Predrag Bejaković
Institute of Public Finance
10000 Zagreb, Croatia
predrag.bejakovic@iif.hr

BOOK REVIEW "THE FUTURE OF PENSION PLANS IN THE EU INTERNAL MARKET"

Editors: da Costa Cabral, N. & Cunha Rodrigues, N.

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Pension systems in many countries face serious problems regarding financial sustainability of the pension insurance scheme and adequate protection of old-age citizens. A new book edited by Costa Cabral and Cunha Rodrigues titled *The Future of Pension Plans in the EU Internal Market* gives a new view on the possible solutions how to ameliorate an unfavourable situation. The book is divided into the following three main parts: Section 1 - Pay-as-you-go versus funded pension plans: Which way to better address common challenges in the EU?, Section 2 - The Capital Markets Union (CMU) and the future of pension plans: opportunities, risks and drawbacks, and Section 3 - Pension plans and the European pillar of social rights: a new scope for EU social policy?. The publication consists of 18 chapters, the authors are mostly university professors from the fields of economics and law, and one of the co-authors is a Nobel Prize winner Robert C. Merton.

In the introduction, the editors explain the aim of the publication and contributions by particular authors. Pension systems around the world should simultaneously go for the development of the inner capital market and the search for new social policy. This is particularly important having in mind the soft nature of social policy in the EU that can provide needed flexibility in response to different trends and the national influences by the EU Member States on the pension insurance schemes.

The first section consists of 5 chapters and begins with the contribution of Miguel Coelho dedicated to the characterization and comparability of old-age pension systems. On p. 32, the author presents an easily comprehensible table with the advantages and disadvantages of various pension models, i.e. (a) funded (capitalised) against unfunded systems (pay-as-you-go - PAYGO), (b) actuarial versus non-actuarial systems, and (c) defined benefit (DB) versus defined contribution (DC) systems, with the aim of better resolving complex challenges in the EU in this regard. He believes that a capitalised (funded) system, with defined contributions and actuarial fairness, has advantages over a public PAYGO system because it enables improved protection from demographic changes, has limited financial liabilities, allows the development and establishment of the capital market and better prevents politicization of the pension system.

Hervé Boulhol and Marius Lüske analyse in their contribution what is new in the discussion about the PAYGO system (how much and where a transfer is from current employees to today's pensioners) versus funded pensions (where current workers save

part of their contributions which are invested in the financial market and then used to finance pensions when people retire). The authors explicate the actuarial similarity between PAYGO and capitalised systems, stressing that the relative benefits and costs of a shift from the former to the latter mostly depend on whether the observed economy is sufficiently dynamically efficient. Boulhol and Lüske underline that this shift creates winners and losers and therefore causes some new arrangement of redistribution. Although under certain circumstances the rate of return on capitalised pensions may be higher than that of PAYGO systems and potentially enable an increase in pensions, the authors believe that funded systems should be implemented only if the change can be sufficiently sustained in the long run.

Yves Stevens analyses the role of government regulation in providing access to funded or unfunded pension systems. He evaluates the models of funded and PAYGO systems not only from the standpoint of risk sharing, but also from the historical and ideological basis of different notions of pension models and their causal meaning and significance. The government is obliged to limit various risks. *This spreading of risks is naturally linked with how a given country sees the different pension forms and the concepts it has historically envisaged and embedded in its national welfare state or social policies* (p. 59). National pension identity schemes reflect an identity that has been moulded historically and ideologically. This is also the reason why pension reforms are more successful when they are parametric instead of fundamental and/or structural changes of the entire pension approach.

Maria Teresa Garcia examines trends in both occupational and personal pension insurance, stressing an important move from defined benefit (DB) to defined contribution (DC) plans. Garcia recognises the main causes of this modification. The shift is a phenomenon spread throughout most of the developed countries, and therefore retirement and financial risks are increasingly being shifted to individuals. The reasons for the aforementioned change can be divided into two categories: changes in the economy (primarily changes in the traits of workers and employers, as well as macroeconomic changes), and regulatory changes that include changes in laws and changes in accounting requirements.

