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AK Position Paper

# Green Paper towards adequate, sustainable and safe European pension systems

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# About us

**The Federal Chamber of Labour is by law representing the interests of about 3.2 million employees and consumers in Austria. It acts for the interests of its members in fields of social-, educational-, economical-, and consumer issues both on the national and on the EU-level in Brussels. Furthermore the Austrian Federal Chamber of Labour is a part of the Austrian social partnership.**

**The AK EUROPA office in Brussels was established in 1991 to bring forward the interests of all its members directly vis-à-vis the European Institutions.**

**Organisation and Tasks of the Austrian Federal Chamber of Labour**

The Austrian Federal Chamber of Labour is the umbrella organisation of the nine regional Chambers of Labour in Austria, which have together the statutory mandate to represent the interests of their members.

The Chambers of Labour provide their members a broad range of services, including for instance advice on matters of labour law, consumer rights, social insurance and educational matters.

More than three quarters of the 2 million member-consultations carried out each year concern labour-, social insurance- and insolvency law. Furthermore the Austrian Federal Chamber of Labour makes use of its vested right to state its opinion in the legislation process of the European Union and in Austria in order to shape the interests of the employees and consumers towards the legislator.

All Austrian employees are subject to compulsory membership. The member fee is determined by law and is amounting to 0.5% of the members' gross wages or salaries (up to the social security payroll tax cap maximum). 560.000 - amongst others unemployed, persons on maternity (paternity) leave, community- and military service - of the 3.2 million members are exempt from subscription payment, but are entitled to all services provided by the Austrian Federal Chambers of Labour.

Herbert Tumpel
President

Werner Muhm
Director

# Executive Summary

We generally support the initiative of the European Commission to launch a Europe-wide, public discussion and consultation on how adequate, sustainable and safe pensions can be guaranteed and how the EU can best support national efforts.

Critical positioning towards the increasing risk transfer to employees and pensioners based on the spread of unsecured DC systems in the occupational pension scheme sector.

**General considerations in the Green Paper we agree upon:**

• Reference to the high degree of the safety of pensions, which had been ensured by public systems during the crisis as well as to the great importance of safe pensions not only for individuals but also from a macroeconomic point of view (stabilisation of demand and economic development / automatic stabilizers).

• (Strong) emphasis on the equal status of the objectives „adequacy" and „financial sustainability"; commitment that pension systems are or have to be systems of inter- and intragenerational solidarity.

• Reference to the crucial importance of the employment targets „more and better jobs" and a „75 percent employment rate" (Europe 2020 strategy).

• A slightly more critical mindset (compared to previous Commission documents) towards private capital-based systems, for example in view of risks and volatilities in the capital markets.

• Critical positioning towards the increasing risk transfer to employees and pensioners based on the spread of unsecured DC systems in the occupational pension scheme sector; The emphasis on the importance of the „safety" of pensions, as the title of the Green Paper indicates, is much welcomed - not least against this background.

• The call for more transparency in pension systems (deficits predominantly exist in case of private pension systems).

**Problematic issues:**

Unfortunately the positive principles mentioned, find only little consideration in the more detailed deliberations and conclusions of the Green Paper. Other weaknesses of the Green Paper are the inaccurate conclusions drawn from the financial and economic crisis and the fact that there is no discussion on how to finance the increasing costs of private capital-based pension systems. Another major shortcoming is the focus on purely demographic conditions concerning dependency rates (thereby the key impact of the future labour market development is pushed into the background).

• The message that the effects of the crisis (i.e. the rise in public debt) increase the necessity of „pension reforms" has been mentioned several times in the Green Book. This message is obviously aimed at further reducing public pensions. The fact that such a pension strategy is in blatant contrast to the target of „adequate pensions" is as much ignored as the crisis experience that public systems haven proven to be much safer (and macroeconomically positive) than private capital-based systems.

• The Commission takes no notice of the impact of the immense spread of funded pensions and of deregulation policy on the formation and expansion of speculative financial market and property price bubbles. The Commission turns a blind eye to the fact that policies adopted by many Member States to move from public pay-as-you-go to private capital-based pension schemes are no „natural trends", but the correctable consequence of (wrong) political decisions. The increasing transfer of risks to the individuals also is the result of political decisions. It has to be noted in this context that the Commission itself has contributed to these unfortunate developments, by focussing on the reduction of public pension expenditure while ignoring the costs shifted to private schemes and by forcing market liberalisation.

