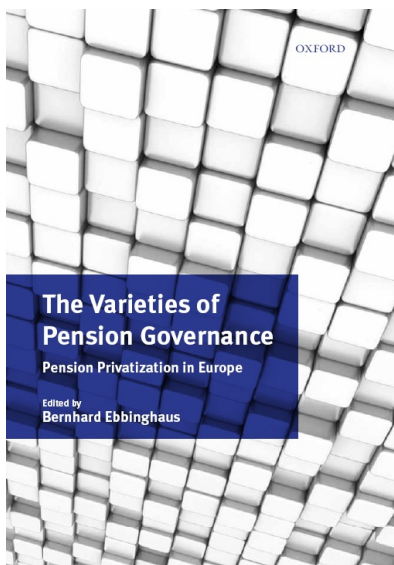




Revisiting Pension Privatization in Europe

Bernhard Ebbinghaus

School of Social Sciences &
Mannheim Centre for
European Social Research (MZES),
University of Mannheim, Germany



Bernhard Ebbinghaus (Ed.):
*Varieties of Pension Governance:
The Privatization of Pensions in Europe*
Oxford: Oxford University Press, 2011

1. Introduction: Privatization of pension responsibility



Global paradigm shift:

„Reforming pensions is one of the biggest challenges of the 21st century!“ (OECD)

- Demographic ‘time-bomb’ of **ageing** societies
 - High **expenditure**, partly due to early exit from work
 - Demographic problem of **pay-as-you-go** pensions!
- Shift toward (pre)**funded** pensions (II-III pillar)
Goal: fiscal and economic **sustainability!**



But: post-crash financial crisis (2007/08-)

- I: Sovereign **debt crisis**: more pressures on PAYG
 - II: DB pension: **underfunded** firm-sponsored funds
 - II/III: DC pension: **lower returns** → later retirement?
- Individualized **risks**: increase in poverty & inequality
Puzzle: How to square financial, social & political sustainability?

2. Challenges to multipillar strategy

- Ageing: Problem for pay-as-you-go financing → shift to funded systems
- Globalization: economic competitiveness → limiting labour costs
- Marketization: high public debt & liabilities → reduce public expenditure
- Financial crisis: negative and low returns → is funded system still better?

→ Goal: ***financial sustainability***

But further **social challenges** („new social risks“):

- Flexibilization: non-standard employment → access / coverage?
- Reconciliation of work and family care → social care credits?
- Plural family & household patterns → individualised pensions?

→ Goal: ***social sustainability***

Consequences for **political legitimation**?

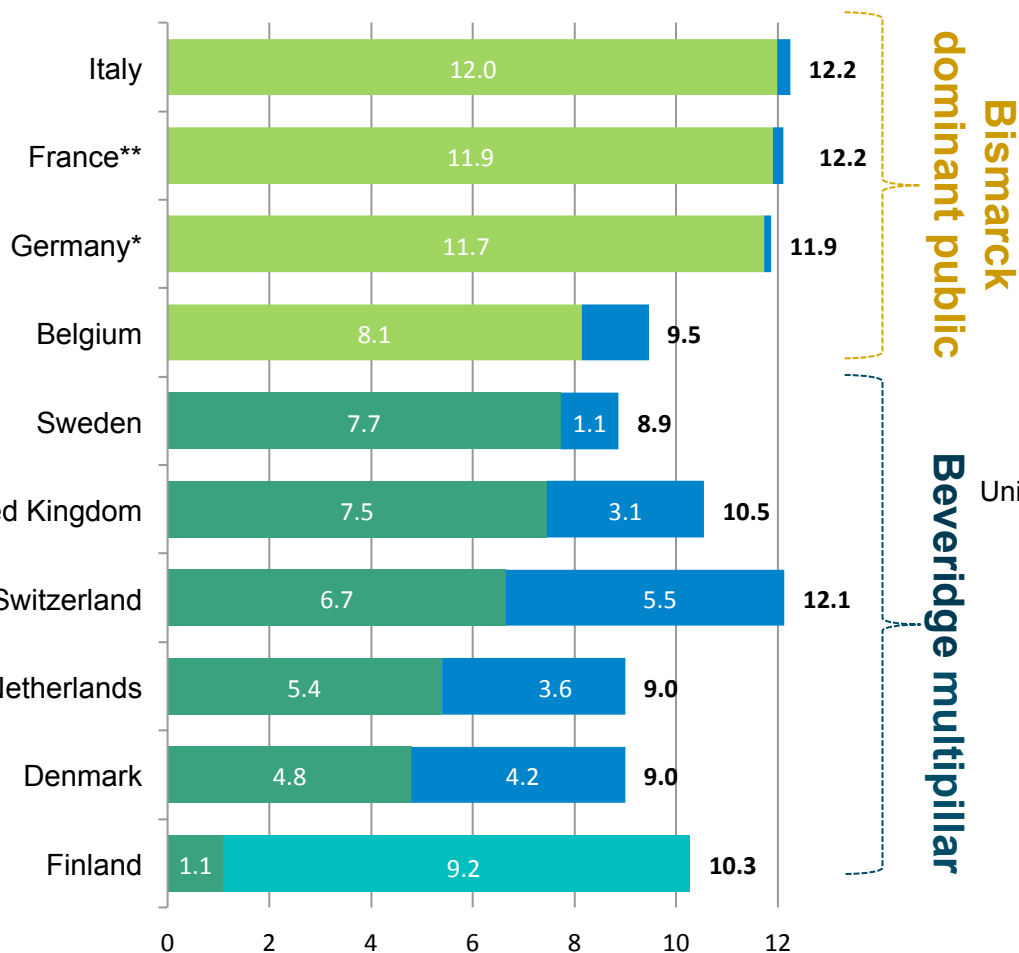
- Increase in old age poverty → return of the state via minimum income
- Increase in insecurity & inequality → state regulation of private pensions
- Post-2007 crisis: low trust in public (PAYG) & private (funded) pensions