Due to ageing populations, many OECD countries have a seriously negative demographic trend. Falilou Fall draws attention to the central question of sustainability and adequacy of various pension systems across the OECD members. Intending to improve sustainability, many countries have introduced different policy measures into their pension systems. Most countries increased the legal retirement age, introduced automatic adjustment of key parameters, primarily changes in life expectancy, and/or increased the contribution rate. On average, 12% of the population aged 65 years or over in OECD countries live in poverty, so the adequacy of pensions is already a serious problem. Pension adequacy can be enhanced by better indexation and adjustment of revaluation rules of pensions. However, there is always a need to balance sustainability and adequacy because too high indexation and revaluation rates increase pension spending, while too low indexation of pensions will cause dangerous adequacy problems.

An analysis of the capital markets union and its role in saving for retirement is the introduction chapter in the second part of the book. The authors Ansgar Belke and Philipp Allroggen explain that the capital markets union (CMU) has two main goals: to improve investment prospects across Europe and to improve financing possibilities for businesses. The CMU aims for a more stable and robust financial sector through deeper integration creating a single market for capital by eliminating barriers to cross-border investments and improving access to financing for all businesses around the EU. In this process, special focus is directed towards SMEs and start-ups as well as to the promotion of retail and institutional investments. The authors remind that although the responsibility for retirement has been shifted towards the individual, *policymakers should at least provide better access, stability, capability and information to savers and investors* (p. 113). Europeans save for retirement but only a few of them invest in stocks or bonds, so the CMU could motivate them to invest in the financial market, particularly out of their home country. That can promote more investments and enable stronger economic growth as well as contribute to bigger pensions.

Gabriel Bernardino analyses the growing financial gap between what people deem they will obtain as retirement income and what they will actually receive. The author writes about the role of improved regulation and the importance of supervisory authorities in regaining trust in pension plans and products. Bernardino uses valuable and nice exam-

ples from Behavioural Economics - procrastination or inertia, loss aversion, and a rule of thumb - that help to understand how human behaviour may affect a financial decision and could influence choices regarding private retirement saving. Private pension products and schemes have to be cost-efficient, which can be obtained by achieving economies of scale and providing adequate smart default solutions, where a group of quality standardised features is accompanied by flexible components and innovation in service provision.

In their text under the title *Welfare gains from a capital market union with capital-funded pensions*, Thomas Davoine and Susanne Forstner scrutinise the long-term effects on the pension system of separate and integrated capital markets. The latter, obtained through a capital market union, is more beneficial if other countries in the market union have PAYGO systems. Households in a country that accepted a capitalised pension system would enjoy long-term benefits ranging between 0.3% and 0.5% of lifetime consumption if the country is in a capital market union, compared to separated capital markets. The main cause is that a capital-funded pension system increases national savings since contributions are saved for future consumption, instead of being immediately consumed by pensioners in a country with a PAYGO system. If capital markets are integrated, households can invest part of their savings in other countries that have PAYGO pension systems and benefit from a relatively higher interest rate that is present there.

Due to a rapidly ageing population, Portugal is exposed to serious problems of the pension system, while the pension benefits are low. Such conditions require the introduction of a supplement to social security with private savings. Portugal is also characterised by a low level of financial literacy. Thus, transferring the responsibility of retirement insurance to the general population could cause many future pensioners to retire poor. As a measure for improving the situation, Merton, Muralidhar and Pinto Ferreira propose introducing a new innovative type of a sovereign contingent debt instrument, i.e. Standard-of-Living indexed, Forward starting Income-only Securities – SeLFIES. Such instrument can simplify retirement planning, ensure retirement security, and also improve the government possibilities for debt financing and infrastructure construction funding. Unlike Treasury Inflation-Protected Securities that are focused mostly on inflation, SeLFIES would also include the living standard risk improvements. This model would be optimal for those who judge *their economic well-being on the basis of their standard of living relative to those around them* (p. 170).

