Opinion of the Economic and Social Committee on 'Economic Growth, Taxation and Sustainability of Pension Rights in the EU'

(2002/C 48/22)

At its plenary session on 29 March 2001 the Economic and Social Committee decided, under Rule 23(3) of its Rules of Procedure, to draw up an opinion on 'Economic Growth, Taxation and Sustainability of Pension Rights in the EU'.

In accordance with Rules 11(4) and 19(1) of its Rules of Procedure the Committee set up a sub-committee to prepare its work on this subject.

The subcommittee 'Economic Growth, Taxation and Sustainability of Pension Rights in the EU', which was responsible for the preparatory work, adopted its opinion on 19 October 2001. The rapporteur was Mr Byrne and the co-rapporteur was Mr Van Dijk.

At its 386th plenary session (meeting of 29 November 2001) the Economic and Social Committee adopted the following opinion by 90 votes to two with 2 abstentions.

1. Introduction

1.1. The provision of adequate pensions to retired people is a key element in the overall structure of European social protection whereby pensioners enjoy a degree of income security.

1.2. In recent years studies undertaken by the Commission and others have drawn attention to the changing demographic structures in the EU and the potential risk this may pose to the financial sustainability of pension systems. The Commission for example has stated that 'The combination of the three pillars making up pension systems offer an unprecedented degree of prosperity and economic independence to older people in Europe. The prospect of population ageing and the retirement of the "baby boomer" generation represents a major challenge to this historic achievement. Population ageing will be on such a scale that, in the absence of appropriate reforms, it risks undermining the European social model as well as economic growth and stability in the European Union (1)'.

1.3. In addition to the demographic issues attention must also be given to the need to adapt pension systems to changing needs of society and individuals.

1.4. The ESC regards the general sustainability of pensions as a crucial issue and has therefore undertaken this own-initiative opinion to examine this issue and the importance of economic growth and taxation to achieving a solution.

1.5. The Committee recognises the large amount of work done by the Commission in recent years to focus attention on this critical issue. The latest Communication from the Commission 'Supporting national strategies for safe and sustainable pensions through an integrated approach' (2) builds on the work of the Economic Policy Committee and the Social Protection Committee.

1.5.1. The Communication proposes the open co-ordination method should be used which, without departing from the subsidiarity principle, will establish common objectives and commonly agreed indicators for the Member States. The objectives are grouped under three broad headings:

— adequacy of pensions;

— financial sustainability of public and private pension schemes; and

— modernisation of pension schemes in response to changing needs of society and individuals.

1.5.2. Although this opinion was initiated before the Commission's Communication (3) was published the Committee believes that this opinion addresses the pension issues raised in the Communication in sufficient detail to enable the Committee to endorse its objectives subject to the comments

(1) COM(2000) 622 final.

(2) COM(2001) 362 final.

(3) SOC/085 — Supporting national strategies for safe and sustainable pensions through an integrated approach — COM(2001) 362 final.

contained in the Committee's opinion referred to in the next paragraph.

1.5.3. The Committee is drawing up an opinion on the Communication which will focus on certain aspects of consistency between the policies involved and the methods for developing cooperation in this area. Consequently the two opinions are complementary and together make up the Committee's contribution to the ongoing debate.

2. The demographic issue

2.1. The demographic studies point to a clear conclusion that the number of older people will rise sharply in relation to the number of people of working age. In its Communication dated 3 July 2001 the Commission states 'The old age dependency ratio will start to rise rapidly in the next decade and double by the year 2050 compared to today' [1] (see Table 1).

[1] COM(2001) 362 final.

Table 1: Baseline projections of old age dependency ratios in EU Member States (65+ over people aged 20-64 years)

%	2000	2010	2020	2030	2040	2050
B	29,5	31,1	38,0	48,8	53,5	52,0
DK	25,5	29,6	35,7	42,0	47,0	43,7
D	28,0	34,1	38,6	50,3	57,0	56,1
GR	30,2	33,6	38,0	44,4	54,7	61,6
E	28,7	30,7	35,2	44,7	59,8	68,7
F	28,5	29,5	38,1	46,4	52,1	53,2
IRL	20,3	20,5	26,2	32,1	38,4	46,6
I	30,7	35,5	42,1	52,9	67,8	69,7
L	24,8	27,6	33,0	42,5	47,2	43,5
NL	23,1	26,2	34,7	44,2	50,1	46,9
A	26,3	30,1	34,5	47,0	57,0	57,7
P	26,7	28,5	32,2	37,2	46,3	50,9
FIN	25,9	29,7	41,4	49,5	49,7	50,6
S	30,9	33,8	39,8	45,4	48,9	48,5
UK	27,8	28,5	33,9	43,1	49,1	48,5
EU–15	28,3	31,4	37,3	46,8	55,0	55,9

2.2. This arises firstly from the improved health and living conditions which EU citizens enjoy which is leading to an increase in average life expectancy. Indeed the Commission points out that all previous forecasts have tended to underestimate the rise in average life expectancy so that current forecasts are more likely to be exceeded than under-achieved.

