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The Open Method of Co-ordination on Pensions –

An Economic Analysis of its Effects on Pension Reforms

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Abstract:

This paper analyses the potential effects of the open method of co-ordination on pension reforms in the European Union from an economic point of view. The main results are: (1) For the first time, the Commission formally participates in the input of pension policy-formation of the member states, but without affecting their ultimate decision-making powers. (2) However, the OMC might foster yardstick competition and thus mutual learning from the reform experiences of other member states. (3) In contrast to that, no clear effects on the rent-seeking behaviour of special-interest groups and thus on their influence in shaping pension reforms can be derived.

Keywords: Pension Reform, EU Integration, Regulatory Competition

JEL-Classification: E61, G2, H55, H7

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1. Introduction

At this year's annual spring meeting in Brussels the European Council welcomed the Joint Report by the Commission and the Council on adequate and sustainable pensions (Council 2003a). This report is an important first result of the open method of co-ordination (OMC) in the field of old-age security. The OMC was explicitly introduced as a new governance method at the Lisbon Summit in 2000. The OMC should be applied in such policy fields in which there are no explicit competencies at the EU level. That is where the responsibilities still rest solely with national governments, as it is the case with social security. National policies are compared and evaluated with respect to common objectives and indicators; the recommendation of best practises should promote mutual learning among the member states. Drawing on the experiences made in the field of the European Employment Strategy (Régent 2002), since 2001 the OMC is also applied to pension politics.

With the Joint Report a first assessment of the effects of the OMC in the field of old-age security can be made. The objective of this paper is to analyse the potential impact of the OMC on pension politics from an economic point of view. All EU member states face nearly the same serious problems with regard to the demographic shifts ahead in the light of persisting labour market problems. Thus, the traditional old-age security systems have come under severe pressure. This calls for fundamental changes to cope with the imminent financial burdens. Since the responsibilities for pension reforms rest with the national level, the main question is whether the OMC may help to promote the necessary pension policy reforms.

In order to assess the impact of the OMC in this field, *section 2* describes the influence already exerted by the EU on old-age security systems, the current design of the OMC on pensions as well as its main outcomes. The impact of the OMC on national pension policy formation and implementation is analysed in *section 3*. This gives rise to the question whether the OMC might lead to a shift of competencies from the national to the supranational level and thus lead to more centralisation in the field of pension politics within the EU. *Section 4* analyses the potential consequences for regulatory competition. The focus is on the impact on mutual learning from the experiences of other countries with pension reforms on the one hand and on coping with rent-seeking behaviour on the other hand. Finally, the main findings are summarized in *section 5*.

2. EU Competencies and the OMC in the Field of Old-Age Security

2.1 The Influence of the EU on National Pension Systems and Policies

The old-age security systems of the EU member states differ in many respects. Although they can be roughly classified as falling either under the Bismarck or Beveridge type[1], each national system displays its own historically evolved particularities.[2] While in the 1990s there

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1 For a short description of the different types of social security systems see Scharpf (2002), for a more detailed discussion see Begg et.al. (2001), Esping-Anderson (1990), Ferrera/Hemerijck/Rhodes (2001).

2 There are differences in the predominant objective (to prevent poverty or to maintain a certain standard of living), in the importance of the first pillar of public pension schemes, the second pillar of occupational pension schemes and the third pillar of private pension schemes as well as in the principles which guide the contributions to, the benefits from and the organisation of these schemes, not to mention the treatment of differ-

had been some debate about whether it would be useful to harmonise the different social security systems or at least to strive for their convergence, now there seems to be a broad consensus that this would be neither reasonable nor feasible (Schmähl 2001). Nevertheless, the pension systems of all member states face the same problems, even though to a different degree. The most important are

- the demographic change, which will lead to a strong increase in the old-age dependency ratio (that is the number of persons over 65 to the number of persons aged 15 to 64);
- labour market problems which result in an insufficient utilization of the labour force potential;
- socio-cultural changes which will increase flexible and non-permanent employment contracts;
- growing international interdependencies (globalisation) which will further strengthen pressure on labour costs and competition among different tax and social security systems.