→ Goal: ***political sustainability***

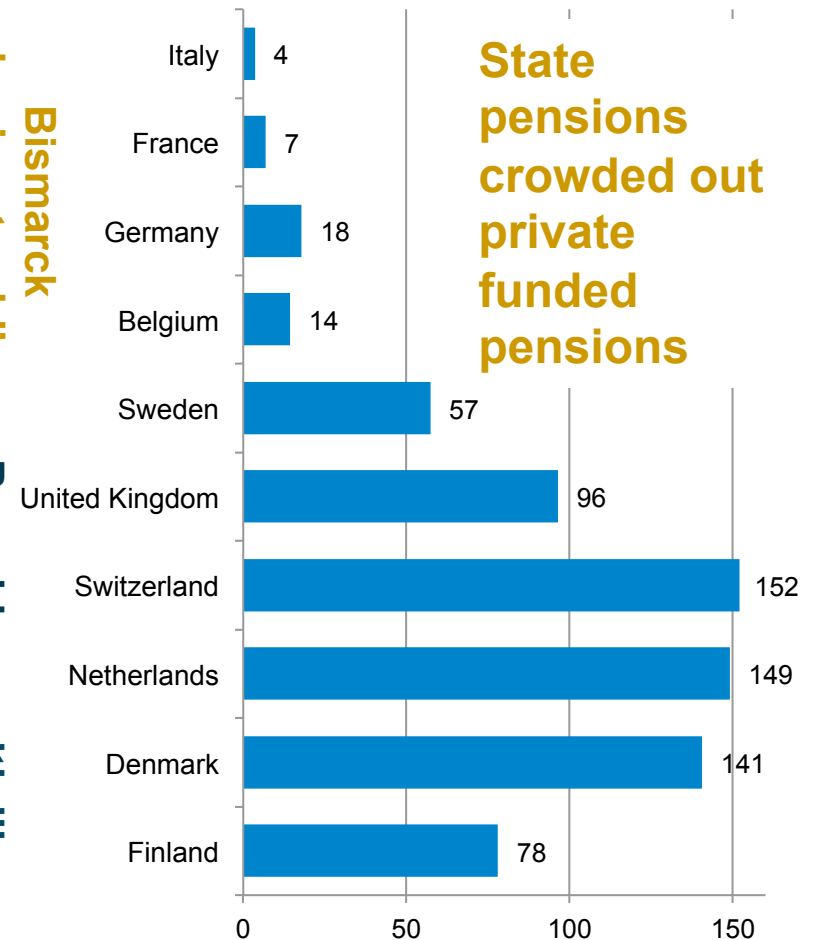
3. Public-private pension mix in Europe before the crisis

Public and private pension expenditure (% GDP), OECD 2006

Public expenditure Private expenditure



Total private pension assets (% GDP), OECD 2007



Source: OECD Pensions Outlook 2008, own calculations.

4. Paradigm shifts in pension policies

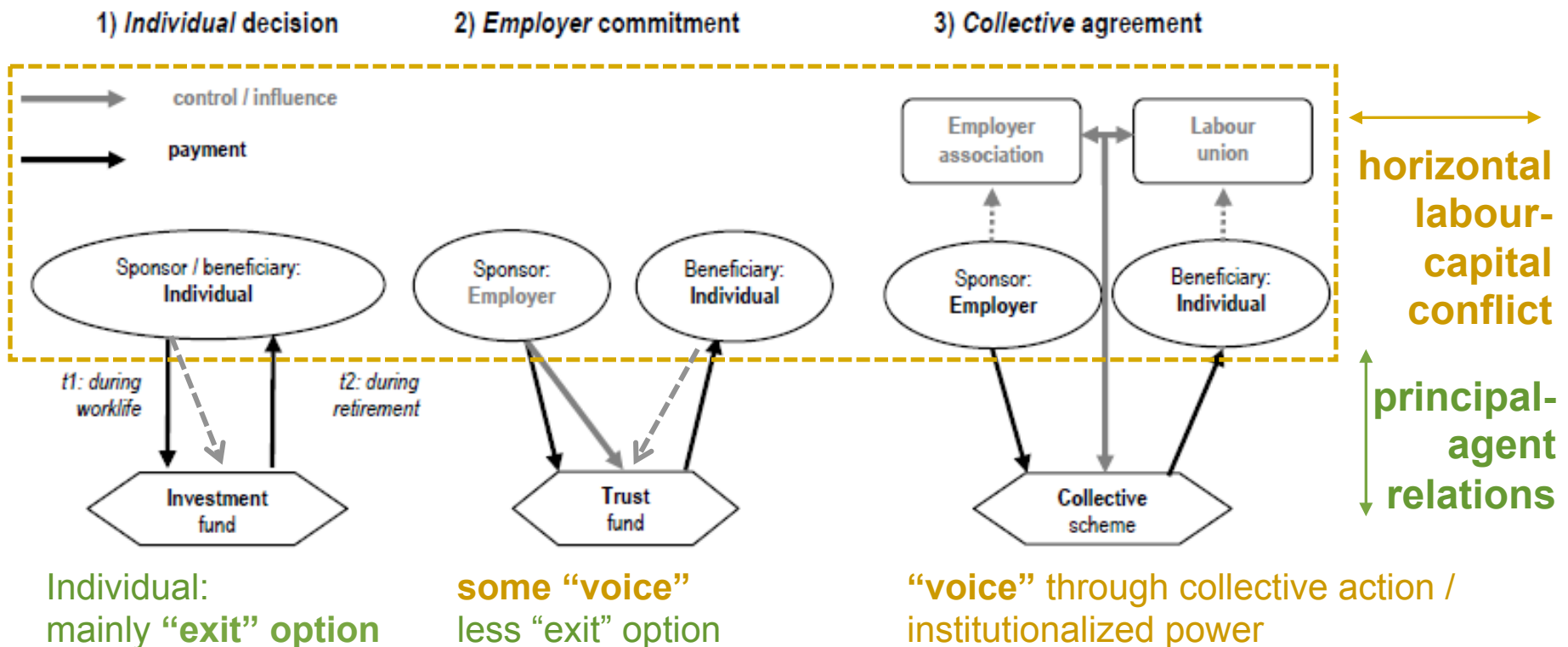
Process	Marketization	Privatization
<i>Principle</i>	Increasing the market-logic and market-dependency (<i>commodification</i>)	Shifting responsibility to non-state actors (<i>risk privatization</i>)
<i>Aims</i>	Financial sustainability, reducing public expenditure	Retreat of the state, self-regulation / choice
<i>Instruments</i>	<ul style="list-style-type: none"> • Employment-related pensions • Longer working life • Actuarial treatment of benefits • Pre-funded pensions 	<ul style="list-style-type: none"> • Mandate for private actors • Collective bargaining • Employers commitment • Voluntary/individual choice

Ebbinghaus, Bernhard (2014), 'The Privatization and Marketization of Pensions in Europe: A Double Transformation Facing the Crisis,' *European Policy Analysis (former German Policy Studies)* forthcoming.