One of the main hindrances to the free movement of people and workers in the EU is that pension rights are not portable across the EU borders. Therefore, Nuno Cunha Rodrigues studies the role of the pan-European pension product (PEPP) and the capital markets union (CMU) as measures to overcome this obstacle. The most important aim of the PEPP is to boost cross-border mobility by providing a simpler pension product for people who have worked or intend to work in various EU Member States. Several measures have already been taken towards stronger coordination of national economic and monetary policies aimed at mitigating the impact of factors that hinder mobility. Attention has been directed towards structural reforms that can improve the functioning of the internal market, particularly regarding the freedom of capital movement. The PEPP has already been approved, while there is also a need to make legislative proposals for an EU framework on covered bonds and securities to increase legal certainty on securities ownership in the cross-border context.

Although the PEPP should help to enhance the functioning of the internal market, improve labour mobility within the EU, strengthen trust in the EU institutions among EU citizens and ensure liquidity of long-term investments, Karel Lannoo is not fully convinced of its final success. The reason is that the blurred, unappealing and inappropriate text agreed between the European Parliament (EP) and the EU Council would not be useful in practice. Due to heavy pressure from the Member States and certain organisations, the text was fragmented, watered down or replaced, so the final version of the PEPP was disappointing. The final form of the text has become applicable only to individual voluntary pension savings in the third pillar, not for any type of professional (occupational) pension insurance. While the PEPP was originally designed as an insurance or savings product, it has become only an insurance product and therefore it has lost its initial intent in significant part. The author concludes that the PEPP *as adopted leaves the impression that it is impossible to construct a truly EU-wide long-term savings product* (p. 196).

Publicized as an instrument to boost the portability of pension rights, the PEPP did not solve the problems related to the deepening financialisation within the EU and adverse consequences for pension regimes linked thereto. In his contribution, José Castro Caldas explains the most important aspects of financialised capitalism: (i) an increasing activity of non-financial enterprises in financial processes, (ii) the shift of bank activities from borrowing and lending to transactions and profit in open financial markets, and (iii) increased reliance of citizens on the formal financial system to improve access to vital goods and services. In 2014, the European Commission wanted to establish a Capital Markets Union (CMU) to improve economic growth and enhance the Eurozone's resilience. However, due to various factors (primarily because of a complex, non-transparent and non-standardised decision-making process), the aforementioned measures did not achieve the desired results and the EU is still actively searching for an optimal model for reviving the role of financial markets in the EU, the development of the CMU and the implementation of the PEPP as its important instrument.

Five contributions presented in the last section of the book are dedicated to a new opportunity for EU social policy. Nazaré da Costa Cabral underlines that optimal development of pension systems should choose between respecting social rights more or becoming more oriented towards financial markets. There is increasing tension between social rights and financial markets that may eventually lead to the prevalence of one over the other. There are two hypothetical alternatives for the future proposal of pension systems, i.e. the individual insurance model and the universal tax-financed model. Although caused by common factors, primarily an ageing society and widespread and fast technological changes, the responses and incentives are substantially or philosophically different. Both PAYGO and capitalised systems face multiple risks, which is almost impossible to predict. These are primarily economic, demographic and political risks, but also various additional risks, like management risks (related to incompetence or fraud and/or imperfectly informed consumers in funded systems), investment risk, longevity risk and annuity market risk. The situation is particularly dire having in mind the new forms of work, like insecure or temporary jobs, which would seriously reduce tax and contribution revenues and cause additional problems for pension system funding. Therefore, the author reminds of the demanding challenge *to find new sources of justification and legitimacy for the role of the markets in pension provision* (p. 243).

The idea of the European social model has been quite often publicly discussed, but with several political meanings. The constantly changing European social policy is a theme of interest for Pedro Adão e Silva and Patrícia Cadeiras. The authors offer an interesting historical overview of social policy in the EU, from the original treaties to the present circumstances. After more than a half-century after integration, the main parts of social policies are still under the control of nation-states. Such national policies are characterised by a variety of institutional organisations and different political principles. Therefore, it should not come as a surprise that European social policy has had the 'Cinderella' status for a longer period, where good purposes and great principles were followed with little action. However, the soft nature of such policy may prove to be a major asset to ensure the required flexibility in response to the differentiated national impacts of the most important trends in European societies, from demography changes to the new form and future of work.

