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Mailing It In:
European Union Efforts at Pension Reform
Michael K. Stransky*

Occupational pension schemes are one pillar of the European pension system; the other pillars are public schemes and individual pension plans. Authoritative sources have noted that the dearth of specific European Union ("EU") rules regarding occupational pension schemes and the stringent requirements upon them, such as workers losing their pension rights should they move between countries, have certain negative consequences, such as impairing labor mobility. On October 11, 2000, the EU issued a *Proposal for a Directive of the European Parliament and of the Council on the activities of institutions for occupational retirement provision* ("Directive").¹ The catalyst to this Directive was to assist the efforts of occupational fund schemes in relieving the impending financial pressures on the Member States' public systems. The Directive is to address various challenges to the overall pension system by strengthening one of its pillars, the occupational pension scheme.

The most prevalent challenge to the European (as well as the US) pension system is the prospect of an aging population, represented demographically by the retirement of the "baby boomer" generation with a corresponding low fertility rate today. In fact, the European Commission has noted that "[p]opulation ageing [sic] 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

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1. COM (00) 507 final (Oct 11, 2000) available online at <http://europa.eu.int/comm/internal_market/en/finances/pensions/com507en.pdf> (visited Mar 25, 2001). When the Commission makes proposals such as this, it often attaches an explanatory memorandum to its proposal. This memorandum is also available in this citation. The Commission's views on "the absence of a Community framework and the negative consequences of this gap" can be found in this memorandum. See Explanatory Memorandum, para 1.1(b). See also Philip Shishlin, *Cross-Border Investing is Nearer for Europe's Big Pension Funds*, Wall St J A24 (June 19, 2000) (quoting EU Commissioner for the Internal Market Fritz Bolkestein that the current pension systems "undermine[] the competitiveness of pan-European companies which have to set up specific pension arrangements in all member states."). For convenience, this proposed directive will be referred to as the "Directive" though it must be formulated into a final directive and national governments and the European Parliament must approve it before it becomes Union law.

Union.”² Currently in the EU, four workers support every pensioner; however, that ratio is expected to drop to two workers by 2025, and even to a one-to-one ratio in some states at that time.³ These demographic facts lie in the background of the pension system and any effort to reform it.

In addition to these demographic challenges, Member States have various national restrictions and statutory provisions detrimental to economic efficiency.⁴ In some Member States, pension funds are often restricted in their investment decisions by rigid and uniform quantitative thresholds—for example, a fund can only invest a certain amount of its assets in domestic stocks, foreign stocks, or government bonds. Also, pan-European companies cannot centralize their pension investments and activities in a single fund, but rather are restricted to executing pension funds in accordance with the pension laws of the individual Member States. Workers moving from one Member State to another often lose a part or all of their acquired pension rights when moving, and their cross-border pension contributions do not attract the same tax advantages as purely domestic contributions.⁵ These national restrictions deter labor mobility, an efficiency requirement absolutely crucial to the success of the single market and common currency.⁶

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2. Communication from the Commission to the Council, to the European Parliament and to the Economic and Social Committee, *The Future Evolution of Social Protection from a Long-Term Point of View: Safe and Sustainable Pensions*, COM (00) 622 final at 2 (Oct 11, 2000), available online at <http://europa.eu.int/comm/employment_social/soc-prot/social/news/pensions_en.pdf> (visited Mar 25, 2001). The Commission also wisely notes that an increase in the demographic old-age dependency ratio can neither be halted by a sudden increase in fertility nor by any realistic level of immigration. Changes in fertility only start having an impact on the labour market twenty years later. However, immigration can contribute towards raising the level of employment—but its positive impact depends on the extent to which migrants can be sufficiently integrated into the labour market.
Id at 5–6.
 3. The Commission has aptly noted that it is actually “much more relevant for an assessment of the prospective sustainability of pension systems to consider the actual number of people in employment in relation to people who do not work.” Id at 6.
 4. See Fritz Bolkestein, *Pension Funds in the European Union*, speech given Mar 30, 2000, available online at <http://europa.eu.int/comm/internal_market/en/speeches/spch109.htm> (visited Mar 25, 2001).
 5. On a related issue, the European Court of Justice recently made a preliminary ruling that Article 52 (now, after amendment, Article 43) of the Treaty on European Union precludes, if certain criteria are met, a Member State from making a tax exemption subject to the condition that the investment be held in a company established in the Member State concerned. *C. Baars v Inspecteur der Belastingen Particulieren/Ondernemingen Gorinchem*, Judgment of the Court (Fifth Chamber), Case C-251/98, 2000 O J (C 192) 8, Apr 13, 2000. Essentially, if a tax benefit accrues to a national from an investment in a wholly domestic company, a Member State may not deny that benefit if the national makes the same investment in another Member State.
 6. A common currency is economically viable when the proposed area for its implementation is an optimum currency area. An optimum currency area by definition is a “group [] of regions with economies closely linked . . . by factor mobility.” Paul Krugman and Maurice Obstfeld, *International Economics: Theory and Policy* 629 (Addison 5th ed 2000). Labor is one of the basic factors of production across the geographic area of Europe, and therefore labor mobility is essential to the