2.3. Secondly there has been a significant fall in the fertility rate, which in some Member States is now below the replacement rate.

2.4. In the debate about the affordability of pensions, various people and bodies are pointing out that immigration could have a positive effect. Others dispute this: the Commission, for example, considers that even though immigration is likely to increase, the dependency ratio will not improve.

In this context, the ESC refers to its previous opinion on immigration policy. If the aim is to adopt a pro-active immigration policy, it is necessary to develop an effective policy of social integration, so that the EU and immigrants benefit fully from the situation.

2.5. The overall position therefore is that the old age dependency ratio will rise significantly over the next 30 to 40 years. This will have implications for the financing of pension systems.

2.6. The Commission has given some figures to indicate the potential scale of the problem. Without reforms the level of expenditure on state pension schemes could exceed 15 % of GDP in 2030 a rate that could not sustained within the current goal of sustainable public finances (see Table 2). Currently pension expenditure averages 12 % of GDP in the EU. It should be noted however that these average figures disguise considerable variation between Member States. The Committee regards as of particular significance the rate at which the percentage may peak in the early years in individual Member States.

Table 2: Projections of public pension expenditure — Current policy assumptions (1)

(as a percentage of GDP, before tax)

	2000	2005	2010	2020	2030	2040	2050	Maximum growth
Belgium	9,3	8,7	9,0	10,4	12,5	13,0	12,6	3,7
Denmark (2)	10,2	11,3	12,7	14,0	14,7	13,9	13,2	4,5
Germany (3)	10,3	9,8	9,5	10,6	13,2	14,4	14,6	4,3
Greece (4)	12,6	12,4	12,6	15,4	19,6	23,8	24,8	12,2
Spain	9,4	9,2	9,3	10,2	12,9	16,3	17,7	8,3
France	12,1	12,2	13,1	15,0	16,0	15,8	N.A.	3,9
Ireland	4,6	4,5	5,0	6,7	7,6	8,3	9,0	4,4
Italy	14,2	14,1	14,3	14,9	15,9	15,7	13,9	1,7
Luxembourg (5)	7,4	7,4	7,5	8,2	9,2	9,5	9,3	2,1
Netherlands (6)	7,9	8,3	9,1	11,1	13,1	14,1	13,6	6,2
Austria	14,5	14,4	14,8	15,7	17,6	17,0	15,1	3,1
Portugal	9,8	10,8	12,0	14,4	16,0	15,8	14,2	6,2
Finland (3)	11,3	10,9	11,6	14,0	15,7	16,0	16,0	4,7
Sweden	9,0	8,8	9,2	10,2	10,7	10,7	10,0	1,7
UK (7)	5,1	4,9	4,7	4,4	4,7	4,4	3,9	0,0

Source: EPC.

(1) With the exception however of Spain, which used a higher decline in its unemployment rate (4 % in the long-term), and Portugal and Denmark which used changes in productivity of 3 % and 1,5 % respectively.

(2) For Denmark, net of the supplementary semi-funded scheme (ATP), the increase from 2000 to the peak year is only 3,1 % of GDP.

(3) Figures refer to the statutory pension scheme excluding the civil servants' scheme 'Beamtenversorgung'.

(4) Provisional data.

(5) Figures refer to the public pension scheme for the private sector and do not include the public pension schemes for civil servants and assimilated employees.

(6) For the Netherlands the second tier is quite well developed. Such characteristics have a direct positive effect on the public pension scheme by reducing the burden of ageing populations on first pillar pensions. However, there is also an important indirect implication: taxes on future pension benefits (which are drawn from private funds) are expected to be quite high and may partially counterbalance the rise in public pension benefits.

(7) The figures for the UK do not reflect the substantial increase in pensions announced recently. This change will increase the share of GDP devoted to public pension expenditure. Social assistance for pensioners has also been substantially increased and will be modified to reward private provision. The UK also has well-developed second and third pillar schemes. Taxes on future pension benefits drawn from private funds will partially counterbalance the rise in public pension expenditure.

2.7. The Committee believes that these forecasts, which arise from the growing imbalance between contributors and beneficiaries, must be addressed to ensure the sustainability of pension systems both for PAYG and funded schemes.

2.8. In fact the Social Protection Committee has expressed the view that issue of sustainable pensions requires meeting a triple challenge:

— to safeguard the capacity of pension systems to meet their social aims of providing safe and adequate incomes to retired persons and their dependants and, ensuring in combination with health and long term care systems, decent living conditions for all elderly persons;

— to maintain the financial stability of pension systems, so that the future impact of ageing on public finances does not jeopardise budgetary stability or lead to an unfair sharing of resources between the generations; and

— to enhance the ability of pension systems to respond to the changing needs of society and individuals, thereby contributing to enhanced labour market flexibility, equal opportunities for men and women with regard to employment and social protection and a better adaptation of pension systems to individual needs.

2.8.1. The Committee suggests that in the context of equal opportunities and meeting individual needs special attention should be given to atypical workers.