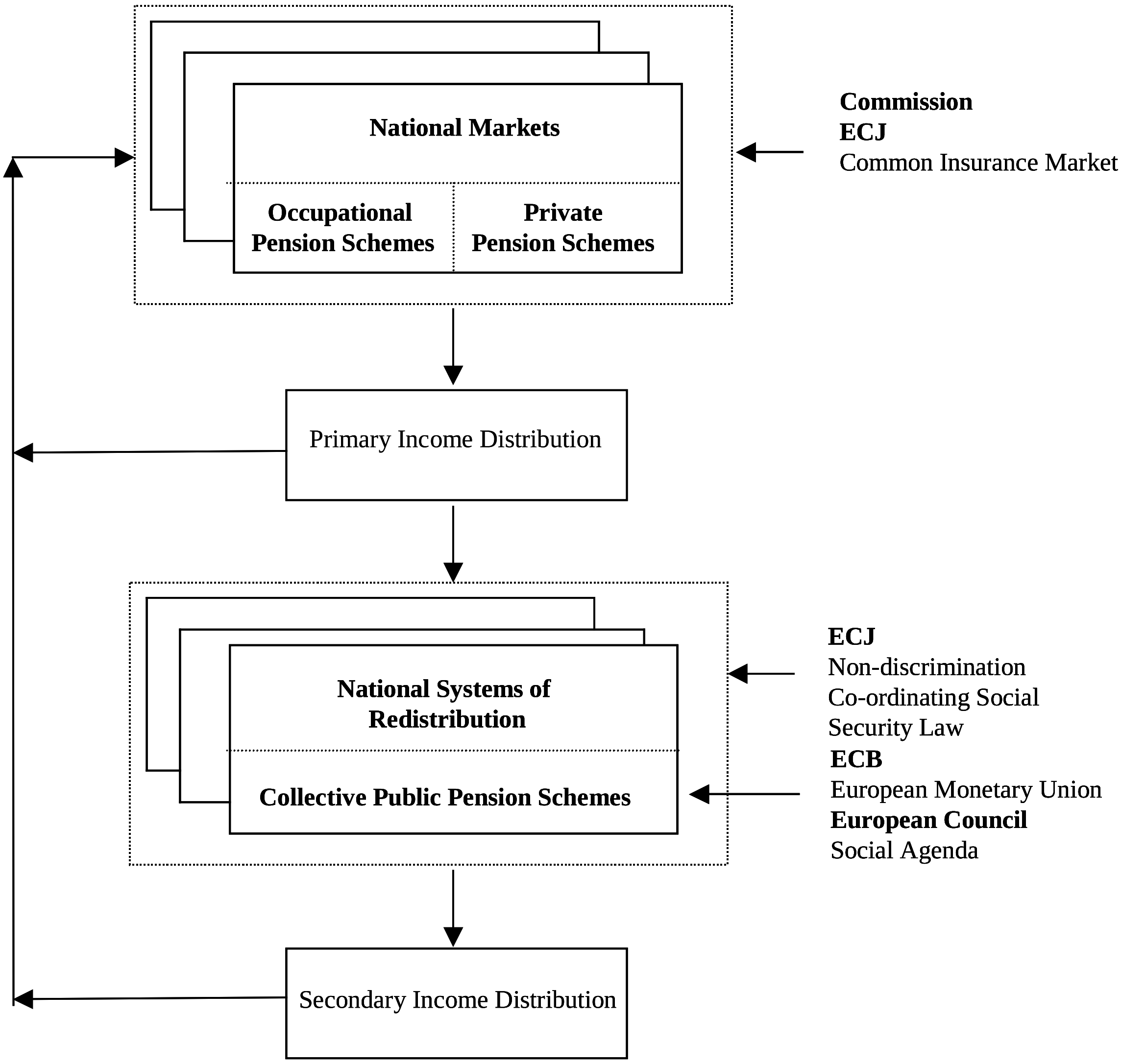
Together, these factors might well lead to financial instability of pension systems, to a decrease in the adequacy of benefits, and to a smaller ratio of persons covered. Among experts, there is a broad consensus about the primary direction reforms should take. Besides reducing labour market problems through employment policies, inefficiencies in pension systems should be reduced. Especially changes in financing with less reliance on pay-as-you-go schemes by strengthening funded elements are favoured. The latter can be realised by introducing funded components in the first pillar of statutory schemes or by shifting the weight from the first to the second or third pillar of occupational and private schemes. Another important step to cope with the imminent challenges concerns measures to weaken incentives for early retirement, so that the effective retirement age increases.

