The Role of the European Union in National Pension Reform

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Many advanced industrialized countries are facing a crisis, as current pension policies become incapable of dealing with demographic changes. Across Europe and North America significant demographic shifts are occurring as life expectancy increases, population growth declines and the baby boomer generation leaves behind a legacy of a baby bust. As a result of these changes, individuals who have paid into public pension systems may reap only meager benefits. As forecasters predict the failure of current pension schemes policy-makers are struggling to find policy solutions to ameliorate the situation.

Past studies suggest that strong labor unions, domestic public protest[1] or a country's historical legacy has defined and shaped pension policy reform (Epsing-Andersen, 1990, 1985; Flora, 1986; Ross, 2000; Guillén, 1999, 1992; Schmitter and Lembruch, 1979). Today, however, the impetus for pension policy reform is no longer dependent solely upon domestic economic and political actors. Instead new global factors are not only shaping, but also perhaps driving the pension reform agenda. Specifically, changes in global finance and international effects upon domestic social and political structures have introduced a new dynamic to pension policy formulation. In the context of Western Europe, this has become increasingly apparent with the deepening integration of the European Union (EU). Thus, in light of global changes, how have international economic and political forces affected the impetus for pension policy reform? More specifically, has the unique situation of an integrated Europe affected such reform?

To answer these questions, myself, along with Dutch economist Pieter Omtzigt at the Università dell'Insubria in Varese, Italy, are examining the impact of international capital markets and the European Union's affect upon pension policy reform in three member states: the Netherlands, Italy and Spain. These countries have been chosen according to their demographic conditions and the type of pension policy they currently have. Italy and Spain already have the eldest populations in the EU and are forecasted to maintain that position (see appendix). The Netherlands on the other hand faces a less steep increase in the elderly dependency ratio (Eurostat, 2000). Pensioners in Italy and Spain rely almost entirely upon a state-run public system that provides generous benefits, whereas the Netherlands has both a public state-run and private pension system. As a result, the Netherlands has the highest reserves of pension funds, relative to GDP, within the EU (Eurostat, 2000).

The strength of this study is that it is truly interdisciplinary. We are incorporating both economic and political science approaches to examine the ongoing effort within West European countries to find a solution to the bleak future of pension payouts. Specifically, we are addressing the differences in demographic changes in Europe, variations of current pension schemes and their ramifications. Moreover, we examine the political and economic impact of the EU as well as the effect of the "new" global economy.

Using these cases we will specifically address two related research questions:

1) To what extent does the global economy affect pension reform? In particular, do moneys invested in private pension funds affect international capital flows and in turn influence other countries to adopt or refrain from adopting private pension systems?
2) To what extent does the European Union influence member state pension policy agenda setting?

The Global Economy and Pension Reform: The Impact of Capital Flows

According to Epsing-Andersen's (1990) seminal work one of the fundamental elements to identifying and classifying welfare states, of which pension policy is a central component, is dependent upon what role the government delegates to the public and private realms. Under this theoretical distinction Epsing-Andersen distinguishes between two types of pension schemes: public and private. Public systems basically refer to the pay-as-you-go (PAYG) system, whereby present taxation and social security contributors finance current pension payouts. On the other hand, private systems, otherwise called capitalized systems, include either occupational pension plans or individual annuities. Basically, workers or their employers put aside a sum of money in a designated pension fund, which is used to purchase stocks and bonds.[2]

At the current rate of demographic change, many industrialized countries with a strictly PAYG system will find themselves in a difficult position as the number paying into the system is much less than the number of pensioners. On the other hand, those countries that have adopted a "mixed system," which include both a PAYG and capitalized system, may find themselves in a better position as the higher return on private funds may compensate for demographic shifts. Associated with private pension schemes is also the impact such invested funds will have upon economic growth along with foreign and domestic investment.

Private pension schemes, particularly among countries in the European Union, have led to foreign investment. Although private pensions have sparked such foreign investment economists have not specifically addressed how such private pension schemes will affect capital flows and the economic well-being of those countries that do or do not adopt a capitalized system. The uniqueness of this project is that it takes into account these capital flows and examines our theoretical assumption that if a country utilizes a capitalized system this will lead to increased investment in domestic and international markets (Omtzigt, forthcoming). As a result, savings may flow away from the country adopting a capitalized scheme and flow into other markets. Such flows may lead to increasing stock prices and higher wages due to greater capital intensity, both in the reforming countries and other countries (Feldstein, 1999). In countries that do not adopt a capitalized system, reforms elsewhere may lead to more foreign ownership of key economic assets and an increased trade deficit. If this economic theory is correct, then it is imperative for countries to coordinate their pension reforms.