2.9. In considering the financing implications the ESC agrees with the Social Protection Committee that the correlation between pension and cost of health care systems must not be overlooked. A higher proportion of older people in the general population will not only lead to higher pension costs but to higher health care costs as well including the impact of both physical disability and senile diseases. Health care currently averages 7 % of GDP in the EU.

2.9.1. The Commission has indicated that the Economic Policy Committee is currently assessing the effect of ageing on health care costs which will provide more reliable estimates of future costs. The Committee very much welcomes this initiative while stressing that an approach based exclusively on financial sustainability could be insufficient and thus jeopardise the quality of the services provided. The Committee therefore also emphasises the need to examine the various components of health-care expenditure, with particular reference to expenditure on drugs, as the Committee has requested in a number of its opinions. The Committee has also expressed the view in a recent opinion that 'the use of supplementary health insurance can and should be hailed as fundamentally beneficial' (SOC/040 — Supplementary health insurance) (1).

2.10. The Committee believes that provided there is concerted and co-ordinated action by Member States there is no need for undue pessimism regarding the ability of the Community to achieve a sustainable solution to the demographic issues. It must also be borne in mind that the problem is both a financial and a social issue. As the Committee has already argued, investment in the social field is beneficial to economic development as a whole. The Economic Policy Committee's report is significant here, as it calls for a reduction in debt to free up resources which can then be invested in social policies.

3. **The pension options**

3.1. The Commission categorises the provision of pensions under three pillars in the EU:

— Pillar 1: The statutory pensions systems — (which are generally financed on the Pay As You Go principle);

— Pillar 2: Funded occupational pension schemes — (which are generally tied to the employer or the sector);

— Pillar 3: Personal pension arrangements — (which are generally provided by life assurance companies);

Pillars 2 and 3 are traditionally known as supplementary pensions.

3.2. The advantages and disadvantages of each pillar were discussed in the Commission's Green Paper 'Supplementary Pensions in the Single Market' issued in June 1997 (2).

(1) OJ C 204, 18.7.2000, p. 51.
(2) COM(97) 283 final.

3.3. The Pillar 1 schemes are by far the dominant method by which pensions are provided across the EU as a whole. However in three Member States, the Netherlands, UK and Ireland, the Pillar 2 and 3 schemes are a major component of pensions provision.

3.4. The Commission has clearly indicated that the level of dependency on each pillar is a matter for individual Member States. The Committee supports this view and believes the crucial need is for each Member State to address the issue in the manner most appropriate to its circumstances and traditions. The aim must be to strike a balance that guarantees the achievement of social objectives and financial sustainability. This will only be possible if the reforms are agreed between governments and the social partners.

3.5. The Committee welcomes the fact that Member States have started this process and that Member States are reporting to the Commission that they do not expect radical transformations of their pension systems and in particular that it does not involve an abandonment of the basic principles and social aims.

3.6. The Committee believes the setting of common objectives and the use of commonly agreed indicators — combined with full use of the open co-ordination method — will contribute to building a consensus between Member States on necessary reforms and provide the opportunity to share experience in this important area. The methods used to achieve these objectives will be a matter for each Member State under the subsidiarity principle.

4. **Improving the sustainability of pensions**

4.1. Against this background the key imperative is to ensure the payment of future pensions irrespective of the method of financing.

4.2. *Impact of economic growth*

4.2.1. Greater economic growth is not an end in itself but a means by which the resources are generated to be used to improve living standards of all citizens. Thus the level of affordable expenditure including pensions cannot be totally insulated from general economic conditions. The rate of economic growth has a potentially significant influence on the sustainability of pensions. This arises particularly via the expectation that enhanced economic growth will lead to higher levels of employment and higher incomes.

4.2.2. The demographic projections in their raw state relate the number of persons of working age to those of retirement age. It is incontrovertible that this ratio is going to change towards a higher ratio of pensioners.

4.2.3. The more important ratio however is between those who are economically active and those receiving pensions. Thus the relatively low current level of labour market participation in the EU (although there is a fair degree of variation across Member States) if projected into the future would reinforce the gloomy prognostications regarding the sustainability of pensions.

4.2.4. If however participation rates could be raised it would reduce the impact of the demographic problem — the greater the improvement in employment rates the greater the pensions impact. A sustained period of high economic growth would however be required to achieve this.

4.2.5. In the following point, we explore in more detail the increase in labour market participation. The ESC would note here that sustainable dynamic economic growth is necessary for employment to increase. Important factors that can affect this are competitiveness, EU economic performance and employment policy.

A coherent and consistent national and European approach is also necessary to increase labour market participation, as is envisaged by the Luxembourg process. An important factor here is that complementary measures, such as childcare and career break options, increase possibilities for combining work and family.

4.3. *Increase in labour market participation rates*

4.3.1. A significant increase in labour market participation rates is one of the most powerful actions, which would improve the sustainability of pensions.

4.3.2. Although there is considerable variation between Member States as noted above average labour market participation rates in the EU are low by comparison with the US and Japan.

4.3.3. However it must be acknowledged that this factor has been known for many years but progress towards increasing the rate has been modest.

4.3.4. The Lisbon Council set a target of 70 % against the current 63 % to be achieved by 2010. It set a separate target for women of 'over 60 %' as employment rates among women have traditionally lagged behind those for men.