Spasova, Louvaris Fasois and Vanhercke discuss the main trends of pension reforms in the EU Member States (MS) in the period 2014-2019, dealing with the question of pension adequacy. As adequacy and sustainability in pension systems are closely intertwined, the authors analyse reforms related to prolonging working life, measures for the protection of pension adequacy, and actions for preserving retirement income. Even though pension insurance systems mostly remain within national competence, one should not neglect the impact of various proposals by the World Bank and the International Monetary Fund. In the last 20 years, the EU has also become an important factor that contributes to pension policy mostly through the Open Method of Coordination and the European Semester. Pension policies in the EU Member States have passed through great socio-economic transformations in an attempt to improve pension benefit adequacy and protect financial sustainability of pension expenditures to achieve fiscal stabilisation of national budgets.

Josef Wöss and Erik Türk contest a conservative view on the sustainability of pension systems, believing that the best solution for pension adequacy

and financial sustainability is an increase in employment rates. They remind how the old-age dependency ratio, i.e. the number of older persons to the number of the working-age population, is quite often misrepresented as the ratio of the number of workers to the number of pensioners. As a positive example, Wöss and Türk present the 'dependency ratio calculator' developed by the Austrian Chamber of Labour. The instrument uses graphs of the age structure and economic status of the population to calculate demographic and economic dependency ratios. Successful integration into the labour market of all working-age persons would significantly improve the future economic dependency ratios and therefore improve pension adequacy and financial sustainability. Mobilising the full employment potential in all age groups and enhanced labour market integration of vulnerable groups such as women, the immigrant population and the elderly could contribute to the achievement of adequate pensions and lessen the problem of financial sustainability of a pension system.

Ivana Vukorepa, Yves Joren and Grega Strban clarify how ageing societies and society fluidity can impact pension schemes and coordination rules at the EU level in terms of both pillars of pension insurance. Fluidity in this context means new patterns of (organising) work and mobility, or in other words, non-standard or unstable forms of employment (like temporary agency work, fixed-term contracts, part-time work, telework, traineeships and student work), which are often not adequately covered by pension insurance. The authors direct their attention to the following three mutually related aspects: (a) changes required in pension insurance schemes because of new working arrangements, (b) the relevance of EU legislation regarding free movement and social security coordination in relation to public and occupational pension insurance, and (c) the importance of persistent and efficient measures for combating fraud and error.

It is almost impossible to sum up all the praiseworthy messages from this excellent book. Briefly, there are no perfect pension systems and the reform process should consider the context in which the respective reforms are being realised. Depending on the setting, accepting a particular approach may have different outcomes. The economic crisis that started in 2007 had a strong impact on the process of reforming pension systems in Europe leading to a reduction in social protection levels of public systems. The goal of adopted measures and numerous reforms was to lower public expenditure. To address such complex and demanding challenges, a number of policy ideas have been developed and various proposals prepared. First and foremost, there is an obvious need to design transparent, well-governed and cost-efficient pension products and schemes. To obtain consumer trust and allow consumers to make informed decisions there is a need for transparency in relation to characteristics, cost and charges as well as sustainability of the private pension solution and its provider. The EU had an influential role in this field, insisting on the promotion of complementary private retirement savings to ensure satisfactory income for the elderly population.

To optimise future retirement benefits, the authors in the book emphasise that pension assets and risks should be diversified. A good mix of public and private pension models would allow better diversification of these risks between various pension fund investment risks and macroeconomic risks to national pension schemes. The way in which defined contribution pension plans are organised puts a high level of responsibility on individuals to manage their retirement savings. This includes various decisions such as how much to save annually, which investments to choose, when they should retire, how long they are likely to live, and how to withdraw their savings when they decide to retire. Public measures to improve financial literacy and information campaigns on various specifics of pension insurance can be significantly helpful and of great value.

Various pension reforms, reduced early retirement possibilities and tighter eligibility criteria for other social transfer programmes operating as existing early retirement schemes have had an impact on retirement decisions. When improving the sustainability of the pension system, one of the successful measures has been an increase in the effective retirement age. Finally, an important challenge to current pension systems is the inclusion of non-standard forms of employment and self-employment in contribution-related pension schemes.