To understand better the impact of international capital flows it is imperative, in the context of EU member states, to examine how the European Monetary Union (EMU) and its creation of a single currency, has affected the investment behavior of pension funds in the EMU area.[3] Specifically, we are looking at how pension funds in Europe have changed their portfolio following the introduction of the Euro. For example, in the case of the Netherlands, membership in the Euro influenced the Dutch pension funds to shift their asset holdings by greatly increasing the proportion of foreign stocks and bonds.

Until now, national governments have been able to constrain their pension funds to keep their assets within national boundaries. For instance, both Germany and Italy have strict legislation to limit the maximum foreign asset holdings. European integration, however, has lead to free capital mobility in all sectors and the European Commission[4] intends to extend that capital mobility within a few years to pension funds as well. Furthermore, the introduction of the Euro has led to the disappearance of exchange rate risk. Thus, we are examining how pension funds in countries that can choose their investments freely have reacted to the introduction of the Euro.

Pension Reform in an Integrated Europe

Spain, Italy, Greece and Portugal have adopted similar pension schemes based predominantly upon a PAYG system. These countries have found themselves in a precarious situation as their population growth has stagnated even greater than their northern European counterparts (see appendix). Thus, it is even more pressing for these southern European countries to adopt pension reforms to compensate for the generational population imbalance. In addition, since these countries are members of the European Monetary Union their foreseen problems with pension distribution may adversely affect the economies of other member states. The disparities among the forecasted success of pension schemes across Europe has led to serious concern regarding "social dumping" and the need to coordinate social policy.

According to Liebfried and Pierson (1996) social policy in the European Union is shared among different levels of government (national, sub-national/regional and supranational), thus creating a "multi-tiered" political system. The EU, including its policies and institutional structure in Brussels, has fundamentally affected the responsibility and competency over policy sectors that national and sub-national governments once enjoyed. Most significant is the EU's role in monetary and regulatory policy, which were traditionally the responsibility of national governments. Social policy, however, is claimed to have remained mostly in the hands of national governments "but their influence *has been* increasingly circumscribed and embedded in a dense, complex institutional environment" (Liebfried and Pierson, 1996: 4).

However, such claims to the predominance of the central government in dealing with particularly contested issues of social policy, such as pension reform, were made prior to the creation of the European Monetary Union and the Euro. On a political level, it seems that as national governments become more involved with one another within an institutional structure, as embodied in Brussels, there is more opportunity for the transference of pension reform policy options and ideas across borders. In addition, as European countries find their economies closely linked to their neighbors', pressures may arise from foreign governments or the EU itself to convince other countries to adopt more sound policy initiatives. For instance, in a recent European Commission communication the Commission has acknowledged that pensions are a matter for member states to legislate, but the Commission suggests member states should adopt a mixed pension system (European Commission, 2000).

The EU presents a unique political arena that can significantly alter the policy options available to reform pension schemes. First, the EU itself is a forum for discussion and debate. In this way, countries interact on a regular basis and share ideas. Thus, different policy ideas can be introduced to pertinent political agents that may otherwise have not emerged within domestic dialogues regarding pension reform. For instance, geographer Gordon Clark (2001) suggests that the Anglo-American pension policy model is becoming more in vogue throughout Europe, which may lead to countries accommodating their own policies to be similar to that of the United States and Great Britain. Such accommodation is similar to the global adoption of neo-liberal economic policies.

Second, the interdependence of the economies of members of the EU and particularly the 12 members of the monetary union presents an unusual situation, whereby member states are increasingly concerned with the economic well-being of their partners for their own self-interest. Thus, member states may become more vocal regarding the domestic policies of other members. In the past, it was unheard of for foreign governments to critique the type of pension policy chosen within a country.[5] With deeper European integration we are beginning to see countries that have relatively more successful pension policies pressuring the countries of weaker policies to reform. For instance there have been some rumblings from Dutch officials demanding the Italians to reform their PAYG pension system.

Third, the EU itself has become an agenda setter for national policy makers. Although the EU in certain sectors cannot usurp the powers of the national or regional governments it can present certain parameters that promote the adoption of certain policy options above others. In this way, the EU can constrain the policy-making autonomy of national governments (Ferrera, 2000). European Monetary Union and other policy initiatives have placed the Commission in a unique position to have significant influence upon member states' pension policy choices. In particular, convergence criteria for EMU, established in the Maastricht treaty, places significant restrictions on member states' spending. Thus, members of EMU cannot adopt policies that induce spending of greater than a 3 percent deficit.

