Pension Reform in Europe: What Has Happened in the Wake of the Crisis?[1]

David Natali[2]

Introduction

What has happened to pension policy since the onset of the Great Recession? To address this question the present contribution provides a summary of reforms in Europe. This article focuses on the fate of the pension paradigm that has dominated recent decades: so-called pension privatisation. Such a paradigm consists of the full or partial replacement of social security pension schemes with pension systems based on individual, private pension savings accounts. This model has been implemented in many countries. From the 1980s onwards, Europe has also seen the spread of pension privatisation.

The recent economic and financial crisis has proved a tough test for that paradigm. Many commentators foresaw further pressure to contain public spending and thus the reinvigoration of the privatisation trend: with austerity measures affecting public schemes and the parallel strength of pension funds (Pochet and Degryse 2012). In contrast, by analysing the output of the reforms, this contribution stresses that European countries have not experienced a coherent privatisation of their pension systems. Firstly, pre-funded schemes have also suffered from the adverse economic context, and some countries have experienced the re-nationalisation of pre-funded private schemes. Secondly, a wide range of reforms have been implemented in Europe. Central Eastern Europe (CEE) has seen a halt to, if not the roll-back of, private pension funds, while pre-funded schemes have spread somewhat in southern Europe (albeit to a far more limited extent than expected). Yet those countries with a more widespread multi-pillar arrangement (like, for example, the UK, Denmark and the Netherlands) have further reinforced the public/private mix inherited from the past, with cost-containment in both public and private schemes paralleled by new incentives to promote the spread of the latter schemes. All these developments are consistent with the persistent, if not growing divergence of pension systems in Europe.

The present article is structured as follows: the first section provides a summary of the effects of the crisis on pensions, while the second and third sections shed light on the reforms passed in the wake of the Great Recession. After reviewing measures related to the first pillar, we focus on measures affecting pension funds (second and third pillars). Section four concludes with a critical review of the more recent reform trends and a brief analysis of the future prospects of pension policy in Europe.

European pension systems and the effects of the crisis

There are a great variety of pension systems in Europe. Some emerged from explicit universalistic anti-poverty ambitions, while others evolved from schemes with an income-maintenance goal. In some of these systems, supplementary pensions quickly developed, while other pension systems centred on a public 'one-pillar' model (Natali and Stamati 2013, 2). The latter are the so-called *social insurance* systems, where the state provides the greater part of pension benefits through national and universal or occupational schemes based principally on social insurance (e.g. France, Germany, Italy and Sweden). The financing method is usually of the pay-as-you-go (PAYG) type. Current contributions paid by both employers and employees (or revenues from ongoing taxation) are not saved, but are immediately used to finance current benefits. The main goal of such pension programmes is 'income-maintenance'. The generous level of coverage and the encompassing character of pension benefits reduce the scope for supplementary occupational and/or individual schemes. Under *multi-pillar* systems, by contrast, the state is liable for basic entitlements aimed solely at poverty prevention, while

[1] The present article is based on the research carried out by the author for the European Social Observatory (OSE) in the context of the Commission-funded European Social Policy Network (ESPN). It is also based on the first results of the research project 'The New Pension Mix in Europe' carried out by OSE and financed by the European Trade Union Institute (ETUI) of Brussels.

[2] University of Bologna-Forli.

additional benefits are provided by supplementary occupational and/or individual schemes (e.g. Denmark, the Netherlands, and the UK). The financing methods are thus mixed: on the one hand, public pension programmes (first pillar) provide flat-rate or means-tested benefits; while supplementary occupational schemes (second pillar) and individual pension funds (third pillar), by contrast, are mainly funded. Current revenues are saved and then used to finance future benefits. Many Central Eastern European countries have implemented the second generation of multi-pillar systems, where public programmes provide contributions-based and earnings-related benefits and are supplemented by mandatory and/or voluntary funds.

Common reform trends up to 2007

From the 1980s up to 2007, Europe saw a progressive shift away from public PAYG schemes and towards prefunded private pensions. Countries with social insurance models started to set up new occupational and/or personal pensions and retrenched public pensions. Countries with multi-pillar pension systems further reinforced pre-funded pillars, while strengthening the regulation of private funds; and central eastern European countries implemented their new pre-funded pension schemes (Ebbinghaus 2015). According to Holzmann (2012), twenty-nine countries passed systemic reforms between 1988 and 2008 and established a mainly non-government funded pension pillar. In Europe, this was the case with Sweden, Poland, Estonia, Lithuania, Latvia, Bulgaria, Croatia, Slovakia and Romania. Continental and Southern European countries followed a more path-dependent trend: public schemes were subjected to cost-containment via a number of measures such as, for example, stricter links between contributions and benefits, higher pensionable ages and the lower indexation and valorisation of benefits. Such an overall trend was consistent with the new paradigm of pension privatisation: the full or partial replacement of social security pension schemes (typical of the social insurance model) with pension systems based on private savings accounts. Pension privatisation proved attractive to governments in that it promised to reduce the fiscal challenge, to cut state guarantees for old age and to foster economic growth and efficiency through the market (Orenstein 2011).