The wording of the Green Paper clearly shows that the Commission continues to focus on reducing public (pension) expenditure.

• The wording of the Green Paper clearly shows that the Commission continues to focus on reducing public (pension) expenditure. Shifting the costs towards capital-based occupational and private pension schemes is still misinterpreted as a means of cost saving. The costs of capital-based systems are still underestimated and the crucial question how to finance increasing costs in this sector still is not addressed. Also largely ignored is the fact that private capital-based systems normally do not entail any social balancing mechanisms (recognition of child-care periods, unemployment etc.) but massive additional risks (financial market volatility).

• The considerable advantages of public pay-as-you-go pension schemes with regard to the ability to guarantee adequate and reliable pension levels also in times of crisis have only been mentioned in passing. The same is true for the very different crisis-related effects of different pension system. While pay-as-you-go public systems have significant anti-cyclic and thereby stabilising effects, funded pension schemes are clearly pro-cyclic and have considerable potential to aggravate a crisis.

• The dependency rates are mainly referred to in connection with purely demographic relations (number of persons above a certain age limit in relation to the number of people of working age). Far too little emphasis is given to the fact that in the end not purely demographic relations, but economic dependency rates (number of people in work in relation to the number of beneficiaries) are the decisive factor. Significantly higher employment rates based on more and better jobs are also of vital importance for adequate and sustainable pensions. The Green Paper does not give adequate attention to this vital connection.

**Conclusion**

Dealing with concepts for alternative and additional sources of finance also at European level should be a cornerstone of future debate on adequate, sustainable and safe pensions.

Unfortunately the Commission misses the opportunity to critically review key elements of its pension strategy in the light of the experiences from the latest financial market crisis. Strategies, which have been severely shaken by the experiences made in the crisis, are not questioned; on the contrary, it seems they will remain in place and will even be continued in intensified form. An unbiased and realistic revaluation of the risks and costs of funded pensions still does not take place. Furthermore the most important approach to secure (financial) sustainability, ‚the utilisation of existing employment potentials through more and better jobs, does not find adequate consideration.

We believe the unbalanced focus on reducing public (pension) expenditure is not an appropriate fundament to find the right answers on how to guarantee adequate, safe and sustainable pensions.

On the background of a substantially aging population to reach the goal of a society for all generations requires a certain increase in resources made available for protecting older people. In sharp contrast to this the Commission still interprets each age-related rise in costs of public pension systems as a danger to (financial) sustainability while rising costs in private systems are not being addressed.

More emphasis is needed on measures aimed at containing pension expenditure by rolling back high invalidity rates early retirement rates (improved health protection, improvement of job prospects for older employees, etc). More emphasis is also needed on fair distribution of the burden of rising costs for older people. Dealing with concepts for alternative and additional sources of finance also at European level (e.g. by preventing tax dumping) should be a cornerstone of future debate on adequate, sustainable and safe pensions.

# The AK position in detail

**Replies to the questions asked in the EU Green Paper on „Adequate, sustainable and safe European Pension systems"**

A sustainable high-quality pension requires - in particular against the background of demographic challenges and crisis experiences - a strengthening of pension systems, which are based on public, collective and inter- and intragenerational solidarity and a restriction and an enhanced control of private systems, which are subject to the risks of the capital markets. It requires efficient social systems to support social cohesion and a political focus on more and better jobs and no further shifting of responsibility and risks to the individual. However, the Commission - as demonstrated by the focus of the questionnaire - largely ignores central aspects and tries to deal with the existing big challenges mainly by treating the symptoms.

Safeguarding a social balance and - associated with it - the prevention of poverty in old age are further essential elements of an „adequate" pension scheme.

**1. How can the EU support Member States' efforts to strengthen the adequacy of pension systems? Should the EU seek to define better what an adequate retirement income might entail?**

The guarantee of a reliable pension income, which adequately maintains the standard of living, is the **central objective of any pension system**. Safeguarding a social balance and - associated with it - the prevention of poverty in old age are further essential elements of an „adequate" pension scheme. The financial sustainability of the pension system is a means to an end; it **serves** the long-term guarantee of achieving these objectives.

Unfortunately, many Commissions documents - including the Green Paper - do not give sufficient consideration to the target of „adequate pensions". On the contrary:

• The Green Paper names many facts (falling replacement rates, risk transfer to the individual, increasing uncertainty, significant depreciation of pension capital etc.), which have to be rated as extremely perturbing. However, its conclusions lack appropriate clarification and the urgently required initiative to develop suitable counter strategies!