Fourth, the EU provides a useful buffer for political leaders. Within a strictly domestic arena, as mentioned earlier, political pressures regarding pension reform can come from labor groups and capital groups. It is clear that pension reform is a highly contested policy area and there are many strong domestic actors that can block change since it could be politically unfeasible. On the other hand, the EU provides a "scapegoat" mechanism that allows public officials to adopt unpopular policy options that are EU suggested or imposed. In response to public outrage, public officials can point the proverbial finger at Brussels and as a result avoid political heat. Such practice was seen in Italy and Spain while they implemented austerity measures to meet the convergence criteria of monetary union membership.

Conclusion

Pension reform is of grave concern for many countries and in a Western European context, especially in Italy and Spain. It seems, however, that pension reform must be understood under the lens of increased European integration and greater globalization. As the Bush administration moves forward in proposing pension reform, and particularly the privatization of pensions, these reforms may have global effects as pension funds are invested internationally. An examination of Italy, Spain and the Netherlands can provide further insight to guide other advanced industrialized countries in understanding the possible global implications of pension reform.

Endnotes

1. For example, in France during Alain Juppé's term and in Italy under Silvio Berlusconi the public protest regarding pension reform were massive and significantly contributed to the fall of these governments.
2. An example of a capitalized system most Americans are familiar with is a 401K plan.
3. The European Monetary Union includes the 12 member states that have adopted the Euro as their currency and have allocated monetary policy decisions to the European Central Bank in Frankfurt.
4. The European Commission is the executive branch of the EU and is a major institution involved in EU policy Implementation.
5. We can see this change in the concern for the member's domestic policies regarding border control and immigration policy. With the free movement of people throughout Europe, European governments have been outspoken regarding the practices of border control and immigration policy of their member countries.

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Appendix

Population Aging
(persons aged above 65 relative to persons aged 20 to 65; in percent)

Europe	2000	2050	Increase
Spain	27	66	39
Italy	29	67	38
Germany	26	53	27
France	27	51	24
Belgium	28	50	22
United Kingdom	26	46	20
Netherlands	22	40	18
Denmark	24	42	18
Sweden	30	46	16
Other OECD			
Japan	27	64	37
Canada	21	44	23
Australia	20	40	20
United States	21	39	18

Sources: CBS (1999) for the Netherlands, Eurostat (2000) for other European countries, and UN (1998) for other OECD countries.

Table from: Kreers, Jereon. "Pension Reform: Issues in the Netherlands." Paper for the NBER Volume on "Coping With the Pension Crisis -- Where Does Europe Stand?" November 10, 2000.

Carolyn Dudek asserts that demographic changes have necessitated pension reform in many advanced industrialized countries. She also realizes that, unlike the past, political and economic global factors inevitably will shape pension reform agendas within Western European countries as a result of the deeper European integration.

Professor Dudek earned a B.A. in political science and international relations from Canisius College, and an M.A. and Ph.D. in political science from the University of Pittsburgh. She is the recipient of numerous prestigious awards and fellowships, including a Fulbright Fellowship to Spain, a Mellon Graduate Fellowship, a European Community Studies Scholarship, and a Jean Monnet Fellowship at the European University Institute in Florence, Italy.

Prior to joining the Hofstra faculty in fall 2000, Professor Dudek was a researcher at the Robert Schuman Centre's European Forum at the European University Institute in Florence, Italy, where she examined the impact of the European Union upon regional nationalist political parties in Europe. Professor Dudek's research interests include decentralization and regionalism within Europe, regional economic development, domestic effects of the European Union, European Union regulatory policy, and international cooperation of pension reform. As a specialist in Spanish politics, Professor Dudek has conducted field research in Spain concerning recent significant changes in pension legislation.

As an educator, Professor Dudek's teaching interest is focused on comparative politics, including politics of the European Union, Western European politics, regime transition, regionalism in Western Europe, regional economic development, and Spanish politics. In addition, Professor Dudek has participated in various forums relating to European issues, including a Fulbright European Union/NATO seminar in Brussels and Luxembourg. She also organized and participated in a roundtable discussion, "New Spain in the New Europe," at the University of Pittsburgh's European Union Center.

As highlighted in her article, Professor Dudek seeks to examine the global implications of pension reform in European Union Member States and hopes to provide further insight to other industrialized countries facing similar issues. - SK