In 2007 the crisis struck

The *Great Recession* has had significant effects on pension systems across the EU. The adverse economic conditions – higher unemployment, declines in GDP, reduced tax revenue, low interest rates and downward trends in the financial markets – have led to budgetary tensions with respect to both PAYG and pre-funded pension schemes. As far as the former are concerned, negative economic trends – such as the contraction of employment and the rise in unemployment – have led to reduced contributory inflows, while leading to increases in total spending to counter the more worrying social consequences of the recession at the same time. A second, more indirect pressure has resulted from the fiscal stimulus implemented by many countries in order to reduce the impact of the crisis, which has led to a rapid deterioration in public finances. A third source of tensions has been represented by the low rates of return on pension funds. Many countries have established public pension reserve funds to improve the first pillar financial sustainability (OECD 2014).

As far as pre-funded pension schemes are concerned, the financial sector crisis resulted in a major drop in the value of the assets of pre-funded schemes. Such losses were largely recovered after the crisis. Further stress was generated by the adverse economic conditions, which resulted in far lower average interest rates. Pension funds whose assets included bonds being devalued thus started to face serious solvency issues. Protracted low interest rates have deeply affected pension funds and insurance companies, by increasing the present value of future liabilities and curbing future investment returns. In sum, collapsing stock markets, increasing bond yields, and persistently low risk-free rates all jeopardised the solvency status of pension sponsors (Natali and Stamati 2013, 18).

Recasting first pillar schemes in the wake of the crisis

After a first round of measures to improve protection and buffer the social consequences of the crisis, reforms have involved a reduction in future replacement rates and benefit eligibility to bring future pension spending under control. As the European Commission and Economic Policy Committee (ECEPC 2012) put it, a comparison of spending projections proposed in 2009 and 2012 shows that average benefits should decline over the decades ahead and that such a negative trend

Table 1

Reforms of first pillar schemes in the wake of the crisis (selected European countries)

	Reforms consistent with major cutbacks	Reforms consistent with more balanced cut-backs and improvements (or just improvements)
Social insurance		
Continental and Southern Europe	Cyprus, Greece, Italy Portugal, Spain	Austria, Belgium, Germany, Luxembourg, Malta
Nordic countries		Finland, Sweden
Multi-pillar countries		
Countries with long-lasting pension funds	Ireland	Denmark, the Netherlands, UK
Central Eastern Europe		Bulgaria, Croatia, Estonia, Romania, Czech Republic

Source: OECD (2014); ESPN (2015).

has become more accentuated since the crisis. Across Europe, the effect of benefit reduction in the 2012 projections is slightly higher than it was in 2009 (-2.6 percentage points of GDP in 2009, -2.7 percentage points of GDP in 2012), which in many cases reflects reforms that have been introduced so as to make the public pension systems sustainable. In Greece, Luxembourg, Romania, Cyprus, Latvia, Poland, Denmark, the Netherlands, Malta, Portugal, Ireland, Slovakia, Slovenia and Germany the offsetting impact of the relative benefit reduction has increased compared to the 2009 projections (ECEPC 2012, 145).

Reforms typically involved a stricter link between contributions and entitlements, more years required for a full pension, higher statutory pension ages, restricted access to early retirement and various financial incentives to work longer (Ebbinghaus 2014). At first glance this is not a new trend: retrenchment has characterised reforms as of the 1980s. Yet the measures introduced since 2007 have shown some innovative traits. Firstly, cost-containment has consisted of short-term cutbacks, with limited (if any) phase-in periods. The last round of reforms has thus affected older cohorts of citizens and pensioners, as well as younger cohorts. Even pensions already being paid out have been subject to cutbacks. Secondly, some countries (such as Denmark, Ireland, Italy and Finland) have introduced automatic mechanisms to control future spending: for instance, by linking indexation and benefit calculation to life expectancy. Thirdly, and in line with the attempt to delay the exit from the labour market, measures have consisted of setting a higher pensionable age and establishing tighter access to early retirement schemes (Denmark, Finland, Greece, and the Netherlands) (Schwarz and Arias 2014). As stressed elsewhere, especially in cases where no ceiling is set for social insurance benefits, the increase in the retirement age may contribute to benefit adequacy while implicitly reducing incentives to contribute to private pension funds (Natali and Stamati 2013). Fourthly, at least in some countries, there is clear evidence that the relative position of the elderly has not deteriorated, since social protection for children and adults usually suffered more from the effects of the crisis (in countries like Bulgaria, Cyprus, Spain and the UK) (ESPN 2015).