5. Private pension governance: actors & interests

Conflicts of interests in supplementary pensions:

- **Vertical conflicts = principal-agent problem** (sponsor/financial agent)
- **Horizontal conflicts:** sponsor (employer) vs. beneficiary (worker)
 - employer commitment: employer sponsors ‘trust’ fund, implicit contract
 - collective agreement: delegated to employer/union negotiations



6. Private pension governance: pros & cons

Collective (= employer/unions co-manage collective scheme):

- ✓ **Pooling** of risks, broader coverage, lower administrative costs
- ✓ **Balancing** interests between sponsors & beneficiaries, informed decisions
- But **less personal choice**, less attractive for higher income groups
- ➔ Collective funds are more like public pensions, **consensus necessary**

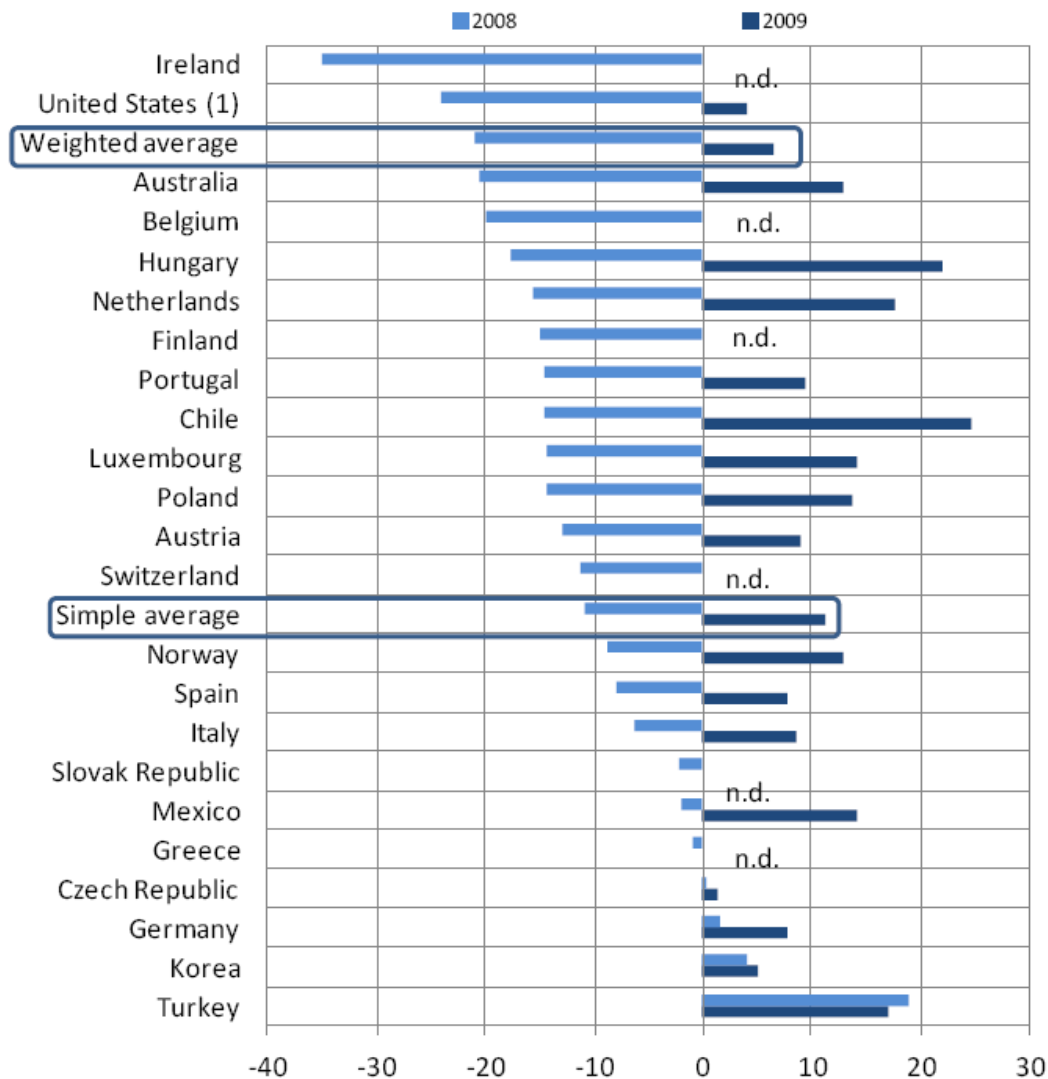
Employer-led (= employer-sponsored pension fund or on the book reserves):

- **Limited representation** of beneficiary interests
- Risk of **bankruptcy** of firm: reinsurance needed
- **Underfunding** problem for sponsors but also who owns surpluses?
- ✓ Employer interest in **binding** employees but higher costs & lower mobility
- ➔ Employer-funds can lead to **conflicts of interests**, thus requiring regulation

Individual:

- ✓ Individual decision to save for old age: **freedom of choice**
- Individual savings depends on financial literacy, **foresight**, and liquidity
- ➔ Individual responsibility but **individualization of risks**, regulation needed