Although responsibilities for social security and therefore for the overall design of old-age provisions still rest with the individual member states, the Commission and the European Court of Justice (ECJ) nevertheless have gained some influence both on national pension *systems* as well as on national pension *policies* through their legislation and jurisdiction (*figure 1*) (Eckardt 2002; Schmähl 2002). The EC Treaty states the following central objectives for creating a common market and a common political union: (1) no discrimination of EU citizens, (2) the implementation of the four basic freedoms, (3) uniform competition rules, and (4) the European Monetary Union (EMU). The ECJ intervenes in its jurisdiction on non-discrimination for example where different access to national pension schemes is granted for persons according to their citizenship or gender. This concerns collective as well as occupational and private pension schemes. Due to its competence to create a common market, the Commission has widespread influence on those components of the second and third pillar of the national pension systems which rely on the market mechanism. A prominent example is the common market on life-assurance, which was established by three generations of directives in 1994. These directives made necessary profound re-regulations in many member states. Because of differences in legal and tax treatment, a directive on pension funds and other comparable occupational pension schemes had been under discussion for years now, but according to the *Financial Services Action Plan* it should be finally adopted by the end of

ent socio-economic groups. For an overview see Economic Policy Committee (2001), OECD (1998), the National Strategy Reports (2002).

2003. With this directive, the preconditions for a common market for occupational pensions would be finally created.

Figure 1: The Influence of the EU on National Pension Systems



Source: Own composition

Also still under discussion is a reform of regulation 1408/71 which is at the heart of the so-called co-ordinating European social law (Eichenhofer 2000; Schulte 2001). It governs the coordination of entitlements which migrant workers and their families have acquired in the social security systems of different member states. Its central role lies in guaranteeing the free movement of labour. The reform of regulation 1408/71 shall summarize and simplify the current state of the co-ordination law. This is characterized by a complicated case law developed by the ECJ over the years. However, it is not intended to intervene in the national social security systems.

A more far-reaching impact on the first pillar of collective pension systems might emerge from the EMU related Stability and Growth Pact and the Broad Economic Policy Guidelines (BEPG). Both tax-financed as well as contribution-financed pay-as-you-go (PAYG) pension systems of the first pillar are part of public budgets. With the demographic changes ahead, these old-age security systems might well jeopardise balanced national budgets if reforms are not undertaken in time. Therefore, the first pillar of national pension systems has come into the focus of the Commission and the European Central Bank (ECB). Although the Stability and Growth Pact gives no competencies to the EU to directly influence national pension systems, the Commission's activities have been recently intensified in this field due to the potential risks for balanced public budgets.[3]

To summarize, at the moment the Commission and the ECJ have well-defined responsibilities with respect to the second and third pillar of national pension systems, as far as both the free movement of labour, goods, services, and capital as well as uniform competition rules are concerned. But they have no direct competencies to regulate the design of the first pillar of national pension systems or to decide on the weight given to the three pillars in single member states. Up to now, the growing influence of the EU on national old-age security is primarily a consequence of decisions taken by the member states themselves to shift the weight for providing adequate old-age income to the second and third pillar. Since these two pillars rely more on private markets, they fall within the responsibility of the EU. But now the OMC provides an institutionalised framework which for the first time allows the Commission to take actively part in the debate on national pension policies in a formal way.

2.2 The Design and First Results of the OMC on Pensions

At the Lisbon summit in 2000 it was stated that the central objective of the EU should be to become "the most competitive and dynamic knowledge-based economy in the world capable of sustainable economic growth with better and more jobs and greater social cohesion" by 2010 (Council 2003b, 1). Also in 2000 the Social Agenda was agreed upon by the European Council. Better coordination of national employment and social policy provisions as well as the modernisation of the national social security systems is regarded as a key feature to reach the above stated aim. The OMC was formally introduced to support this strategy in such policy fields where the EU has no legislative competencies, as for example in the field of old-age provision and social inclusion.