• The Commission has said for years that pensions need reform. However, it has mainly been concerned with limiting public and expanding private pension schemes, unfortunately without giving sufficient consideration to the consequences for the adequacy and reliability of the pension level associated with it. The Green Paper too primarily pursues the reduction of public pension cost, which is misinterpreted by the Commission as a guarantee for financial sustainability.

• This position is also made very clear in its approach towards foreseeable increases in cost because of the rising number of elderly people:

o If these increases in cost become apparent in public systems, the Commission immediately takes the opportunity to warn the Member States and to demand „pension reforms" to stop this rise.

Higher future contributions to public systems are generally discredited as „painful".

o However, the Commission ignores it if the same (or in most cases much higher) increases in cost are expected for private systems, obviously regarding this as unproblematic.

o Higher future contributions to public systems are generally discredited as „painful" (compare page 10 of the Green Paper).

o In contrast, significantly higher contributions for additional private/occupational funded pension schemes appear to be „painless" and insignificant in respect of the question of financial sustainability.

• The actual importance that the Green Paper attaches to the targets „adequacy of pension levels" and „safety" is unfortunately clearly in contrast to the introductory statement that adequate pension incomes would be a priority of the European Union and therefore play an extremely important role for the citizens and social cohesion.

The decision, which level is adequate, is a matter for the Member States. Any „clarification of adequacy" by the Commission would be inappropriate.

However, the development of qualitative criteria for an adequate pension income, based on the target of securing the standard of living and under consideration of important aspects such as reliability and risk-bearing, could be a useful contribution to guarantee the future adequacy of pension systems. The same applies to determining the minimum replacement rates.

However, we consider the fact that the Commission at last attaches appropriate importance to its own analyses and contributions concerning the priority target of the sustainable guarantee of an adequate pension income to be much more important! This does not only require clearly defined clarifications, but above all:

• The concentration on the target of „securing adequate pensions" as well as exposing (imminent) undesirable developments and the development of possible counter strategies.

• The realization of the fact that a high-quality pension system in an ageing society will inevitably require more resources and that not every additional expenditure in public systems can be put on a level with a lack of financial sustainability!

• Moving away from the one-sided focus of the sustainability discussion on public pension expenditure. A best possible efficient target achievement (sustainable guarantee of adequate pensions) can only be guaranteed if all pension costs both for the individual and the society are included in the analysis, whereby it is completely irrelevant whether these are incurred in public or private and occupational schemes. The focus limited to public expenditure does not provide a useful decision-making basis, but is an obstacle to sensible solution strategies.

**2. Is the existing pension framework at the EU level sufficient to ensure sustainable public finances?**

It is not the responsibility of the Commission to guarantee public finances within the „EU framework for pensions", but to support the Member States in the sustainable safeguarding of adequate und reliable pension systems!

We reject a restriction of the competence of the Member States concerning pension issues. This also applies to any actual restrictions under the guise of fiscal policy requirements.

To only restrict the issue to the effective retirement age is not enough.

**3. How can higher effective retirement ages best be achieved and how could increases in pensionable ages contribute? Should automatic adjustment mechanisms related to demographic changes be introduced in pension systems in order to balance the time spent in work and in retirement? What role could the EU level play in this regard?**

To only restrict the issue to the effective retirement age is not enough. The use of long-term significant employment potentials requires a concentrated European policy with employment policy priorities and intensive efforts to improve the employment prospects of all disadvantaged groups (single mothers, young people, early school leavers, low-qualified adults, people with health problems, people in precarious employment etc.). The often dramatic situation many young people are confronted with in the labour market (few employment opportunities, lack of job security, precarious jobs etc.) is not only a waste, entailing considerable costs for the individual and society, but also simply not compatible with a social Europe!

Hence, the significantly better integration of older people into working life and the rise of the effective exit age from the labour force only represents one - although very important - starting point.

• As the Green Paper points out several times, raising the effective exit age from the labour force/retirement age urgently requires intensive and comprehensive efforts to significantly improve the general conditions for elderly employees to participate in the labour market!

• Most Member States have already significantly improved or are planning to improve the incentives for the insured to exit the labour force at a later point. Hence, the cost of early retirement is increasingly transferred to them. Following the fact that corporate personnel policy greatly influences the effective retirement age, it would be time to motivate companies to engage in necessary behavioural changes and to pay their share of the high social costs of a non-age appropriate personnel policy.