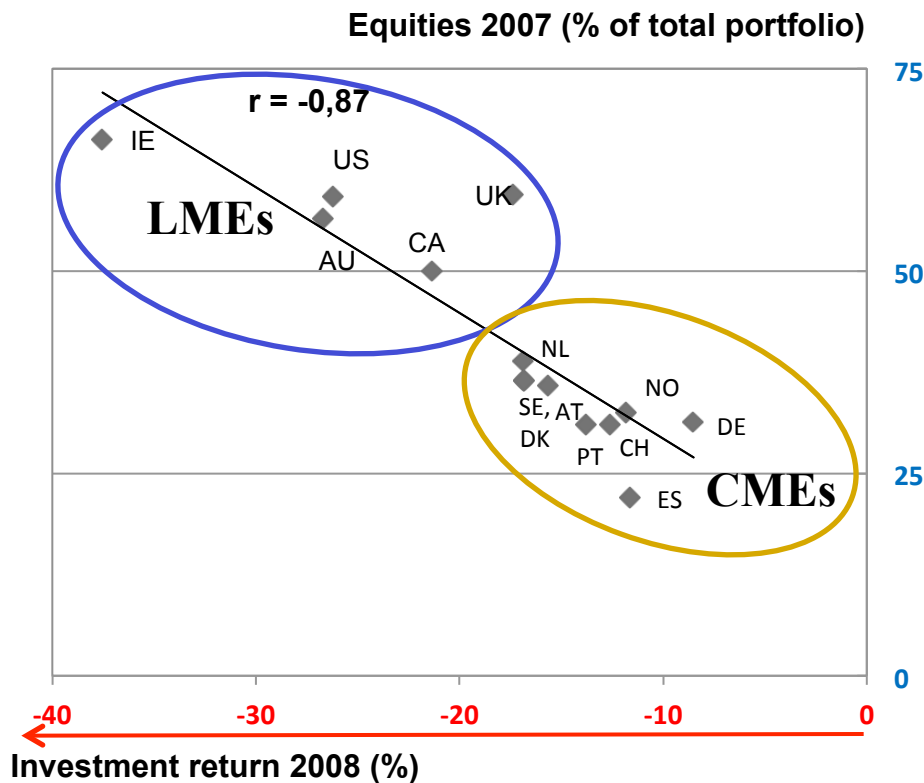
7. Financial crisis and pension fund performance



- **Financial market crisis** 2007/08+(worse than 2001)
- **Negative net returns**, decline in world assets
- **Risky** investment in equities (but later also Greek bonds)
- **Underfunding** of defined benefit (DB) pensions
- **Public reserve** funds are also affected
- Sovereign **debt crisis** will affect public PAYG pensions
- Acute problems particular for those **close to retirement**

8. Net return and equity investments during the crash (2007/08)

Pension funds



Sources: OECD (2009): Pensions at a Glance

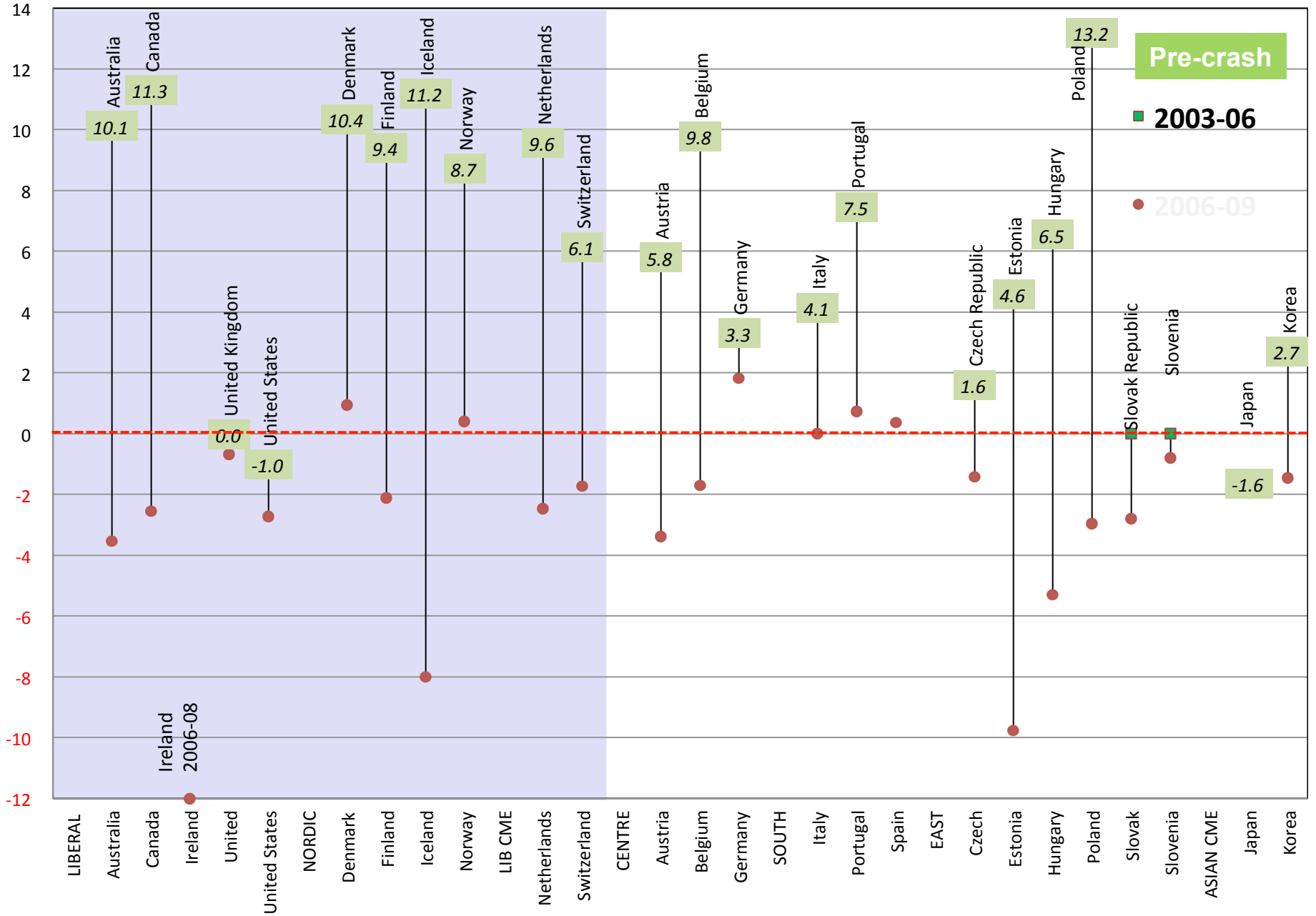
LMEs: Liberal Market Economies

- Mature pension fund capitalism
- More risky investments (equities, etc.)
- Less regulation (“prudent investor” rule)