The OMC has evolved from the experiences gained by the European Employment Strategy (EES) which follows the same overall procedure (*figure 2*).[4] The EU Council defines common objectives and (as far as possible quantitative) targets, to which the member states regularly present national strategy reports. Based on these reports the Commission and the competent Committees involved assess and compare the national efforts to reach these targets. Ideally, the Commission will formulate recommendations for each state based on the best practises identified in the national strategy reports, which the member states then would implement. The whole process rests on the idea of benchmarking, peer review, and mutual learning. For it to work, not only commonly agreed objectives but also well-defined indicators to reliably compare the performance of different member states are a necessary prerequisite.

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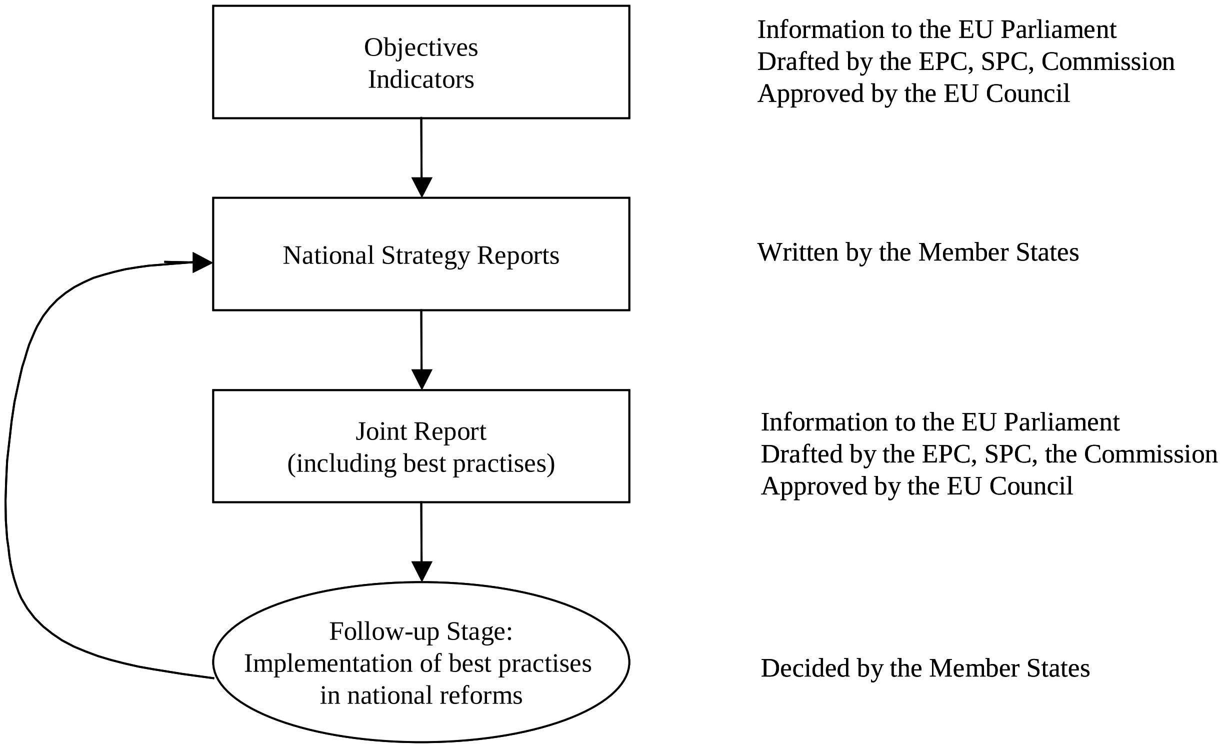
[3] In 1999 the Ageing Working Group AWG was established by the Economic Policy Committee. It carried out projections of public spending on pensions up to 2050 (Economic Policy Committee 2001). These projections might well prove to be quite influential in the discussion of the necessity of further pension reforms in the individual member states.

