the tax system and systems of social support work.

Hence, in practice, French, German (and even US) pension systems tend to achieve a higher level of re-distribution than is commonly believed, because their schemes are not so strictly Bismarkian, or earnings-related, as is often thought.

In these terms, countries range from the UK and Ireland at one end of the spectrum - where the earnings related element in state pensions is modest or non-existent - to Belgium - where there is a stronger link between earnings and pensions – and on to countries where the systems are almost purely earnings related – Austria, Spain (but with a cut-off point), Sweden, Italy, Netherlands, Finland, Luxembourg.

Preliminary OECD calculations regarding future pensions suggest that, for workers on average earnings, income from state pensions can be expected to vary from around 40% of income when in work in the UK, around 50-55% in Germany and Belgium to around 75% in France, Finland, Italy,

the Netherlands and Luxembourg and 80-85% in Sweden, Austria and Spain.

This indicates one aspect of the extent of the commitment or ‘pension promise’ that Member States are making. However, in order to make specific estimates, it is still necessary to take account of life expectancy, actual retirement age, the degree to which pensions are indexed and, not least, the extent to which workers actually receive their full pension entitlement.

Such adjustments tends to push France and Italy further up the financial ‘commitment’ scale, and to bring Austria and Sweden down somewhat. However, the basic differences between Member States do not change fundamentally. And some countries – notably the UK and Ireland – are clearly relying heavily on future pensioners making their own ‘non-public’ provisions if they are to have acceptable levels of income in their retirement.

The public budget implications of current plans and actions

Although the evidence in the EU’s Joint Report on Pensions published in 2003 suggests that the range of policy issues are now being addressed in a more balanced way across the EU, there is no doubt that a preoccupation with financing has been the driving force for the reform and modernisation of pension systems, initially dwarfing other concerns.

Attention had focused on three main forces affecting the financial equation - increased life expectancy (which means that state schemes will be paying out pensions for longer); the exceptional jump in the size of the 65+ retirement age population as the baby-boom generation reaches retirement age; and the increases in the number of people qualifying for earnings-related pensions (with, notably, more women working and accumulating pension entitlements).

The estimates on longevity are clearest, with life expectancy, compared with today, expected to increase by 4 to 5 years over the next 50 years. Given that the average life expectancy today for those aged 65, is 15.5 years for men and 19.5 years for women, this alone could lead to an increase in average pension expenditure of 25-30%.

The European Commission has also taken account of the above-average number of people reaching retirement age over the next 10 or more years, because of the large 'baby boom' cohorts. Putting these two factors together, it has estimated that the dependency ratio – the number of people aged over-65 year compared with the number aged 15-64 (the working age population) – which is around one to four today, could increase to one to two by 2050.

In terms of public expenditure on pensions, these calculations suggest that the average expenditure on pensions - 10.4% of GDP in 2000 - could rise to 13.3% by 2050, but with a very wide variation by Member State – from 5% to over 20% – all assuming no policy changes.

On the other hand, success in raising EU average levels of employment in line with the Lisbon objectives would both increase state and economy-wide revenues and reduce expenditures on pensions, and the Commission estimates that this alone would reduce the possible increase in public pension expenditure by over 30% in the period to 2050.

Moreover it has also been estimated that, if effective retirement ages were increased by one year, without increasing pension entitlements, this would cut the increase in pension expenditure by a further 20% by 2050.

In other words, those two measures together – raising the employment rate and delaying effective retirements by one year - could halve the expected increase in pension spending commitment, without any other actions to increase contributions or to reduce pension benefits.

Public attitudes and expectations

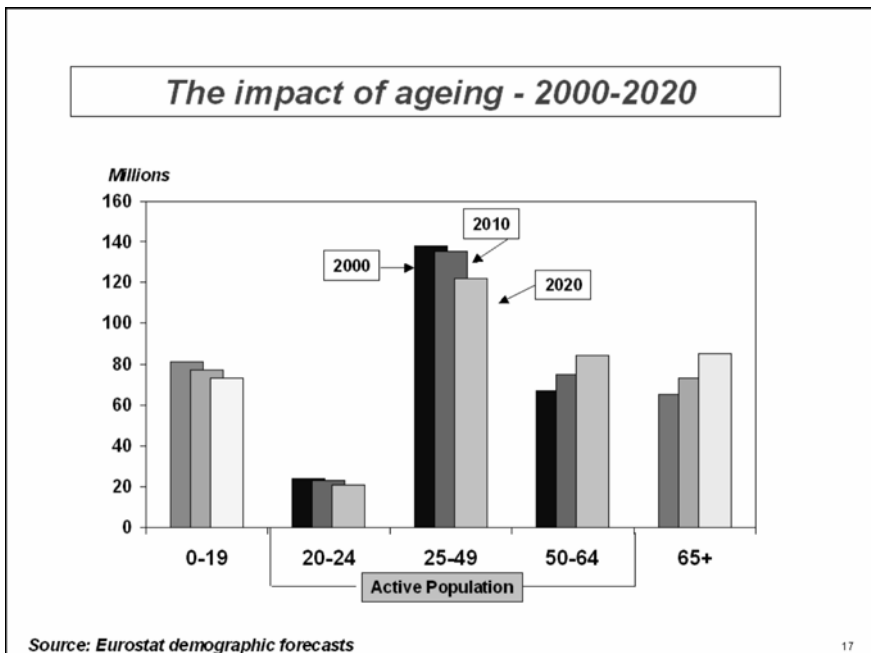
Given the wide range of policy actions already taken, or planned, by governments to deal with the pensions 'problem', and the fact that the full implications of continued demographic ageing are far from immediate, the results of a Eurobarometer survey in Autumn 2001 is revealing about the way public confidence appear to have been undermined by the prevailing political debates.