In Stockholm, European heads of government stepped up these objectives: by 2005 participation must be 67 %, and 57 % for women. In addition, an objective of 50 % was introduced for older workers.

4.3.5. While the Committee supports the concept of improving participation rates it believes based on past experience that it represents a major challenge to the EU Member States. Obviously a key factor would be a sustained rate of economic growth in excess of 3 % p.a. but despite a good performance in 2000 this will not be achieved in the next few years . However it is hoped that in the medium term prospects for growth and employment may improve. The Committee believes that a successful combination of favourable macro economic conditions and sustained reform measures is needed to promote growth and employment.

4.3.6. The Committee considers that while there are occupations where the possibility of early retirement is justified it agrees with the Social Protection Committee that the economic and social needs which caused early retirement to be regarded as acceptable are now changing. Thus the practice whereby older workers retired early although sometimes enabling younger workers to gain jobs or be retained in employment has been a factor in producing lower participation rates and increased dependency ratios. The Committee suggests that the whole subject of encouraging greater participation rates by older workers requires a special study to develop appropriate strategies to achieve this.

4.3.7. The Committee supports the aim of increasing the female labour market participation rates but the Committee points out that this will require the provision of stronger support in relation to child-care facilities. In the opinion of the Committee it is necessary to promote the reconciliation of family and career needs to avoid a further fall in fertility rates. In fact an increase in fertility rates would be beneficial to the demographic position. The Committee has dealt with fertility rates in more detail in its Information Report on *The Demographic situation in the EU and future prospects* [1].

4.3.8. The Committee supports the view of the Social Protection Committee that the new target for increasing the participation rate of older men and women is particularly important. The Committee also believes that appropriate instruments are required to ensure training needs and flexible working arrangements are provided for older workers and particularly for disabled people to enable them to enter the workforce as many would wish to do.

4.3.9. The Committee emphasises the importance of achieving these labour market participation targets because of the benefits which would result for pensions but stresses that other measures should be pursued in parallel to ensure success in the goal of achieving sustainability of pensions.

4.4. *Reducing public debt*

4.4.1. The Committee acknowledges that reduction of public debt and therefore debt servicing costs will strengthen the financial position of Member States. This will allow them more scope to support the financing costs of future pensions, albeit that the impact will vary as between Member States.

4.4.2. The Stability and Growth Pact to which all Member States must adhere including the reduction of public debt and the generation of surpluses will therefore increase the capacity to support pension schemes in the longer term. This would for example facilitate the creation of Reserve Funds (see paragraph 7.5).

4.4.3. The Committee also draws attention to the importance of improving tax collection and in particular the elimination of tax evasion as a contributor to Member States' financial positions.

4.5. *Projections of public pension expenditure under the Lisbon scenario*

4.5.1. The Economic Policy Committee has developed a scenario on the basis of the Lisbon targets and asked Member States to make another projection of expenditure on pensions in accordance with that scenario (see Table 3). As shown in the Table the difference in the maximum gap in debt growth as a percentage of GDP varies from 0 % to 2 % with the exception of Greece where it reaches 4,2 %.

(1) SOC/017 — Information Report 'The demographic situation in the EU and future prospects' — CES 930/99 fin.

Table 3: Projections of public pension expenditure — Lisbon scenario (1)

(as a percentage of GDP, before tax)

	2000	2005	2010	2020	2030	2040	2050	Maximum growth	
								Lisbon	Current policy
Belgium (2)	9,2	7,9	7,6	8,7	10,3	10,8	10,4	1,6	3,7
Denmark	10,2	10,7	11,8	12,8	13,0	12,1	11,3	2,8 (3)	4,5 (4)
Germany	10,3	9,8	9,5	10,5	12,2	12,6	12,3	2,3	4,3
Greece (5)	12,6	12,1	11,9	14	16,8	20,2	20,6	8	12,2
Spain	9,4	9,2	9,2	9,8	12,0	14,9	15,8	6,4	8,3
France	12,1	11,3	11,7	13,6	14,7	14,8	N.A.	2,7	3,9
Ireland	4,6	4,6	5,5	6,7	7,4	8,3	8,2	3,7	4,4
Italy	14,2	13,9	13,9	14,0	14,6	14,5	14,1	0,4	1,7
Luxembourg (6)	7,4	7,4	7,5	8,2	9,2	9,5	9,3	2,1	2,1
Netherlands (7)	7,9	8,3	9,2	11,5	13,3	13,9	13,4	6,0	6,2
Austria	14,5	14,4	14,4	14,7	15,8	15,2	13,5	1,3	3,1
Portugal	9,4	10,1	11,0	12,7	13,5	12,7	11,0	4,1	6,2
Finland	11,3	10,9	11,6	13,6	15,1	15,4	15,6	4,3	4,7
Sweden	9,0	8,6	8,7	9,4	9,6	9,4	8,9	0,6	1,7
UK (8)	5,1	4,8	4,4	4,0	4,0	3,8	3,4	0,0	0,0

Source: EPC.