It is the sole responsibility of the EU Member States to maintain the legal framework of their respective pension regimes, and thus they have the exclusive power to address these demographic challenges and statutory inefficiencies. France and Spain have emphasized adjustments to the parameters of their existing, mandatory "pay-as-you-go" schemes,⁷ such as adjustments to the contribution rate, retirement age or benefit payment level. Sweden has favored accumulation of reserves within the existing public scheme, while Italy has opted for an increased reliance on private schemes. The long-term sustainability of pension schemes is most sound in the two countries with the most open and private systems, the United Kingdom and the Netherlands.⁸ The differing actions taken to meet the challenges to the pension system clearly exemplify the various governing philosophies of the Member States with respect to reforms in this area.

The Commission noted its ability to coordinate national regulatory schemes at the supranational level, and its recent Directive addresses directly some of the outlined concerns. Though the Directive maintains qualitative restrictions, it proposes that pension funds be allowed to invest up to 70 percent of their assets in shares, far more than is allowed in most EU states.⁹ The Directive is also designed to allow multinational corporations to create pan-European funds, rather than creating individual funds in each Member State, thereby allowing fund managers and custodians across Europe to compete for business.¹⁰ The Commission estimates that this would save 40 million Euros a year in administrative costs.¹¹ It is the goal of the EU to facilitate coordination in this area, namely in Member State efforts to address challenges to their individual pension systems.

success of the common currency. These hindrances of the European pension system, such as portability of pension rights and differing tax treatment, only exacerbate the fact that labor was not that mobile throughout Europe before the institution of the common currency for various other reasons, at least not to the levels requisite to label properly Europe as an optimum currency area. See *id.* at 632 (discussing the lack of labor mobility in Europe); *id.* at 634 ("Europe is not an optimum currency area.").

7. The public pillar whereby current laborers provide wealth transfers through the state to pensioners.
8. See Philip Shishkin, *Cross-Border Investing is Nearer for Europe's Big Pension Funds*, Wall St J A24 (June 19, 2000) ("The Dutch pension fund has served as one of the models for the commission's proposals. Dutch funds are invested around the world, have a large investor participation and good supervision mechanisms. The Dutch system is probably the best one' says one commission official.").
9. Directive, art 18(6) (cited in note 1). However, the more successful pension regimes, namely the US and UK, are governed by the standard of "prudence," rather than some qualitative stipulation. See, for example, Employee Retirement Income Security Act, 29 USC §§ 1001 et seq., 1104 ("[A] fiduciary shall discharge his duties with respect to a plan . . . with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.").
10. Directive, art 19 (cited in note 1).
11. Explanatory Memorandum, para 1.1(b) (cited in note 1).

It is important to note what this Directive does not do. First, it does not address how Member States organize the pillars of their pension systems. Member States are free to maintain their public schemes without interference, and can encourage or discourage private pension systems as they see fit. It is entirely within the realm of the Member States to address the demographic challenges to their pension systems. This specific Directive is not the comprehensive effort needed to support and reform the overall pension system, as it fails to factor in other political and economic dimensions of pension reform.¹² This failure to recognize outside economic trends is detrimental in some respects—for instance, the catalyst to this Directive was to facilitate occupational funds' efforts to benefit fully from the single European capital market and the Euro. However, the Commission has failed to note that there is little benefit to be derived from investments in the Euro.¹³ Though the EU has made an admirable initial effort at addressing the challenges to the pension system, its focus on only one pillar, rather than a more comprehensive effort, may frustrate the realization of any benefits that could otherwise be derived from these efforts.

This Directive's failure to address the differing tax treatment of pensions may also prevent any attainment of benefits.¹⁴ Some Member States currently tax contributions to occupational pension funds, while others tax the withdrawals as income from a fund comprised of pre-tax contributions. The Commission hopes that greater use of occupational pension funds will alleviate the burdens on the public system; but until this tax exigency is resolved, many of the benefits of the other provisions of the Directive will remain unfulfilled. It is simply confounding to consider the accounting difficulties that will be encountered by a firm in its attempt to consolidate funds for pensions from different Member States, some of which have been taxed already and some which have not. States will most likely be aggressive in ensuring that reforms in this area will not jeopardize the tax windfall they receive from these funds. Thus, it will be difficult, if not impossible, for companies to consolidate their individual pension funds into a pan-European fund until this discrepancy is resolved.

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12. Current popular proposals in the US are conversely similar in that they rely almost exclusively upon unrealized budget surpluses to sustain social security, rather than structural reforms to the social security program. A prominent example of this was President Clinton's "save social security first" plan announced during his 1998 State of the Union address.
 13. The idea that the Euro was going to become a strong reserve currency or a challenge to the dominance of the dollar has clearly not played out. After its initial offering of one Euro for \$ 1.17, the Euro was trading at \$ 0.84 on October 30, 2000.
 14. This Directive is the codification of numerous Green Papers and consultancy studies, all of which noted this situation and failed to make recommendations for it. See, for example, Pragma Consulting, *Rebuilding Pensions 1* (European Commission 1999) available online at <http://europa.eu.int/comm/internal_market/en/finances/pensions/pensions2.pdf> (visited Mar 25, 2001) (noting that, despite its 102-page length and "its ambitious scope, the report does not cover taxation").