In this survey, some 60% of people already see ageing as ‘a major problem’, and 50% expect to see themselves getting by ‘with difficulty or great difficulty’ on their state pension.

On the other hand, 15% of people apparently see themselves as ‘able to enjoy retirement without having to worry about money’ and a further 30% report that they would be ‘able to live reasonably well’ if they were careful with their spending.

Some of these apparent inconsistencies may reflect a misunderstanding about the term ‘state pensions’, but they may also reflect what people read in the press, and what they hear from the lips of politicians.

All of which serves to underline the dangers of allowing the substance of the debate to be taken over by scaremongers, and to demonstrate the limited extent to which the public in most Member States are aware of the real facts, issues and options, and are able to actively contribute to public policy making – as the recent EU Joint Report on Pensions acknowledges.



Sustainable populations and pensions

Against this background it is important to see that one part of the demographic ‘problem’ is actually a positive factor, namely that people are living longer – which is the result of higher living standards, better diet and, to some degree, medical advances and the quality of public health services.

But the even bigger, but more overlooked, aspect of the ‘problem’ is that birth rates have fallen dramatically over recent decades, affecting the growth of working-age population, and the age balance of that population.

The fall in birth rates is commonly explained, on the one hand, by female emancipation and birth-control and, on the other, by the rising ‘opportunity cost’ for women of having children as their employment opportunities have expanded with increasingly equal access to education and the labour market.

However this is not the whole story. Another important factor is that the cost of raising children - in terms of what is now expected of families – has risen significantly. Good homes with separate bedrooms, education up until the mid-20s or beyond in some countries, with wider social support and responsibilities, and so on, are now all part of what parents are expected, even required, to provide. At the same time, increased mobility and the loosening of family ties have reduced the opportunity to share such costs with, and obtain support from, the wider family.

Although we have not been able to investigate this in depth, there is little apparent evidence that governments have done much, if anything, to modify taxation provisions in order to compensate parents for the rising costs of raising children. On the other hand, governments are now taking much more seriously the need to provide publicly supported child-care provisions, and to encourage more family-friendly work arrangements in order to help achieve higher employment rates. Nevertheless, in a number of Member States, much still needs to be done in these respects. This is not only the case in the south of the EU, where there is still reliance on the wider family to provide child care support, sometimes making it difficult for grandparents (grandmothers in particular) to work, but also in some northern countries where child care is both limited and expensive.

EU 15 Population projections				
<i>Medium Scenario</i>				
		2000	2000-2010	2000-2020
0 - 15		59m	- 3m	- 6m
16 - 19		22m	- 1m	- 2m
20 - 24	Working age	24m	- 1m + 3m	- 3m - 4m
25 - 49	Population	138m	- 3m	- 16m
50 - 64		67m	+ 8m	+ 17m
65+		65m	+ 8m	+ 20m
TOTAL		376m	+ 8m	+ 10m

Source: Eurostat demographic forecasts

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It is important to note that this is not a challenge to ‘free choice’. As far as can be judged on the basis of opinion surveys, the desire to have children has not diminished. What has happened is that, in modern urban European societies, having children has become something of a luxury – readily affordable in many cases only by high dual income households. For those on lower incomes it is a major struggle to raise a family, with poverty and benefits traps driving many to stay within the benefit system, and outside the labour market.

Governments therefore bear a major – albeit indirect - responsibility for falling birth-rates. They cannot back coyly away from this, as if having children or not were purely an issue of individual choice. All public policies affect behaviour, and governments have at least as much a responsibility to help sustain the long-run balance of societies as they have to defend their populations against potential aggressors. Fertility rates do vary over time and across countries, and the evidence suggests that differences can be traced in part to government policies of various kinds.

Moreover, if governments seek only to frighten people into saving more, because they are expected to live longer, this will – apart from the immediate effects on consumption, and thus economic growth - further serve to discourage younger generations from having children, thereby aggravating the long-run ageing problem, pushing up the dependency ratio, and ‘making the risk of a bleak old age a self-fulfilling prophecy’, as one group of researchers has put it.