The claim of the Commission that the perception would grow and that a rise of the legal retirement age would be an important signal for employees and employers (and would motivate them to aim at a higher effective retirement age) is as one-sided at the expense of the employees affected as the opinion that the automatic adjustment of the retirement age to the rising life expectancy would present a promising political option.

The most important starting point to guarantee a sustainable, adequate and safe pension income is the utilisation of long-term significant employment potentials, whereby a longer period of employment is just one of many aspects.

• Making such statements, the Commission again confirms that it is predominantly concerned with reducing public pension expenditure without giving particular consideration to the adequacy and safety of the pension income.

• An increase of the retirement age within the meaning of the qualifying age for a full pension affects, because of the higher deductions ceteris paribus, only a corresponding (further) reduction of the pension income in the public systems. An increase of the earliest possible entry age would, in view of the existing highly inadequate employment opportunities, be accompanied by an additional increase in unemployment. A rise of the effective labour exit/retirement age would therefore be as little automatically associated with it as rising employment rates. In general, it is not a lack of motivation, which prevents people from staying in the labour market but the lack of actual opportunity

• Automatic adjustments of the pension rights - for example by raising the retirement age in accordance with the increasing (future gain in) life expectancy - do not prove to be an adequate approach. Pension issues are highly complex and of course also highly political. Governments must use their distribution, social and economic opportunities to shape policy and should not shirk their responsibilities. In our view, modern democracies must not allow that fundamental decisions, for example in respect of pensions, are taken away from the processes of formulating political demands and objectives or interest mediation (legislative procedure)!

**4. How can the implementation of the Europe 2020 strategy be used to promote longer employment, its benefits to business and to address age discrimination in the labour market?**

The most important starting point to guarantee a sustainable, adequate and safe pension income is the utilisation of long-term significant employment potentials, whereby a longer period of employment is just one of many aspects.

Apart from a policy coordination, which is generally more orientated towards setting employment policy priorities, comprehensive education, health, labour market and employment policy measures, more and better - also age-appropriate - jobs and significantly improved participation opportunities are also required. However, the focus must not only be on the elderly but on all groups, which are disadvantaged in the labour market.

Such a new orientation in the direction of integrative and investive social and economic policy is not only essential for the long-term guarantee of adequate pension levels but also for achieving the vision outlined in Europe 2020, to change the EU into an intelligent, sustainable and integrative economy, which is characterised by a high level of employment and productivity and strong social coherence!

The focus should rather be aimed at a reverse of the current trend to deregulation (e.g. in respect of assessment regulations).

That the Commission itself significantly underestimates and ignores the opportunities and potentials associated with it is revealed in statements of Green Papers such as: „… showed that, on account of the shrinking labour force, the only source of growth by 2020 will be labour productivity …"

**standards on acquisition and preservation plus a tracking service for all types of pension rights be a better solution?**

The positive contribution, which assumes a further expansion of cross-border activities by financial intermediaries, is significantly overrated by the Commission, whilst the risks associated with it - in particular in connection with inadequate regulations - are ignored. The focus should rather be aimed at a reverse of the current trend to deregulation (e.g. in respect of assessment regulations).

The obstacles for mobility by restrictive regulations concerning acquisition, preservation and transferability of additional pension claims do not only exist in case of cross-border but also of job changes within the internal market. A new initiative to remove these obstacles is basically to be welcomed. However, it should be clear that this will not make a substantial contribution to guarantee sustainable, adequate and safe pensions.

**Obstacles to mobility in the EU**

**5. In which way should the IORP Directive be amended to improve the conditions for cross-border activity?**

**6. What should be the scope of schemes covered by EU level action on removing obstacles for mobility?**

**7. Should the EU look again at the issue of transfers or would minimum**

**Safer, more transparent pensions with better awareness and information**

**8. Does current EU legislation need reviewing to ensure a consistent regulation and supervision of funded (i.e. backed by a fund of assets) pension schemes and products? If so, which elements??**

**9. How could European regulation or**

**a code of good practice help Member States achieve a better balance for pension savers and pension providers between risks, security and affordability?**

**10. What should an equivalent solvency regime for pension funds look like?**

**11. Should the protection provided by EU legislation in the case of the insolvency of pension sponsoring employers be enhanced and if so how?**

The most effective and efficient approach to significantly increase the safety of future pension incomes again, would be the clear reverse of these - in any respect negative - structural changes.