[4] Not de jure, but de facto also the *BEPG* can be regarded underlying the same procedure as the OMC. For an overview of the areas to which the OMC is applied see Working Group (2001); for a detailed discussion see for example De la Porte/Pochet (2001; 2002a), Goetschy (1999), Hodson/Maher (2001).

The OMC is not uniformly applied to all the diverse areas like employment policy, social exclusion, education or pension policies. For example, the OMC on pensions does not involve a ranking of the member states according to the performance of their pension systems. Furthermore, there are no formal sanctions in the case of non-compliance. While in some areas like employment the Commission could provide financial incentives, in the filed of pension politics only pressure from the process of peer review might induce member states to adopt pension reforms.

Figure 2: The Design of the OMC



Source: Own composition.

In 2001 the EU Council agreed upon "safeguarding the capacity of systems to meet their social objectives, maintaining their financial stability and meeting changing societal needs" (Council 2002, p.9) as the three main principles national pension schemes and policies should strive for. These principles are specified in eleven objectives (*figure 3*). In the 2002 and 2003 BEPG the principle of financial sustainability of pension systems is included with a three-pronged strategy. By raising employment rates, reducing public debt levels, and reforming pension systems, the impact of an ageing society on public finances should be coped with (Commission 2002a, 19; Commission 2003, 10f.). Up to now, no agreement could be reached about quantitative targets for the overall principles and/ or the different objectives.

In autumn 2002 for the first time the member states presented National Strategy Reports (National Strategy Reports 2002). To evaluate the success of the measures taken to reach the agreed objectives, the Economic Policy Committee (EPC) and the Social Protection Committee (SPC) are in charge of developing indicators which allow for a comparison of the performance of the different pension systems.[5] Since this proves to be a very difficult and complicated task and because of limited personnel resources, the schedule could not be kept.[6] Thus, currently there are only few indicators used. As indicators for the overall principle of adequacy, relative poverty ratios and the relative income situation of older people are calculated and the inequality of the income distribution is presented (Council 2003a). To evaluate the impact of different pension schemes on financial sustainability, age-related employment rates according to the Lisbon and Stockholm targets are used. Besides, the average age of withdrawal from the labour market and public pension expenditures as a percentage of GDP are calculated (Council 2003a).

Figure 3: The Objectives of the OMC on Pensions

Principle 1:	**Adequacy of Pension Systems**	
	Objective 1:	Preventing social exclusion
	Objective 2:	Enabling people to maintain living standards
	Objective 3:	Promoting solidarity
Principle 2:	**Financial Sustainability of Pension Systems**	
	Objective 4:	Raise employment levels
	Objective 5:	Extend working lives
	Objective 6:	Making pension systems sustainable in a context of sound public finances
	Objective 7:	Adjust benefits and contributions in a balanced way
	Objective 8:	Ensure that private pension provision is adequate and financially sound
Principle 3:	**Modernisation: Responding to Changing Societal Needs**	
	Objective 9:	Adapt more flexible employment and career patterns
	Objective 10:	Meet the aspirations for greater equality of women and men
	Objective 11:	Demonstrate the ability of pension systems to meet the challenges

Source: Own composition according to Council (2003a)

Even these few indicators have already prompted a lot of controversy among the actors involved, which shows the great importance of commonly agreed indicators. There are both problems with the availability of data and with the design of the indicators (Behrendt 2002; Stanton 2002). The income data used are from the European Consumer Household Panel with the latest dating from 1998. Therefore, reforms in national pension systems, which had been put in force thereafter, are not reflected in these data. It also has to be ensured that the national data are comparable with respect to definitions and methods of data acquisition. The design of indicators for adequacy and modernisation is very demanding. Poverty measures are very sensitive to the formula used, the time horizon applied, the income components included and so forth. Besides, the OMC on pensions mainly focuses on the first pillar of public pension schemes, and here primarily on monetary transfers. To really compare the living standards of pensioners from different member states, transfers in kinds as well as access to services have also to be taken into account, especially with regard to health, long-term care, and housing. Moreover, monetary transfers like tax subsidies in the second and third pillar are only marginally reflected in the Joint Report. Furthermore, indicators which refer to the current income

[5] For the composition, tasks and working of the committees see Jacobsson/Vifell (2003).