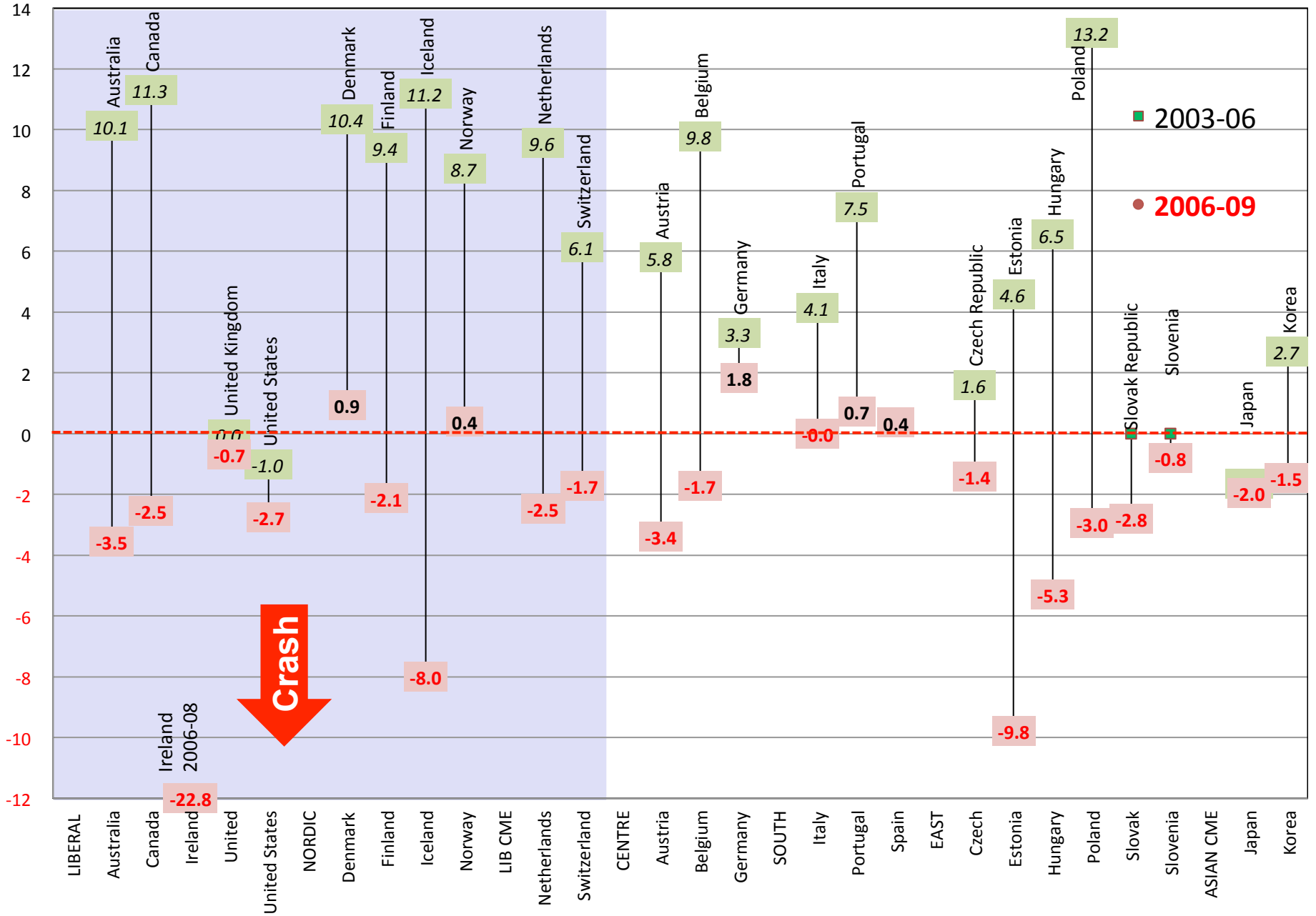
CMEs: Coordinated Market Economies

- only NL, CH, DK mature pension fund capitalism
- More regulation than LME
- Less risky, more secure investments or insurances
- More buffer through DB schemes (firm, sector)

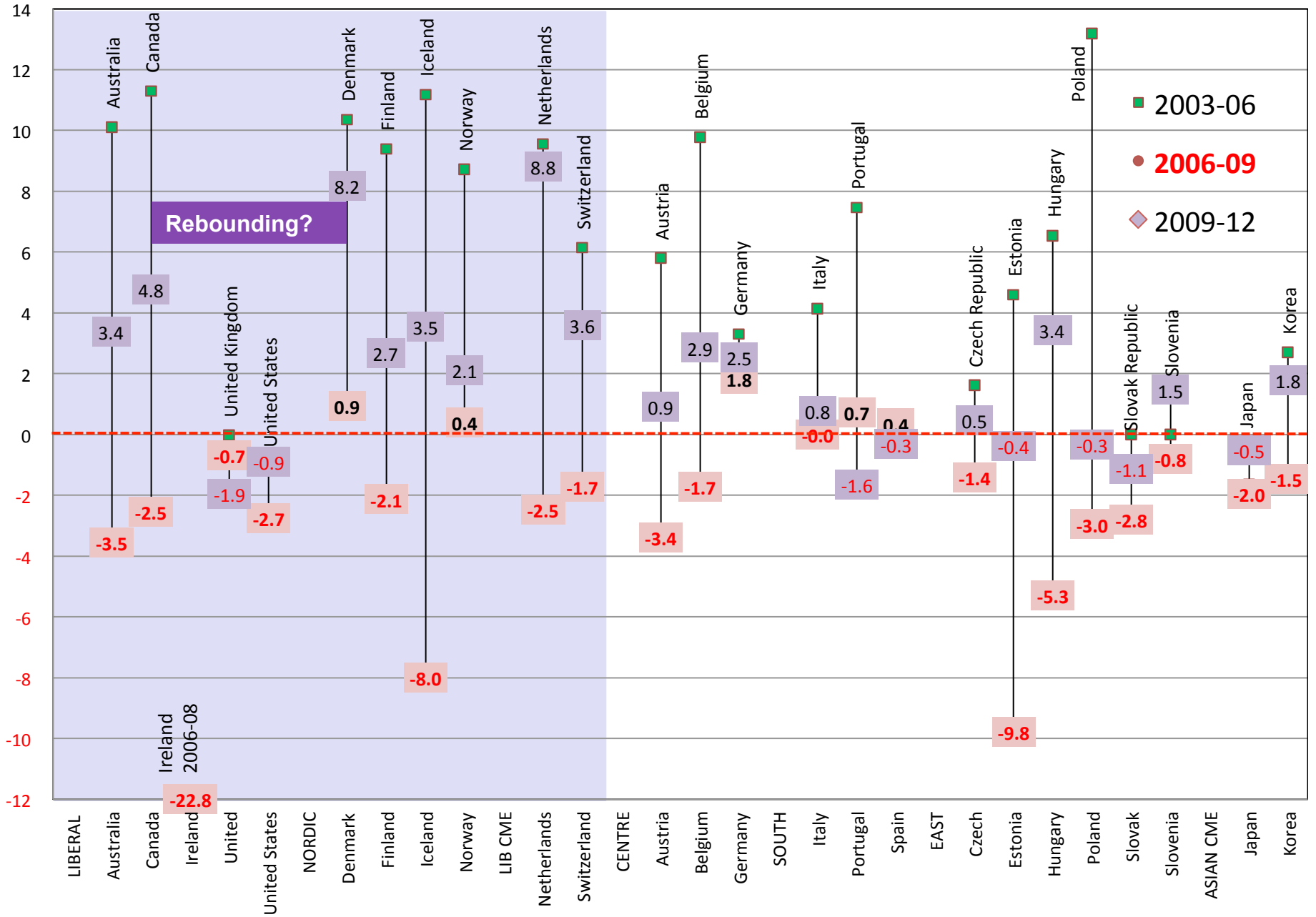
9. Net Annual Return (%) of Pension Funds, OECD 2003-12



