Ensuring the sustainability of EU pension systems

Conference on "Emerging Challenges in the Impact of Taxes on Pensions"
Brussels, 25 February 2013
Ladies and gentlemen,

I would like to begin by thanking the Presidents of Pensions Europe, ESIP and EurelPro for their invitation to speak at this conference.

It is now a year since the Commission launched the White Paper on Pensions, and, for the most part, work on the issues raised in the Paper is well underway.

However the area of taxation needs to be developed further.

I am therefore grateful for this joint initiative from the three European pension's organisations for organising this conference on the interplay between taxation and pension systems.

I particularly appreciate that organisations representing public and private pensions have come together to stage this event.

Today, pensions represent the key source of income for one in four Europeans, and direct public pension expenditure accounts for more than 10 per cent of GDP in the European Union. This share is higher when we count the cost of tax expenditure to private pensions and it is expected to rise further.

Increasing life expectancy and low fertility rates will pose a challenge for pension adequacy and public spending in the future.

Pressure on public finances has increased due to the protracted economic crisis in Europe. Rising unemployment and an eroding tax base have led to a sharp increase in government debt across the European Union. For most Member States this has made budget consolidation a priority.

The Annual Growth Surveys underlined that budget consolidation involves reviewing both expenditure and revenue. It is about the money we spend as well as the money we raise – or forgo – through tax rules.

In the White Paper we highlighted that in order to ensure adequate and sustainable pensions, Europeans will need to work both more & longer - and - save more for their retirement.

But we also emphasised that we must ensure better access to supplementary schemes and the cost-effectiveness of such schemes.

**A brief review of initiatives on complementary savings**

Let me now briefly turn to the follow-up work on the eleven initiatives in the White Paper, which are directed at developing complementary retirement savings.

Under the Cypriot Presidency work has resumed on the directive on acquisition and preservation of supplementary pension rights, also known as the 'portability directive'. I am confident that under the current Irish Presidency important progress will be made.

And as you are all aware, the services of Commissioner Barnier, with input from the European supervisory authority EIOPA, are preparing a proposal on revising the IORP Directive.

My services are looking at how we can better ensure protection of workers’ occupational pension rights in the event of insolvency of their employer.

But the Commission is taking further action to improve protection and information.
A task force under the Pension Forum will soon start working on a code of good practise for occupational schemes.

In March a feasibility study on the development of a pension tracking service will start. And my services will further examine with the Member States on how to better disseminate information to citizens concerning their pension entitlements.

The services of Commissioner Borg will soon launch a consultation on improving consumer information and protection standards for third pillar retirement products.

More generally, we have commissioned a study from the OECD on many aspects of private pensions including taxation – a direction which is reflected in the list of speakers due to address you today.

As a follow-up to the White Paper on Pensions, Commissioner Šemeta's services are working on ways to reduce the risk of cross-border pensions, as well as other forms of income, either being subject to double taxation or escaping taxation altogether. They are also working on questions pertaining to indirect taxation.

**Taxation and longer working lives**

In view of future demographics and in light of the economic crisis, many Member States have begun reforming their pension systems. This should reduce future costs and establish a better balance between contributions and entitlements, as well as between years in work and years in retirement.

Common features in *public* pension reform include increases in pensionable ages of men and women, restricted access to early retirement schemes, and changes to the valorisation and indexation of pension entitlements.

The book value of *privately* funded schemes declined dramatically at the beginning of the crisis. While some losses have since been recovered, authorities in Member States with extensive private schemes have focussed on restoring solvency and making sure future schemes have the ability to resist and absorb economic shocks.

These reforms have improved the medium and long-term sustainability of public pension expenditure. However, the effects of reforms on the *adequacy* of pensions are uncertain, and depend on a longer working life with fewer interruptions, as well as supplementary pension savings.

Changes to the pension systems need to be underpinned with employment and social policies that promote active ageing and longer participation in the labour market. The Social Protection Committee’s first Pensions Adequacy Report published last year stresses that longer working life will be the key to pension adequacy in the future.