This Directive was designed to encourage the use of the single market, but without a uniform treatment of pension funds, there is in fact no single market to employ. For example, the fact that Member States currently tax these funds at different rates illustrates how there are competing markets for pension funds among which a private economic actor may choose. Where a laborer can receive the most advantageous tax treatment of his pension may factor into his decision where to sell his labor; with this differing tax treatment there is not one single labor market but in fact many. The EU repeatedly assures its members that it is not attempting to dictate a harmonization of economic and social law, but it is difficult to imagine a true single market existing without uniform laws and policies in areas of such economic consequence.

Even if the EU is able to address these taxation issues, the Directive faces other political difficulties before it receives final approval. Though the Directive does not address public schemes, France somehow sees this Directive as a threat to its state pension system and has vowed to block its enactment.¹⁵ Private pension companies are also unhappy with the Directive because it accords much more favorable treatment to occupational funds than what a 1994 Directive granted private pension companies. This dissatisfaction comes after numerous compromises were made simply to bring the Directive to this stage. Various state and private interests may hinder any proposal to invoke aggressively the private sector in an effort to alleviate the burdens on the state pension systems.

These developments also illustrate that European countries have conflicting social models and priorities, and because of that, the EU is still properly labeled an intergovernmental institution. Some countries, such as France and Sweden, emphasize an active government in social affairs with the provision of cradle-to-grave support. Others, such as Britain, favor a less regulated approach. Individual Member State policy in the area of pensions provides a paradigmatic illustration of this. France forbids the existence of occupational schemes and relies heavily upon its state pension system; whereas Britain supports its citizens' use of private retirement planning. The fact that France would actively seek to prevent other EU Members from coordinating their occupational pension schemes illustrates the various social priorities among the EU Member States. There need not be a moral qualification as to which system is preferable to note the detrimental effects of such conflicts. The very fact that EU Member States hold such diametrically opposed views on such policies of consequence can only hamper the uniform progression of the EU. Though the EU continues to proclaim a goal of moving towards "an ever closer Union," it will be difficult for the Member States to move forward together when so many domestic

15. See Geoff Winestock, *EU Commission Pushes Proposals on Pension Funds*, *Wall St J Eur* 2 (Oct 6, 2000) ("[W]hen it is put to member governments and the European Parliament, it is likely to face pitched opposition, especially from France.").

policies that bear upon economic union remain fully within the domestic control of Member States. The differing approaches to various issues, of which retirement security is one, illustrate that the EU remains a collaborative intergovernmental institution comprised of fifteen different sets of economic and social policies.

In this collaboration, many have noted that the pension system of Europe is in dire need of far-reaching reform, but Member States have been unwilling to take the necessary sweeping action to execute it. The EU has failed to note that those countries whose pension systems are best suited to address the demographic challenges explained above, namely the United States and United Kingdom, have pension systems that facilitate individual responsibility for one's own retirement, namely by allowing people to access and exploit private equity markets.¹⁶ Proposals by the British to create a less regulated EU market, governed by the standard of prudence,¹⁷ did not make the final Commission Directive. Though the need for extensive reform and increased utilization of private markets has been widely discussed, there are currently no specific proposals that address the tax situation.

The decision respecting the tax treatment of occupational pension schemes will probably forecast the EU's future reliance on the private sector. Whatever the decision, it must simply be made so that citizens can begin to make private economic choices in reliance upon it. Perhaps the EU can direct that all occupational pension contributions made from some date certain in the future be treated as an investment with pre-tax funds to be taxed as income upon withdrawal, while any contribution made prior to that date be taxed according to the pre-existing law.¹⁸ Whatever taxation scheme is selected, it will allow EU citizens to plan for their own retirement accordingly. Failure to make any decision will continue to hinder EU Member State utilization of strengthened occupational pension schemes to address demographic challenges to their overall pension system.

16. See *Old Hopes Stirring: Freeing Europe's Pension Funds*, *Economist* 92 (Oct 14, 2000).

Given that they all agree that a demographic "pension time-bomb" is ticking, Europe's policymakers have done remarkably little to defuse it. . . . Governments have discouraged their citizens from investment in private pensions by imposing rules that lower the returns earned by pension funds, such as limits on how much money they may put into equities, or into foreign securities of any sort. As a result, European pension-fund investors have largely missed out on the bull market in shares over the past two decades.

Id.

17. See note 9.

18. For example, before the phase-in date, if the contribution was a post-tax contribution to be withdrawn without tax, it should be able to be withdrawn without being taxed in the future, even though the Directive law in the future may call for taxation of occupational pension fund withdrawals.