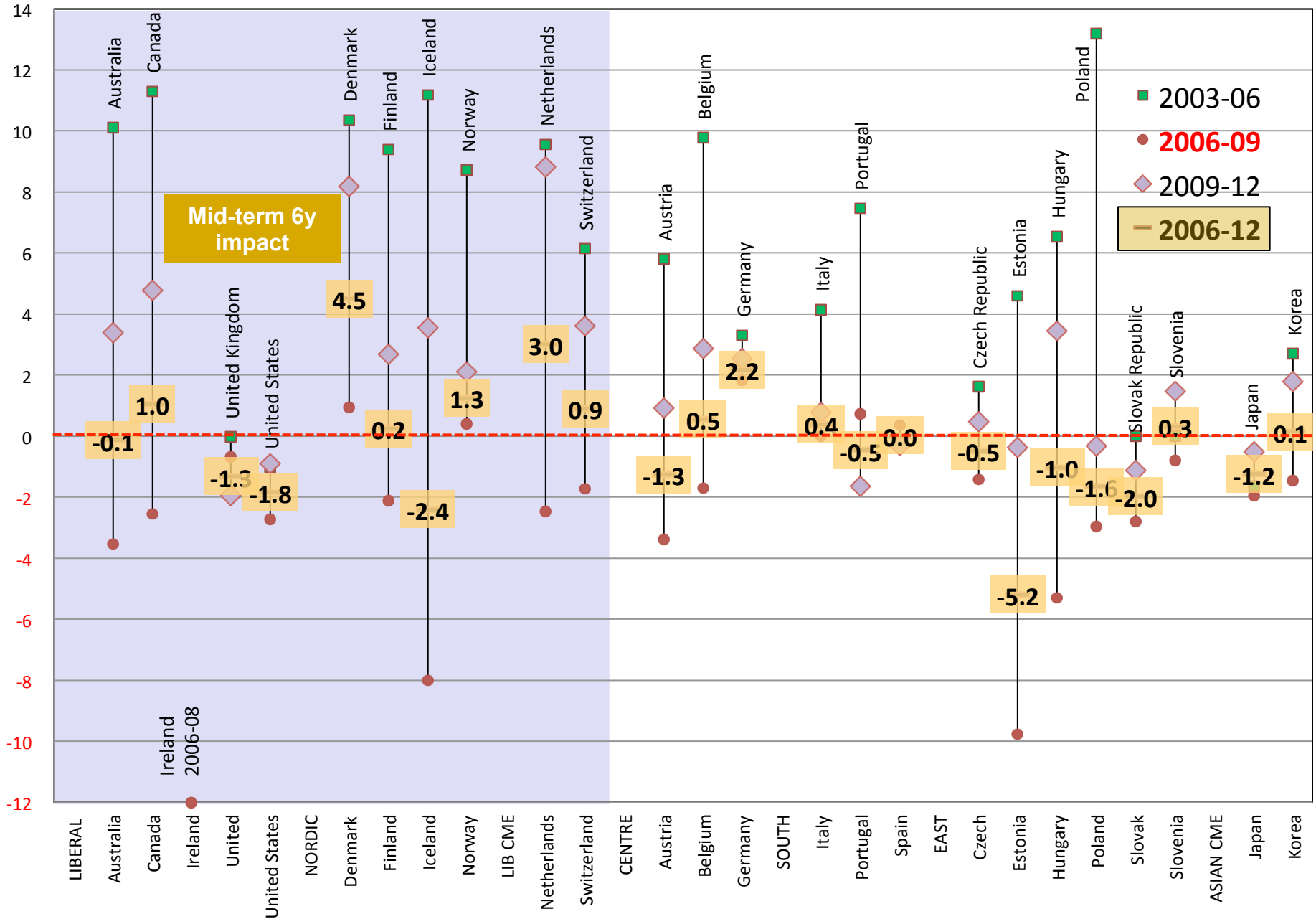
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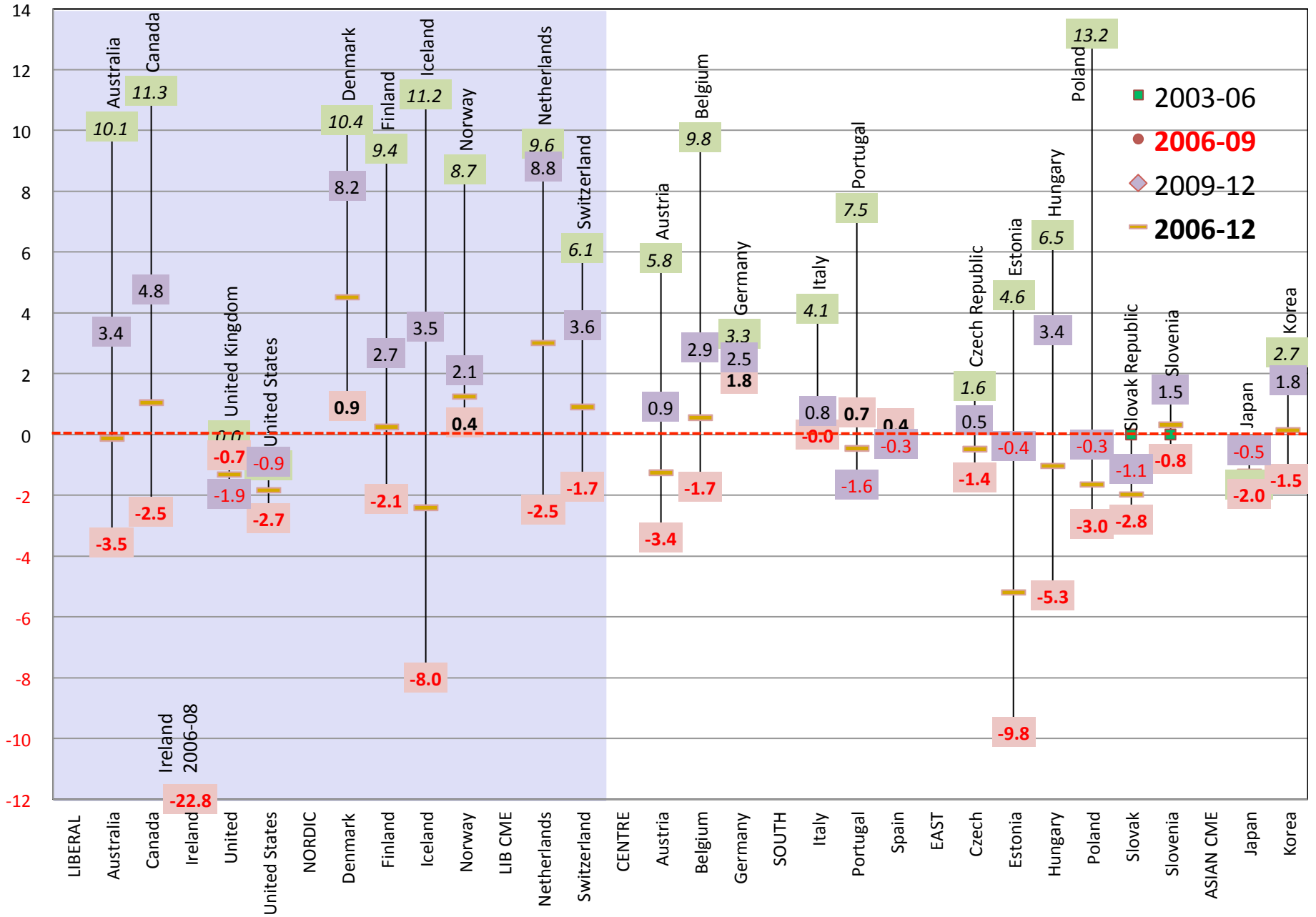
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