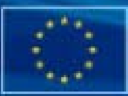

European Commission
Economic and Financial Affairs

Multi-pillar pension reforms in the Stability and Growth Pact

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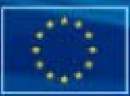
EBRD conference on Pension Systems in Emerging Europe – 1 April 2011

Outline

- The cost of ageing and public finances
- Multi-pillar pension reforms
- Current treatment in the Stability and Growth Pact (SGP)
- The critique of the current rules and proposals for amendment

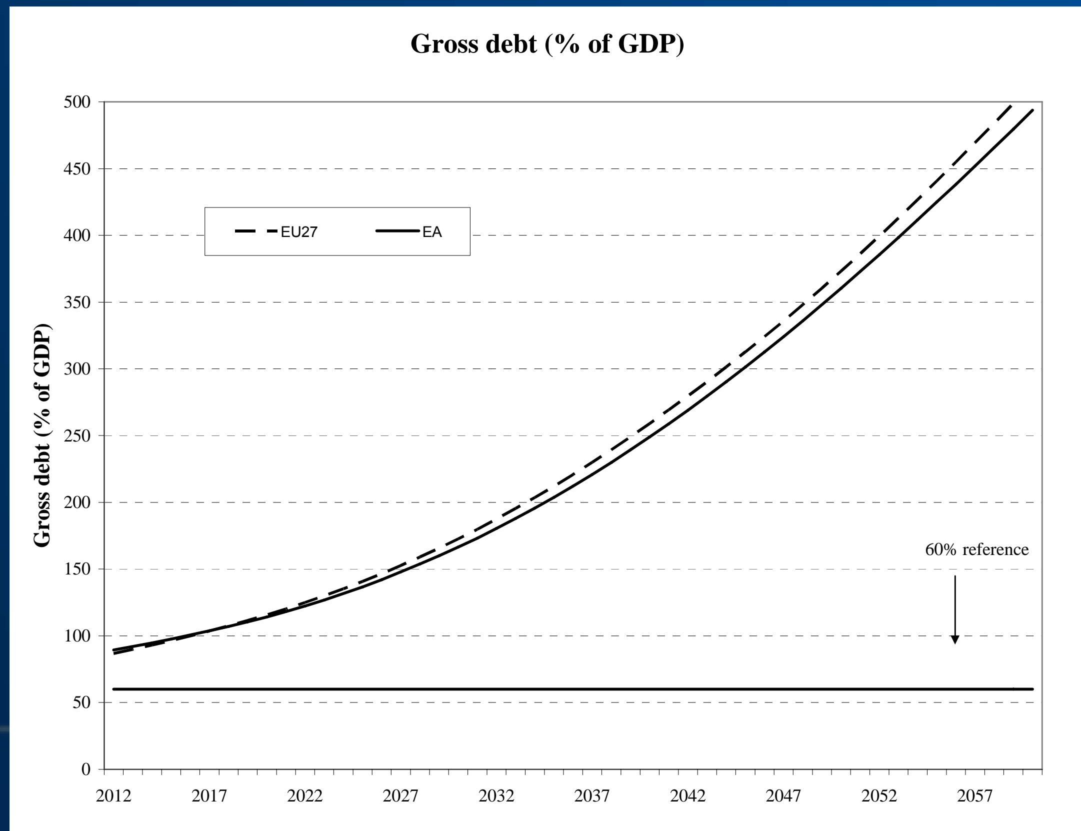
The cost of ageing and public finances

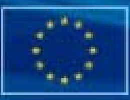
- Defined benefit unfunded pension system + ageing population = increasing deficits in the public pillar



The cost of ageing and public finances

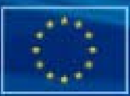
- Discounted future public pillar deficits = implicit government debt (related to ageing)





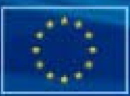
The cost of ageing and public finances

- Defined benefit unfunded pension system + ageing population = increasing deficits in the public pillar
- Discounted future public pillar deficits = implicit government debt (related to ageing)
- Total government liabilities = explicit government debt (bonds) + implicit government debt
- Fiscal sustainability requires sufficiently large future surpluses to cover all government liabilities



Multi-pillar pension reforms

- Multi-pillar (aka systemic) pension reforms
  - improve the sustainability of the public pension system, but the impact on the overall pension system is ambiguous (depends on the level of pension benefits)
  - introduce a mandatory defined-contribution pillar
  - split the liabilities/contributions between pillars
  - beneficiaries assume part of the risk/responsibility
- Parametric pension reforms address sustainability but not the concept of old-age insurance itself



Multi-pillar pension reforms

- Prior to the reform the public defined-benefit unfunded (PAYG) pension pillar (1st pillar) is unsustainable

Public pension system

6.0%
4.5%
3.0%
1.5%
0.0%
-1.5%
-3.0%

16%
12%
8%
4%
0%
-4%
-8%

1990 1995 2000 2005 2010 2015 2020 2025 2030 2035 2040

pension payments (right scale)
contributions (right scale)
deficit (left scale)