[6] Originally, these indicators were planned to be available in spring 2002.

position of pensioners mainly reflect past employment biographies and pension politics. Therefore, work is under way, but not yet completed in developing prospective indicators to evaluate potential future income positions of pensioners. This points to another important problem, since a reasonable balance between highly aggregated and rather disaggregated indicators must be found. The consequences of different pension systems have to be evaluated not only for average values, but for persons with different employment biographies, including a-typical ones. Micro simulations might be a promising way to supplement aggregated indicators.

Since currently there are no precise indicators available for all the objectives to be assessed, both the first draft version as well as the final Joint Report which was approved by the Council at its spring meeting 2003 are primarily descriptive. They provide an analytical overview of the different pension systems and the main measures taken to reach the common objectives. All in all, neither a ranking of the relative performance of the individual pension systems of the member states nor a clear-cut list of best practises was drawn. Nevertheless, the material presented allows to draw one's own conclusions about the relative (dis-) advantages of different pension systems and policies taken.

The Joint Report also mentions a number of follow-up tasks (Council 2003a, 105f.). In the first place further work on the development of indicators should be done, in particular with respect to future effects like expenditure projections or prospective replacement rates. Above that the applicant countries are also invited to provide National Strategy Reports based on the eleven common objectives. By 2006 an update of the member states' National Strategy Reports has to be provided to the EU Council which then will review the progress achieved and assess the further application of the OMC on pensions (Council 2003b). Meanwhile, the process on streamlining which mainly concentrates on the BEPG and the EES might also affect the OMC on pensions, since there are overlapping activities which might be concentrated (Commission 2002b).

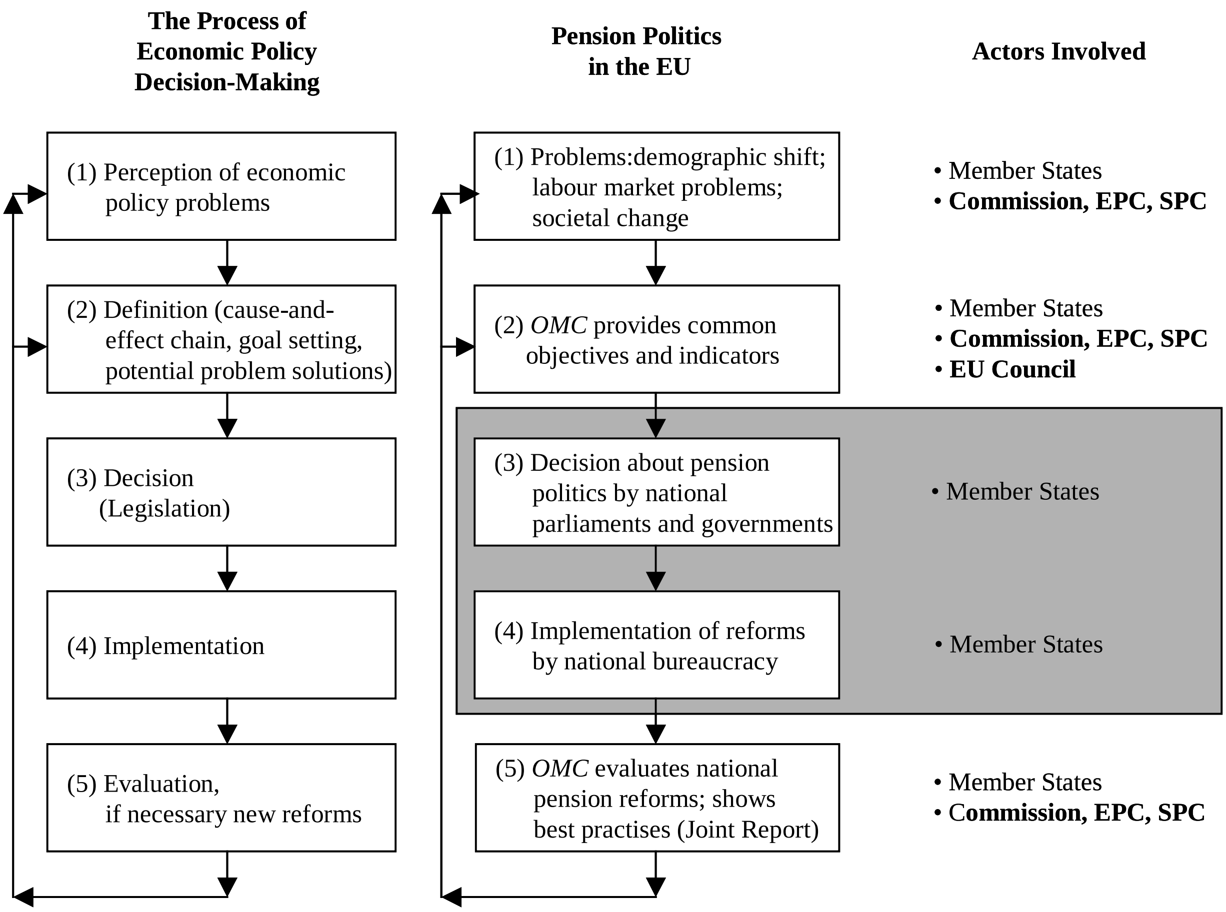
3. The Impact of the OMC on Pension Policy Formation