This stark scenario has resulted in suggestions that an optimal long-run strategy for progressively restoring a sustainable population balance requires an inter-generational re-adjustment with a simultaneous *reduction* in pay-as-you-go pensions and *increase* in child allowances. In this way, it is argued, EU societies will be better able to ensure that there will actually be enough people of working age around in the future to pay for the pensions of those who have retired.

In this respect, however, some rebalancing of priorities is needed in order to reduce the number of pensioners on low income, which is unacceptably high in some Member States. This would mean focusing more attention on the distribution of income among those in retirement, as opposed to concern only about the overall scale of transfer to this section of the population.

Conclusions on pensions

The obvious good news on pensions is that, on average, pensioner income in the EU appears, in most countries, to be not significantly lower than, the income of other sections of the community. Moreover, the relative position of pensioners may be even higher once account is taken of wealth as well as income and expenditure ‘needs’.

However, in terms of ensuring a poverty-free retirement for all, much still needs to be done in the sense that quite a lot of people still seem to slip through the net, with women and older (over 75) pensioners currently doing much less well than men and younger pensioners. There are also some serious imbalances in coverage and level of entitlement, especially in Southern countries.

In addition, it is less clear how comfortable pensioners' lives really are without looking much more deeply into the extent and quality of other social and health care provisions – which, if they are inadequate, can be a big drain on income and capital and, indeed, painful in a very literal sense.

The Nordic countries are tackling the challenge with a range of policy responses, but it has to be recognised that these solutions involve levels of public administration and taxation, and degrees of social partnership, that other Member States may have difficulty in replicating. Overall, the Anglo-Saxon systems remain a cause for concern given the already apparent implications of inadequate pension provision, whatever the benefit in terms of limiting public debt.

Effectively EU citizens are being asked to choose between some combination of working a little longer than expected, accepting a somewhat smaller pension than anticipated, or paying increased contributions. These are difficult choices and there are bound to be conflicts of interest. The issue of age of retirement arouses strong views. It is certainly important to make allowances for the fact that many people have held down onerous or dangerous jobs throughout their working lives, had started work early, and now have relatively shorter life expectancy.

In this regard, there is an obvious logic in seeking to maintain a balance between the length of the working life and the length of the period of retirement – which is not only increasing as people live longer but is also characterised by more years of good health than in the past. It would be unfortunate for Europe's future pensioners if political compromises on these different issues were not struck at the present time, and if a mixture of financial panic, regressive social engineering, and commercial greed – all of which are currently present – were allowed to dominate the pensions debate. It would be even more unfortunate if this led to a progressive undermining of one of Europe's greatest social achievements.

Over the longer term, governments need to restore faith in the social insurance principle behind collective public pensions, and ensure that pensions are structured 'to prevent poverty, and not just alleviate it' – to use the words of the EU's own 2003 Joint Report on Pensions.

In this context, while the various EU Member States still need to pursue detailed reforms on their own terms – some with more urgency than others

- they all need to recognise that, even if current reforms are effectively pursued, some issues still create concerns:

- The unequal treatment of workers in precarious and permanent jobs which continues into old age
- The fact that countries with below average income levels will continue to have disproportionately poorer pension provisions than others
- The fact that women's pensions are likely to remain lower than men's for some time
- The fact that state pensions are likely to pay out less in the future than they have in the past, which is likely to have negative consequences for those in the weakest positions in society
- The fact that pension policy reforms are too often being pursued independently of wider health and social care provisions, which collectively determine the well-being of pensioners.

In terms of pension policy reforms, the apparent move away from the old ideological, and ultimately sterile, debates about funded versus non-funded schemes, is to be welcomed. However, the importance of having an open political debate, involving all those affected in one way or another, to ensure public acceptance of pension reforms is still not understood and accepted in all countries.

The fact that public schemes have been shown to be more efficient, less costly to administer and inherently more equitable than private schemes should not be forgotten either. At the same time there is a need to be cautious about generalising some of the more sophisticated 'mixed' reforms – like those in Sweden, Denmark and the Netherlands.

Such reforms may be working well because they are built on a solid foundation of social consensus and respect for social partnership and, perhaps most importantly, linked to sophisticated social support systems. They may work less well in countries where governments are less trusted, where administrations are less competent, and where those most directly affected – social partners and pensioners – do not have a tradition of control or influence over pension policy.

More generally, and over the longer run, EU Member States will need to move away from reactive responses to the financial consequences of population ageing and the effects of early retirement to develop more proactive approaches, including a possibly substantial shift in the tax and benefit structure so as to encourage a return to a more sustainable rate of endogenous population growth.

Pension reforms obviously need to be pursued within a sustainable financial framework. However, what ultimately matters most in terms of achieving financial stability is not just how generous pension are, or how high contributions or tax rates are set, but how fast the economy is growing, and how much employment rates are increasing. A nightmare financial scenario for pensions with economic growth of less than 2% a year becomes much less frightening with growth of 3%, or more, a year.