The safety of the pension income is of immense significance both for the individual and for the macroeconomic development and stability. The shift of emphasis from public to private funded schemes and the increasing transfer of risk to the individual are not only linked to significant direct wealth losses, (which are not reflected in the GDP values), but also with considerable potential system destabilisation and enormous consequential costs also for public budgets.

Measures, which aim at an effective restriction of the sometimes exorbitant high risks for employees and pensioners in capital-based systems, are as much required as are improved solvency rules. The argument that the reduction of uncertainty and risks would be associated with considerable costs and would therefore affect the spreading of such systems is misleading. Not only the reduction and restriction of risks and uncertainty entail considerable costs, but risks and uncertainty must also be correctly classified as „costs". The apparent attractiveness of risky pension products is largely based on the exclusion of such costs (and on estimating unrealistically high yield expectations).

However, it should be clear that - although costly - risk reduction in capital-based systems is possible and basically sensible, but that these systems according to their nature always carry an inevitable, significant additional risk. These imminent system risks must not be underestimated and the possibilities of their restriction should not be overrated, as it unfortunately happens all too often.

The structural changes required by the Commission - which can be observed in the individual Member States with various degrees of intensity - such as the change from pay-as-you-go to funded pension schemes as well as the increasing shift of the risks to individuals are no „natural trends", but the - correctable - consequence of (wrong) political decisions, in which the Commission itself because of its one-sided focus on reducing public pension expenditure did play its part.

In our opinion, the most effective and efficient approach to significantly increase the safety of future pension incomes again, would be the clear reverse of these - in any respect negative - structural changes.

**12. Is there a case for modernising the current minimum information disclosure requirements for pension**

The idea that better economic knowledge of the individual would substantially improve the adequacy of pensions and might be able to avoid stereotype behaviour patterns in this environment is very much out of touch with reality.

**products (e.g. in terms of comparability, standardisation and clarity)?**

**13. Should the EU develop a common approach for default options about participation and investment choice?**

In view of the serious lack of transparency concerning many funded pension products in respect of pension claims, extent and burden of risk as well as allocated costs and their breakdown, stricter information duties are urgently required.

However, this does not remove the actual problem that these systems are associated with - often considerable - risks and costs. Furthermore, the impact of better information on risks should not be overestimated. The possibilities - in particular for laymen - to even come close to assess financial market risks adequately are extremely limited. Expectations and behaviour are very much dependent on the surrounding conditions and these rarely invite - particular in respect of the financial markets - rational decisions. Even in periods of long-lasting very high rises in share prices (which inevitably cannot be sustained permanently and carry an enormous risk of a counter movement), critical expertises and media reports are in an absolute minority. On the contrary, the majority of financial experts, which are often players in the finance industry themselves or are at least very close to it, strengthen even far overshooting cycles with their euphoric estimates and recommendations.

The idea that better economic knowledge of the individual would substantially improve the adequacy of pensions and might be able to avoid stereotype behaviour patterns in this environment is very much out of touch with reality. The formal economic education, which the relevant players normally have in abundance, does not provide any effective protection against the strong influence of the „herd instinct". Furthermore, this economic knowledge was not able to prevent the creation and distribution of countless financial products, whose effects and risks many of the players did not come near to understand.

The focus of the Commission on such strategies represents an aberration. Instead of counteracting the highly problematic trend of shifting risk and responsibility to the individual, attempts are made to downplay the problem and to justify the continuance of this development.

**Governance of pension policy at EU level**

**14. Should the policy coordination framework at EU level be strengthened? If so, which elements need strengthening in order to improve the design and implementation of pension policy through an integrated approach? Would the creation of a platform for monitoring all aspects of pension policy in an integrated manner be part of the way forward?**

We basically consider the coordination mechanisms at European level, such as the method of open coordination and the pension forum for the additional pension scheme as sufficient. We reject the expansion of EU competencies concerning pension issues and the restriction of those of the Member States.

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If the EU - as the Green Paper emphasises - really wants to take up the worries of the citizens concerning their future pensions and provide suitable support for national reform measures, it must first pay due attention to the priority need of the people for adequate and safe pensions, distance itself from the one-sided focus on reducing public pension expenditure and counteract the highly problematic trend of shifting risk and responsibility onto the individual!

Should you have any further questions please do not hesitate to contact

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