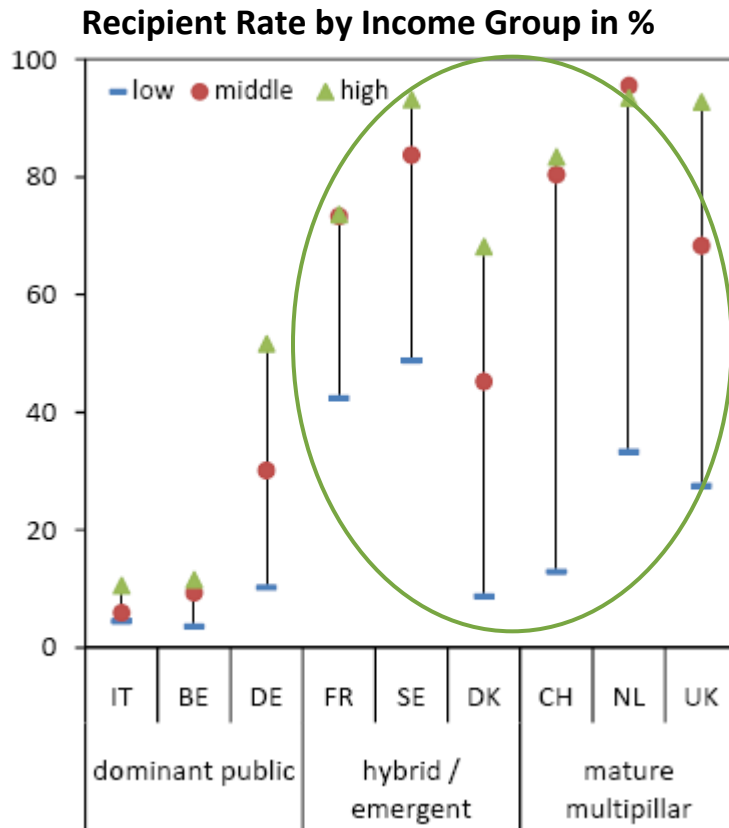
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10. Multipillar sustainability: Post-crisis consequences