(1) For the Lisbon scenario, France assumed unemployment rates and active employment rates below the ones described above. The active employment rate is lower because no allowance is made for changes in pension eligibility requirements to increase labour force participation by the elderly. France's assumptions provide a more optimistic scenario in the medium term (around 2010-2020) whereas the opposite occurs in the longer term. Italy's active employment rates are lower than those described in the general methodology, whereas Spain's productivity growth is slightly higher after 2035. Portugal used the mean-variant population scenario rather than the high-variant scenario.

(2) Belgium assumes an employment rate of 76,5 % taking into account tighter conditions for early retirement and long-term unemployment schemes, the increase in the participation rate of women (except for those below the age of 30) and the increase in the effective retirement age. An increase in the employment rate of younger people was not assumed as this would imply lower attendance rates in education.

(3) For Denmark, net of the supplementary semi-funded scheme (ATP), the increase from 2000 to the peak year is only 1,6 % of GDP.

(4) For Denmark, net of the supplementary semi-funded scheme (ATP), the increase from 2000 to the peak year is only 3,1 % of GDP.

(5) Provisional data.

(6) In the case of Luxembourg the current scenario is the same as the Lisbon scenario: this scenario assumes an unconstrained growth of real GDP of 4 % per year over the entire projection period which corresponds to the average growth of the last 40 years. Figures refer to the public pension scheme for the private sector and do not include the public pension schemes for civil servants and assimilated employees.

(7) For the Netherlands the second tier is quite well developed. Such characteristics have a direct positive effect on the public pension scheme by reducing the burden of ageing populations on first tier pensions. However, there is also an important indirect implication: taxes on future pension benefits (which are drawn from the private funds) are expected to be quite high and may partially counterbalance the rise in public pension benefits.

(8) The figures for the UK do not reflect the substantial increase in pensions announced recently. This change will increase the share of GDP devoted to public pension expenditure. Social assistance for pensioners has also been substantially increased and will be modified to reward private provision. The UK also has well-developed second and third pillar schemes. Taxes on future pension benefits drawn from private funds will partially counterbalance the rise in public pension expenditure.

4.5.2. It should be noted this scenario is based on quite optimistic assumptions including:

— annual GDP growth at or above 3 % on average in the period to 2007;

— male and female participation rates converge to 83 % by 2045 (in most countries this would require later retirement);

— male and female unemployment rates converge to 4 % by 2045;

— projections for the working age population are taken from the 'high scenario' provided by EUROSTAT, and

— productivity levels and growth converge across the EU to match the US by 2050. US productivity growth for the first half of the current century is assumed at 1 % against the current 2,3 %.

4.5.3. The Committee acknowledges that this very broadly based scenario is a projection of the future rather than a forecast. Nevertheless it accepts the conclusion of the Economic Policy Committee that while having the potential to make a major contribution to addressing the financial impact of ageing it will not by itself resolve the problem of financing long-term pensions. However, the Committee would emphasise that, given the current deterioration in the global economic environment in terms of cyclical conditions and jobs, the economic and employment policy scenario set out above must, with justification, be considered optimistic. Hence, the Committee feels there is an urgent need for a better-coordinated European economic and employment strategy — involving all players — in order to boost growth and jobs.

5. **Actions to improve sustainability**

5.1. The extent to which the EU population will continue to age in future will have a significant effect on the sustainability of pensions. The current evidence is that increased longevity will be progressive so that it is essential to initiate action now to anticipate the extra costs that will arise. The EPC have already acknowledged that even in their optimistic scenario the outcome would not fully cover the financial impact of ageing and recent global developments heighten the risk of underachievement. Action now will prevent the costs of sustaining pension payments becoming insupportable since the additional costs can be spread over an extended period. This also seems entirely in keeping with the concept of intergenerational solidarity.

5.2. The Committee supports the view expressed by the Social Protection Committee that an unfair sharing of resources between the generations must be avoided. This also points to the need for early action to avoid burdening the coming generations unduly.

5.3. Possible action fall under two broad headings:

(a) improve the sustainability of PAYG schemes,

(b) supplement existing pension arrangements by the introduction of a larger element of pre-funded arrangements (Pillars 2 and 3).

These headings are not mutually exclusive.

5.4. *Improve the sustainability of PAYG scheme*

In addition to the items already dealt with in Section 4 this could include the following depending on the circumstances of each Member State:

(a) Increasing participation rates for older workers (see 7.3).

(b) Assess the possibility of increasing contribution rates (see 7.4).

(c) Creating reserve funds to cushion the ageing effect until age cohorts realign to a lower age dependency level (see 7.5).

(d) Modifying the qualification criteria for future pensions (see 7.6).

(e) Reviewing the structure of third level education which in some Member States unnecessarily delays entry into labour market (see 7.7).

(f) Reducing public debt to release resources to sustain the pension system (see 4.4).

(g) A combination of the above.

5.5. In the context of the single market the Commission has been taking steps to enable supplementary pension schemes to be introduced without specifically promoting their development. The Commission via its recent draft directive has also sought to improve the protection of pension scheme members by more rigorous control procedures, the provision of relevant information to improve transparency and an investment regime designed to deliver improved returns within controlled risk.