Multi-pillar pension reforms

- Liabilities are 'transferred' outside the public pension system, to the mandatory defined-contribution funded pillar (2nd pillar)

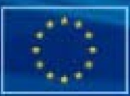
Public pension system

6.0% 4.5% 3.0% 1.5% 0.0% -1.5% -3.0%

16% 12% 8% 4% 0% -4% -8%

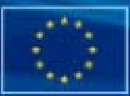
1990 1995 2000 2005 2010 2015 2020 2025 2030 2035 2040

pension payments (right scale) contributions (right scale) deficit (left scale)



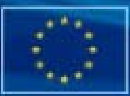
Multi-pillar pension reforms

- Contributions are diverted from the 1st to the 2nd pillar, creating larger deficits in the public system in the short- and medium-term



Multi-pillar pension reforms

- No change (at inception) in the sustainability of the overall pension system!



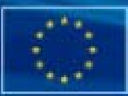
Multi-pillar pension reforms

- Sustainability unaffected; why the special treatment?
- Eurostat (2004) had correctly reclassified mandatory DC funded schemes to within the private sector
- Tax reduction (lower contributions to the 1st pillar) is no longer concealed by forced private pension savings (contributions to 2nd pillar)
- Front-loaded deficit impact affects compliance with the Maastricht criteria

Current treatment in the SGP

Short-term vs. long-run perspectives

- Trade-off for fiscal surveillance: enforceability, timeliness, credibility vs. efficacy, country specificity
- Numerical rules heavily rely on observable, measurable, short-term public finance statistics
- Assessing long-term fiscal sustainability needs forecasts, estimates and results are policy dependant



Current treatment in the SGP

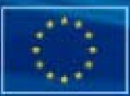
One size fits all?

- SGP rules should not encourage or discourage any particular economic structure (pension system)
- Reform of the Pact (2005): Council agreed on special treatment in excessive deficit procedures (EDPs)
  - allowing time for the adaption of fiscal policy to the front-loading of deficits
  - excluding the compensation for systemic pension reforms
  - introducing a transitory period of 5 years (2005-2009) with the application of the 'degressive scale', if the deficit is 'close to the reference value' and excess reflects the costs of the reform

The critique and amendments

The critique of the current SGP rules

- Likely triggers were: expiry of the transition period, reform of the Pact, soaring budget deficits
- Second pillar pension schemes mature in 40-50 years, thus the 5-year period is insufficient
- Tougher to meet Maastricht criteria: unfair to reforming countries
- Current rules left open the possibility for reversals



The critique and amendments

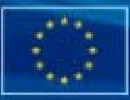
The critique of the current SGP rules

- The critics requested
  - either changing the statistical treatment (withdrawing the 2004 Eurostat decision)
  - or, equivalently, deducting fully the costs of implementing systemic pension reforms from the budget deficit in the context of the EDP
- Both versions of the request would amount to full compensation

The critique and amendments

The assessment of the request

- Reduction in implicit liabilities must not be considered equivalent to reductions in explicit liabilities
- Comparability with other types of measures (tax incentives for old-age savings, parametric pension reforms, other structural reforms or R&D investment)
- Statistical certainty must be fostered, actual data to be used
- Deviations from accounting rules must be limited in time



The critique and amendments

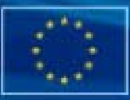
The Commission proposal

- More encompassing view of the fiscal stance through enhancement of the 'relevant factors'
- More prominent role to the debt criterion
- Greater flexibility when assessing the case for EDP if government debt is below 60% of GDP

The critique and amendments

The Commission proposal

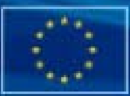
- Greater flexibility extended to the existing special allowance for systemic pension reforms:
- More admissive application of the ‘degressive’ scale if
  - debt is below 60% and “the deficit is somewhat above what is considered as close to the reference value”, but
  - the excess in the deficit reflects the costs of implementing a systemic pension reform and
  - for abrogation the ‘closeness criterion’ was proposed to be kept
- ‘Anti-reversal’ clause



The critique and amendments

State-of-play

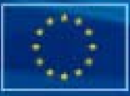
- Council report to the European Council (December 2010) supported COM proposal
- Council working group for the legislation of the economic governance package has made important changes
- Parliament is only consulted for corrective arm
- Package is expected to be adopted by Council and Parliament still under HU Presidency



The critique and amendments

State-of-play

- Special allowance only applies when the government debt ratio is below 60% and
- ‘the deficit does not significantly exceed a level that can be considered close to the reference value’ and
- ‘overall fiscal sustainability is maintained’
- Elimination of the ‘degressive’ scale
- For abrogation the ‘closeness criterion’ is kept



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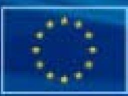

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Multi-pillar pension reforms

- Reduction in implicit liabilities must not be considered equivalent to reductions in explicit liabilities