While all European countries have approved reform packages featuring both cutbacks and some improvements in benefits, the balance between the two differ from country to country. In some member states, those most affected by the crisis and thus under fiscal pressure (Southern European countries, some Central and Eastern European countries, the Baltics and Ireland), reforms focused on short-term consolidation with evident reduction of benefits (Table 1, column 1). To give just a few examples, in Portugal, as a result of the measures passed in the period 2008–12, the ratio between the average old age pension and average wages has decreased by about 45 percent. In Greece cuts to total pensions in payment for private sector pensioners have ranged from 14.3 to 44.2 percent (in real terms) (ESPN 2015).

Other countries have experienced a more mixed set of reforms: with long-term reductions accompanied by some benefit improvements (Table 1 column 2). This is the case of those countries less affected by economic, financial and fiscal tensions, like Austria, Germany and the Netherlands. Others, like Belgium for example, experienced a mix of retrenchments and improvements in minimum pension benefits. There were also a few countries (such as Bulgaria and Croatia) where the national political climate proved to be at odds with the idea of cutting pensions as part of fiscal consolidation.

Recasting supplementary pension funds

Reforms in Europe have not consisted of a general rise in the role of pension funds (in terms of contribution rates and coverage). As far as the social insurance pensions systems are concerned, Southern and Continental European countries have not passed major reform measures on pre-funded schemes. Yet some of these countries have legislated a cut in tax subsidies for contributions to voluntary pension funds (including Austria, Belgium, Greece, Italy and Spain). At the same time, the coverage of voluntary pension funds has slightly increased (in Italy and Spain for instance), but at a much slower pace than in the past (Table 2, column 1). Greater stability has also characterised the Nordic countries, where public PAYG schemes coexist with widespread pension funds: this particularly applies to Finland and its weak voluntary private funds (OECD 2014) (Table 2, column 2).

In the so-called multi-pillar systems, pension funds have experienced financial stress; but reforms have aimed at improving their sustainability, rather than reducing their role (Table 2, column 2). Their coverage has remained stable or increased in countries like Denmark, the Netherlands, and the UK. The latter is the only country in which a major reform was passed. In 2008, the government adopted a reform of supplementary schemes and introduced 'auto-enrolment', whereby employers have to enrol their employees into an occupational pension scheme. This is expected to reverse the long-standing decrease in the coverage of occupational pensions in the UK. In the Netherlands, efforts to restore pension funds' solvency have consisted of benefit cuts, such as the suspension of indexation; increases in contributions, and the introduction of higher pensionable ages.

In Central and Eastern European countries where, since the late 1990s, national pension systems have embraced the 'privatisation' paradigm, some countries have followed a different path (Drahokoupil and Domonkos 2013). Many countries first decided to put contributions on hold, a move that was followed by a more radical intervention (Table 2 column 3). Hungary rolled back mandatory pension funds in 2010. In Poland, the contribution to mandatory pension funds decreased from 2014, from 7.3 to 2.92 percent of wages. Pension fund members had to choose to pay contributions to pre-funded schemes, or to pay their whole contribution into the PAYG system. Savings currently remain in the pension funds, but will be transferred to a pay-as-you-go system gradually. Individuals could choose to remain members of funded schemes on a voluntary basis. Several other

Table 2

Reforms of pre-funded schemes in the wake of the crisis (2007–14) (selected European countries)

	No major reforms and stable coverage of voluntary pre-funded pension schemes	Reforms consistent with the stability of widespread pension funds	Temporary reduction in the role of pension funds	Major reduction in the role of pension funds
Social insurance				
Continental and Southern Europe	Austria, Cyprus, Germany, Greece, France, Italy, Malta, Portugal, Spain			
Nordic countries		Finland, Sweden		
Multi-pillar countries				
Countries with long-lasting pension funds		Denmark, Ireland, the Netherlands, UK		
Central Eastern Europe			Bulgaria, Croatia, Estonia, Romania,	Latvia, Lithuania, Hungary, Poland, Slovakia

Source: OECD (2014), ESPN (2015).

countries, including Latvia, Lithuania and Slovakia (ESPN 2015) significantly reduced contributions.