5.6. Whilst a transition even partly from PAYG to a funded system might be considered attractive to some States and has been introduced for example in both Sweden and Italy, the social consequences have to be carefully considered.

5.7. This is because payments would have to be made to two systems simultaneously. It would be unacceptable that current pensioner's income be put at risk by diversion of contributions away from PAYG systems into the funding of future pensions. Nevertheless some level of pre-funding is feasible as demonstrated by Sweden and would make a worthwhile contribution to easing future costs.

5.8. The main attraction of funded schemes remains that they are not dependent on a future relationship between contributors and beneficiaries, which by definition cannot be accurately predicted. Funds should be invested in a well diversified portfolio to minimise risk but the placing of restrictive quantitative limits should be avoided. The Committee has produced an opinion on the Commission proposal for a directive covering the activities of second pillar schemes [1].

5.9. However given the relative importance of the State schemes the greatest effort needs to be concentrated on steps to maintain their sustainability.

6. **Taxation**

6.1. The Committee suggests that Member States can use taxation to encourage action on pensions which they wish to promote.

6.1.1. Tax relief on contributions can be used to encourage individual financial provisions for personal pensions or other forms of saving for retirement provision e.g. to supplement the State system.

6.1.2. Tax relief can also be used to encourage employers to introduce funded pension arrangements for their employees. The development of supplementary pension schemes at company or category level, on the basis of agreements included in collective contracts, would be useful.

6.1.3. Taxation arrangements for funded pension schemes are based on three different concepts among EU Member States:

(a) EET i.e. contributions exempt, investment income exempt and pensions taxed.

(b) ETT i.e. contributions exempt, investment income taxed and pensions taxed.

(c) TEE i.e. contributions taxed, investment income exempt and pensions exempt.

The concept that if income is deferred (through pension contributions) then tax should also be deferred is logical. Also given the larger share of GDP accruing to pensioners in the future the total exemption of pensions from tax is likely to be difficult to sustain.

6.2. From the point of view of the single market it is important that speedy progress is made to deal with the problems caused by cross-border pension arrangements. In this connection the recent Communication on Taxation from the Commission is welcomed and has already been the subject of a separate opinion from the Committee [2].

7. **General comments**

7.1. Ensuring the payment of pensions to a steadily ageing population is one of the main challenges facing the EU. EU citizens must be able to expect that the necessary efforts will be made.

7.2. The Committee's main concern remains securing the income of future pensioners. Pensioners are a vulnerable sector of society and their interests must be protected. The Committee therefore strongly supports the view that appropriate action should be taken to achieve this while respecting the need to maintain intergenerational solidarity.

7.3. *Increasing participation rates for older workers*

7.3.1. An increase in labour-market participation rates is very important for the financial sustainability of pensions. As pointed out earlier, this rate is substantially lower for workers between 55 and 64 than for other age groups. This is largely due to arrangements enabling older workers to retire early.

(1) OJ C 155, 29.5.2001, p. 26.

(2) ECO/071 — The elimination of tax obstacles to the cross-border provision of occupational pensions — COM(2001) 214 final.

These arrangements were introduced so that older workers could give way to younger workers in a socially responsible manner. This was necessitated by high unemployment.

7.3.2. Views have changed since then. The labour-market situation in many Member States has changed. The financial consequences of early retirement arrangements are also weighing ever more heavily.

7.3.3. In previous opinions the ESC has already argued for a higher participation rate among older workers. Various measures were proposed in the opinion on older workers:

— an age-aware personnel policy;

— tax incentives for employers to keep on older workers;

— part-time pensions;

— tax incentives for employees to stay in work longer;

— flexible pension arrangements.

7.3.4. If the participation rate of older workers is to rise, the Committee sees no reason to harmonise the retirement age for the time being. At present that is a national matter and should remain so.

Finally, the Committee sees little point in a debate on raising the retirement age until the participation rate of older workers has been increased substantially, as the most important indicator is the effective retirement age and not the legal retirement age.

7.3.5. The Committee recommends therefore that flexibility be created so that those in good health and wishing to continue working are provided with the opportunity and financial incentive to do so in either a full-time capacity or on a reduced basis. The possibility for a worker, after an appropriate age, to reduce working hours progressively would cater for reduced capacity and at the same time allow the worker to remain active on a salary sufficient for his/her needs and defer the drawing of actual pension.

7.3.6. This flexibility would have to exist in both State and private sector schemes in parallel whereas currently the rules relating to retirement flexibility within a Member State often differ between the pillars. Later retirement patterns may be encouraged if there is cohesion in the way flexibility is applied under each of the pillars in each Member State. Later retirement would have economic benefits while contributing to better and more secure pensions.

7.4. *Assessing the possibility of increasing contribution rates*

7.4.1. The Committee accepts that increased contribution rates from both employers and employees could be used to improve the sustainability of pensions.

7.4.2. The Committee is concerned however at the possible consequences of increasing contributions:

(a) It increases the cost of employment and is thus potentially in conflict with the aim of increasing labour market participation rates.