This requires active ageing strategies, investments in life-long learning of all age groups, the adaption of work places to the needs of older workers, and new forms of labour force participation.

The tax system can provide incentives for longer working lives, as taxes on labour impact on labour supply and employment rates, in particular the employment rate of older workers. A modern tax and benefit system should create incentives for active participation in the labour market until, or even beyond, the statutory retirement age is reached.

In order to offset the reductions in labour taxation, it may be necessary to increase taxation in other areas, such as value added taxes, green taxes and property taxes. However, their increase, if not properly designed, could have unfavourable distributional effects and hamper the goal of reducing poverty.
In addition, shifting taxation from labour to other sources may impact on the financing of social protection. This is a risk particularly in countries where social protection is primarily based on social insurance contributions. However the financing of social protection could be preserved by earmarking a portion of revenues for this purpose, as done for instance by Germany for VAT.

**Efficiency and cost-effectiveness of tax and other incentives**

In a tough review of all expenditures, Member States will also have to look at the cost of promoting funded 2nd and 3rd pillar pensions through tax exemptions and other subsidies.

They will have to examine whether fiscal incentives offered to pension savers and to pension funds yield enough value in terms of pension provision. They will also have to consider whether similar or better results can be achieved through other or complementary means.

The key argument for subsidies through tax exemptions is that 2nd and 3rd pillar schemes are *voluntary*. Economic incentives are necessary to motivate employers and individuals to move consumption into the future and build extra entitlements through complementary savings.

Yet, even with high subsidies it has been impossible in some Member States to raise coverage above 50%. Instead, authorities are now trying a regulatory approach of auto-enrolment. If this works could subsidies then be lowered?

In a number of Member States the pervasiveness of tariff agreements with workplace pensions means that such schemes in reality are what OECD calls quasi-mandatory. If this is so could incentives to save be phased out or perhaps continued at a lower level?

Finally, public authorities may also be inspired by the idea of *mandatory* private pensions.

We live in a Union where all countries subscribe to the idea of mandatory third party insurance for drivers of motor vehicles. Should we not also consider making it mandatory for citizens to take out pension insurance in the work place or in third pillar schemes to boost the adequacy of their pension entitlements?

Making it mandatory need not mean that we should abolish or even reduce fiscal incentives. But it would mean that we have more room to consider how much we subsidise and with which distributional profile.

These are just some suggestions from Member State practices. The Commission is not wedded to any of them. We would invite all stakeholders to consider and discuss by which means we can best promote complementary retirement savings while limiting the cost to public budgets.

Ladies and Gentlemen,

**The Social Investment Package**

As I said in the beginning, the discussion we are having today takes place in a context of significant pressure on public budgets, with at the same time increasing inequalities and record-high unemployment rates.

While addressing the financial crisis is key, we also need to modernise our welfare states. This calls for a stronger focus on social policies that support employment and social inclusion in an efficient and effective way.
The Commission has therefore developed a **Social Investment Package** which I presented last week. It sets out a new agenda for social policy to help the Member States carry out the structural reforms needed to emerge from the crisis stronger, more cohesive and more competitive.

The Social Investment Package outlines how investment in social policy can strengthen people’s employment prospects and ensure adequate livelihoods throughout life.

In times of economic crisis and increasing pressures on public budgets, it is of utmost importance to spend government revenues in the most efficient and effective way possible.

The taxation framework can play here an important role by providing incentives to invest in human capital, active ageing, longer working lives, and more adequate pension entitlements.

The European Commission will continue to support member states with policy advice based on comparative evidence and examples of good practice from across the European Union.

Ladies and gentlemen,

Tackling the challenges facing our pension systems calls for a holistic approach, involving labour market and taxation measures.

The crisis has triggered a wave of pension reform across Europe. This is necessary for consolidation of public finances in the short term and enhancing the sustainability of pension systems in the longer term.

Cooperation and dialogue with all stakeholders is central to our efforts to reshape Europe’s economic governance in the wake of the crisis.

I trust I can count on your support as we seek to tackle these challenges.

Thank you.