	Private DB	Private / public DC
Problem:	Underfunding	Lower returns
Short-term impact	<ul style="list-style-type: none"> • Firm insolvencies • Higher reinsurance premiums • Easing funding rules? • Move to average-career DB • Conflicts between current and future members? 	<ul style="list-style-type: none"> • Low/negative returns = lower savings • Higher individual contributions needed • Interruptions due to unemployment • Postponement of retirement?
	Higher contributions needed and / or lower benefits	
Long-term impact	<ul style="list-style-type: none"> • Coverage based on firm-attachment, mobility problem • Increased pressure on firms to move to DC • Reform of protection funds • Revised funding rules 	<ul style="list-style-type: none"> • Labour market risks in voluntary schemes leads to gaps • Minimum statutory guarantees? • Mandatory annuities after retirement? • Nudging strategies
	Better supervision and stricter regulations of investments	

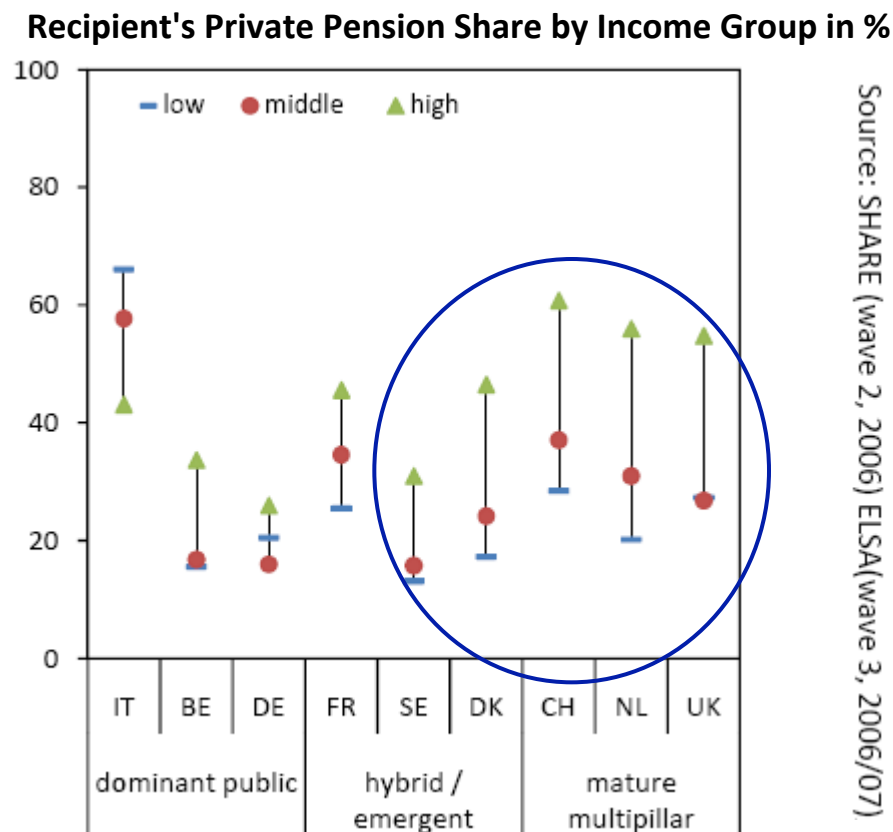
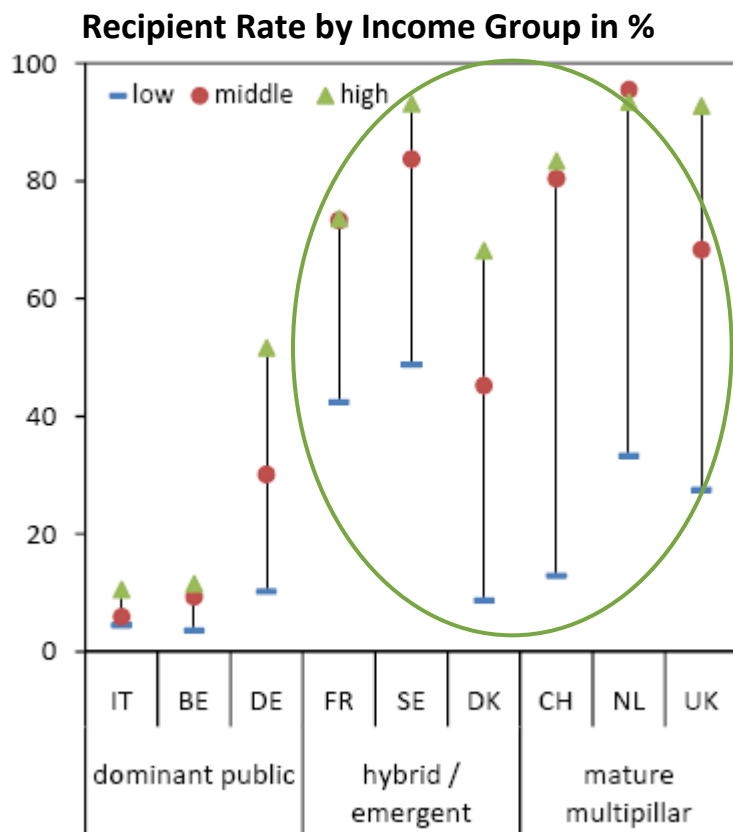
11. Social sustainability: inequality in coverage & benefits



Source: SHARE (wave 2, 2006) ELSA(wave 3, 2006/07)

- **Higher income** groups more likely to be covered by private pensions
- **Middle (& lower) income** groups covered when **(quasi)mandatory pensions**

11. Social sustainability: inequality in coverage & benefits



Source: SHARE (wave 2, 2006) ELSA(wave 3, 2006/07)

- **Higher income** groups more likely to be covered by private pensions
- **Middle (& lower) income** groups covered when **(quasi)mandatory pensions**
- **Large income share** (50%) particularly for higher income groups
- **Private funded pensions** important in UK, CH, NL and Nordic countries

12. Reconsidering financial, social and political sustainability

Varieties of privatization in Europe:

- **State** retreats from direct financing but tax subsidies & negative externalities!
- **Marketization**: increased importance of funded pensions
- Cross-national diversity in private pension **governance**
- **Trend toward individualization of financial risks** (DB→DC)
- **Financial crisis** lead to declining trust in funded solutions
- Need for **better regulation & good governance**
- Danger of increasing old age **poverty & inequality in future!**



Further readings

Monographs:

• **B. Ebbinghaus** (ed.): *The Varieties of Pension Governance. Pension Privatization in Europe*. Oxford: OUP 2011.

Journal publications:

• **B. Ebbinghaus**: The Privatization and Marketization of Pensions in Europe: A Double Transformation Facing the Crisis, *European Policy Analysis* 2014.

• **B. Ebbinghaus**: Varieties of Pension Governance under Pressure: Funded Pensions in Western Europe,' *CESifo DICE Report* 2012(4): 3-8.

• **B. Ebbinghaus & T. Wiß**: Taming pension fund capitalism in Europe: collective & state regulation in times of crisis *Transfer* 17/1, 2011: 15-28.

• **B. Ebbinghaus & N. Whiteside**: Shifting responsibilities in Western European pension systems, *Global Social Policy*, 12(3) 2012: 266 –282.

Working papers:

• **T. Wiß**: *Pension Fund Capitalism and Financial Crisis*. IHS Working Paper, Political Science Series / No. 126, Vienna: IHS 2011.