(b) It is potentially inequitable in that workers would be asked to pay considerably more than the economic cost of the benefits they would personally receive in the future as a result of the imbalance between contributors and beneficiaries in the middle years of this century.

(c) It could reduce the EU's ability to compete for internationally mobile inward investment.

(d) It could encourage a 'brain drain' from the EU of highly skilled people.

7.4.3. The Committee believes therefore that any proposal to increase contributions should be assessed against the likely impact on employment.

7.5. *Cushioning the increase in pension cost by the use of Reserve Funds*

7.5.1. The Committee suggests that one way of reinforcing the sustainability of Pillar 1 schemes is, where possible, to set aside funds now which can be drawn on post 2020 to off-set the increase in cost.

7.5.2. Ireland is one of a number of Member States that have introduced this method. In 1998 the Irish Government announced revised pension arrangements. This included the establishment of the National Pension Reserve Fund to which the Government is committed to contributing 1 % of GDP annually. In addition the proceeds of recent privatisations have been added to the fund. The fund will be invested under the supervision of an independent Board and used eventually to reduce the burden of funding State pension costs post 2025 and is 'ring fenced' so that future Governments cannot divert the funds to other uses.

7.5.3. The Committee considers that 'ring fencing' is an important safeguard which will protect pensioners by ensuring that these funds cannot be used by a future administration for other purposes.

7.5.4. This method is not a move to pre-funding per se but a means of securing a more equitable balance between the generations.

7.6. An option for improving the sustainability of pensions is to modify the qualification criteria for future pensions. The Committee is aware that a number of Member States have made this type of adjustment to the pension entitlement rules. The Committee does not see this as an area where general recommendations are appropriate firstly because of the subsidiarity principle and secondly because any such action must be appropriate to the particular circumstances of the Member State concerned and desirably discussed with the social partners.

7.7. The Committee is aware that in some Member States the structure of third level education delays unnecessarily the entry of graduates into the labour market. The new demographic situation makes it desirable that this be reviewed. However the Committee stresses that this proposal is not designed to reduce the level of education which, given the Lisbon Council aim of becoming the most competitive knowledge-based economy should, if anything, be enhanced.

7.8. *Supplement state pensions with funded top-up schemes*

7.8.1. Many Member States consider that the promotion of supplementary pension schemes can make a contribution to the sustainability of their overall pension systems. Any such funds should be invested in a well diversified portfolio to minimise risk but the imposition of restrictive quantitative limits should be avoided.

7.8.2. Minimum regulatory standards to ensure the security and sustainability of funded supplementary schemes have already been proposed by the Commission.

7.8.3. Supplementary pension schemes are particularly used in three Member States — the Netherlands, UK and Ireland. In these countries the State pension (PAYG) is set at a relatively low level and many workers rely on supplementary schemes to top up their pensions. Whilst there is virtually universal coverage in the Netherlands for a variety of reasons including reluctance of employers to establish a scheme, workers in transient jobs etc. the coverage of workers in such schemes in the latter two countries is too low.

7.8.4. This issue has been addressed recently in both the UK and Ireland. In the UK the Government has introduced Stakeholder pensions. Under this system the Government has established a framework in which pension providers can offer Stakeholder pensions. Employers must co-operate with the arrangement by implementing payroll deductions but employer contributions remain voluntary. In addition costs are capped under the legislation to ensure the maximum amount possible actually is invested for the worker's benefit. In effect the scheme delivers a portable savings plan for use in providing an eventual pension.

7.8.5. The Committee suggests that the use of this type of scheme might be useful for other Member States to consider to supplement their State schemes.

7.9. *Adapting pensions to a changing society*

7.9.1. The Committee agrees with the Social Protection Committee that attention needs to be directed at adapting pension systems to changing employment patterns and to the need to ensure gender equality.

7.9.2. Important considerations are involved and the Committee believes that there is much to be gained by sharing the experience between Member States.

7.9.3. A desired long term goal would be the individualisation of pensions i.e. that pensions would be an entitlement of the individual not as in some cases at present derived from dependency on another person. This would mainly affect women. However because of their employment patterns e.g. periods out of work for child rearing, care would have to be taken not to leave them with inadequate pensions. Some Member States have successfully addressed this problem.

7.9.4. There are a significant number of self-employed business people in the community who often do not make adequate pension provision for themselves and their dependants and may not qualify for adequate provision under the first pillar. Attention needs to be directed to ensuring this category are adequately covered.

7.9.5. The Committee notes that some Member States support their elderly people in other ways in addition to the provision of a pension. This includes a variety of arrangements, for example, more favourable taxation, free electricity, free or reduced fares for public transport, tax relief for rent. The Committee believes that this type of support is particularly effective in relieving poverty among older citizens.

7.10. *Issues required to be addressed in supplementary schemes*

7.10.1. One of the major problems with pension schemes in some countries is the long vesting period (up to 10 years) before a worker becomes entitled to his pension. This is clearly in conflict with the view that pensions are forms of deferred pay i.e. pension rights are earned each year in same way as pay. The Committee believes that long vesting periods should be abolished.