Some other CEE countries, like Croatia, Estonia, Romania and Bulgaria, have reinforced the multi-pillar model introduced in the past. In these countries, pension funds have suffered some temporary cuts, but no roll back (Table 2, column 4). In Croatia, for some categories of insured persons, opting out from second pillar funds and moving only to the first pay-as-you-go pillar is a valuable option. In Estonia the temporary reduction of mandatory contributions to pre-funded pension schemes was stopped after the crisis eased. For these countries, there has been no evidence of a general reduction in contribution rates, while mandatory private funds have not been transformed into voluntary schemes (ESPN 2015).

Conclusion

Recent reforms across Europe have not confirmed the expected further and overall privatisation of pension systems. By contrast, the evidence above proves that austerity has hit both public PAYG schemes and private pre-funded schemes. Both have seen measures to contain costs (higher pensionable age, the introduction of automatic stabilisers of future spending, reduced indexation and higher taxes and/or contributions). While the retrenchment of social insurance schemes is not new, innovative measures have consisted of: cutbacks to pensions in payment; automatic mechanisms to contain future pension spending and depoliticise future intervention; systematic attempts to increase the pensionable age and to delay the exit from the labour market. As for private pre-funded schemes, cost-containment has consisted of reduced tax subsidies, increased contributions, more limited indexation and/or direct cuts to benefits, and as an extreme measure, the shift of pension funds' assets to the public budget.

All this has consisted of different public/private mixes. The latter have been shaped by pension systems inherited from the past. Those countries with well-established private pensions have passed measures to maintain the multi-pillar model of the past. In the case of UK there was a further attempt to increase the coverage of supplementary pensions through auto-enrolment. Countries with social insurance pension models in Continental and Southern Europe have opted for less favourable fiscal treatment of pension funds, and this has happened at the same time as the slow spread of private schemes. What is more, at least in the countries where social insurance benefits do not have any ceiling, the future increase in the pensionable age will probably improve public pension protection and thus reduce scope for pension funds. The troubled path of private funds is even more evident in Central Eastern Europe. Some countries have rolled back their mandatory pension funds introduced since the 1990s, while others have approved temporary reductions in mandatory contributions to private pension schemes. Yet few countries have confirmed, if not provided, more room for the private schemes.

Such evidence proves that the public/private mix of the future is still uncertain. We can expect further reforms due to persistent strains on the financial viability and social adequacy of pension systems. On the one hand, public schemes need further intervention to reinforce their viability in the context of a timid economic recovery. On the other, private pensions have not been dismantled, but their popularity has declined among policymakers, at least in some countries. What is certain is that future pension systems will be shaped by the policy legacy.

References

Drahokoupil, J. and S. Domonkos (2013), "Averting the Funding-Gap Crisis: East European Pension Reforms Since 2008", *Global Social Policy* 12(3), 283–99.

Ebbinghaus, B. (2015), "The Privatization and Marketization of Pensions in Europe: A Double Transformation Facing the Crisis", *European Policy Analysis* 1(1), 56–73.

European Commission and Economic Policy Committee (ECEPC) (2012), *The 2012 Ageing Report: Economic and Budgetary Projections for the 27 EU Member States (2010-2060), European Economy 2/2012,* Publications Office of the European Union, Luxembourg.

Holzmann, R. (2012), *Global Pension Systems and Their Reform. Worldwide Drivers, Trends and Challenges* , World Bank Discussion Paper no. 1213, Washington D.C..

Natali, D. and Stamati, F. (2013), "Reforming Pensions in Europe: A Comparative Country Analysis", *ETUI Working Paper* No. 2013.08, Brussels.

ESPN (European Social Policy Network) (2015), *Synthesis Report on the Impact of the Crisis on Pensions in Payment and Current Retirement Patterns*, unpublished manuscript.

OECD (2014), Pensions at a Glance 2013: OECD and G20 Indicators, OECD Publishing.

Orenstein, M. A. (2011), "Pension Privatization in Crisis: Death or Rebirth of a Global Policy Trend?", *International Social Security Review* 64(3), 65–80.

Pochet, P. and C. Degryse C. (2012), "The Programmatic dismantling of the European Social Model", *Intereconomics* 47 (4), 200–29.

Schwarz, A.M. and O. S. Arias(2014), *The Inverting Pyramid. Pensions Systems Facing Demographic Challenges in Eastern Europe and Central Asia*, World Bank Europe and Central Asia Reports, Washington D.C..