7.10.2. The demographic factors, which effect PAYG schemes, are also important for funded schemes. The main consideration is that actuaries ought to be making timely adjustments to contribution rates to ensure adequate technical reserves are being created to match longer life expectancies.

7.10.3. The Committee has already welcomed and commented on the proposed Directive for Occupational Pension schemes which seeks to facilitate cross-border operation of Pillar 2 schemes [1].

7.10.4. The above Directive does not deal with the essential issue of taxation but the Commission has dealt with it in a recent Communication on which the ESC has already drawn up an opinion [2].

7.11. *Enlargement*

7.11.1. The Committee believes that the sustainability of pensions in the applicant countries is also a major issue in both economic and social terms both for the applicant countries themselves and the Union as a whole. Applicant countries should be encouraged to assess the long-term viability of their pension arrangements and to initiate action to improve sustainability where necessary.

8. **Conclusions**

8.1. The Committee attaches the highest priority to the protection of pensioners both present and future to ensure that they enjoy a decent standard of living in retirement. The Committee commends the Commission therefore for directing the spotlight on this issue in the context of demographic and social change.

8.2. The Committee is also pleased to note that Member States are now actively involved in planning to improve the sustainability of their pension payments. It is inappropriate to propose common solutions for Member States since their basic positions differ so much.

8.2.1. In this context the Committee believes that Member States should examine the potential use of the use of supplementary schemes (the second and third pillars) as supportive measures but recognises that supplementary pensions are not a panacea.

8.3. The Committee strongly emphasises the link between longevity and health and long term care costs as well as pensions. The Committee welcomes the planned work by the Economic Policy Committee to establish the likely long term profile of these costs. The special costs of the disabled should not be overlooked.

8.4. The Committee believes there is also a need to modify pension arrangements to reflect changes in society itself and welcomes the fact that this is clearly recognised in Commission communications.

8.5. The Committee believes that a major contribution to sustainability could come through improved economic performance — an increase in GDP growth rates could make it possible not just to reduce unemployment but to generate higher labour market participation. Achieving this will however be a major challenge and will require concerted action programmes focused on these targets. The work of the Economic Policy Committee is making a substantial contribution to a better understanding of the opportunities in this area.

8.6. The potential implications of increasing pension costs on Member States is so significant that the proposed use of the open method of co-ordination is to be warmly welcomed. The setting of common objectives with appropriate indicators will reassure Member States that all other States are taking action and also provide a learning opportunity to transfer experience from one Member State to another.

(1) OJ C 155, 29.5.2001, p. 26.
(2) ECO/071 — The elimination of tax obstacles to cross-border provision of occupational pensions — COM(2001) 214 final.

8.7. The Committee recommends that the applicant countries be encouraged to undertake similar assessments of their pension systems to assess long-term sustainability.

8.8. Finally the Committee stresses again the need for action now to address the crucial issue of the sustainability of pensions which is of vital concern to all existing and future pensioners in the EU.

Brussels, 29 November 2001.

The President

of the Economic and Social Committee

Göke FRERICHS

Opinion of the Economic and Social Committee on the 'Communication from the Commission to the Council, the European Parliament and the Economic and Social Committee: Supporting national strategies for safe and sustainable pensions through an integrated approach'

(2002/C 48/23)

On 5 July 2001, the Commission decided to consult the Economic and Social Committee, under Article 262 of the Treaty establishing the European Community, on the above-mentioned communication.

The Section for Employment, Social Affairs and Citizenship, which was responsible for preparing the Committee's work on the subject, adopted its opinion on 7 November 2001. The rapporteur was Ms Cassina.

At its 386th plenary session (meeting of 29 November 2001) the Economic and Social Committee adopted the following opinion by 92 votes in favour with one abstention.

1. Introduction

1.1. In response to the mandate entrusted to it by the Stockholm (1) and Gothenburg (2) European Councils, on 3 July 2001 the Commission published a Communication (3) to the Council, the European Parliament and the Economic and Social Committee on 'Supporting national strategies for safe and sustainable pensions through an integrated approach'.

1.2. The discussions and assessment of the content of the communication will provide input for a report for submission at the Laeken European Council (December 2001), when the Member States are to reach an agreement on the objectives and on the means of securing safe, sustainable pension systems in the EU. This should be done within a framework of voluntary cooperation, coordination, exchange of best practice and comparable statistics, along the lines of the Commission's proposals in its 1999 communication on the more general aspects of social protection (4).

1.3. Before it received the referral mentioned in point 1.1 above, the Economic and Social Committee had already decided to set up a subcommittee to draft an opinion on 'Economic growth, taxation and sustainability of pension rights in the EU'. The subcommittee's opinion will comment

(1) '... the potential of the open method of coordination should be used to the full, particularly in the field of pensions, taking due account of the principle of subsidiarity.'

(2) '... to prepare a progress report for the Laeken European Council, on the basis of a Commission communication setting out the objectives and working methods in the area of pensions' ...

(3) COM(2001) 362 final.

(4) COM(1999) 347 final 'A concerted strategy for modernising social protection'.