The OMC on pensions is first of all a procedural instrument which provides an institutional framework for the exchange of information and collective learning about national pension systems and pension reforms in the EU member states (Hodson/Maher 2001). However, for the first time the OMC gives the Commission an explicit mandate to comment on national pension policies. To assess the resulting implications for policy-making in the field of old-age security, in the following it is analysed how the OMC changes the decision-making process in this field.

From a positive point of view, economic policy decisions are generated in an evolutionary problem-solving process (Slembeck 2003). In this process, economic problems are not given as such, but they are the result of individual and collective perceptions about the underlying problems, their causes and their potential solutions. The number and kind of political solutions are limited by the restrictions set out in the political framework of the respective member state, which is based on its constitution. In the field of pension policies, the OMC supplements the national decision-making level by providing an additional institutional framework on the supra-national level of the EU. With this institutional innovation, both the rules of the game as well as the number and the kind of players have changed. In addition to the national governments and the social partners, now also the Commission, the EPC, and the SPC take part in pension politics.

In a decision-making perspective, different phases of policy-formation can be distinguished (*figure 4*): (1) perception of the problem, (2) definition (cause-and-effect-chain, goal-setting, potential problem-solutions), (3) decision (through the legislature), (4) implementation, (5) evaluation and if necessary reforms (modification of the problem-solution). Put in this framework, the ultimate decision-making power as well as the implementation of pension reforms still rest with the nation level (phases 3 and 4). However, the OMC grants the Commission influence on the input of policy-making. It is involved in pension politics through the definition of common problems, objectives and possible problem solutions in phases (1) and (2). By evaluating the measures taken by the national governments and by underlining best practises, the OMC gives also hints to further reforms and thus modifications of current pension policies (phase 5).

Figure 4: The OMC on pensions from a decision-making perspective



Source: Own composition.

While the general principles are commonly agreed upon by the Council, nevertheless tensions between them exist. This is seen in particular in the weight which is attached to the two main principles of adequacy and financial sustainability of pensions. These tensions translate also into the priority which is assigned to reforms regarding either one of these principles. However, this dispute is rather a dispute among economically- and socially-oriented actors than between the Commission and national governments (de la Porte/Pochet 2002b).[7] Since both groups have different cognitive belief systems and theories which guide their perception of the problems on hand, also the proposed solutions vary (Denzau/North 1994; Slembeck 2003). Roughly spoken, socially-oriented actors are more in favour of the adequacy goal, whereas economically-oriented actors give more weight to the goal of financial sustainability for pension reforms. The latter claim that the coming demographic shift may put the PAYG financed collective pension schemes and thus also public budgets under huge pressure. This would not only negatively affect the respective member state through higher debts and/or taxes, with negative consequences for economic growth and intergenerational justice. Above that, it would also exert negative externalities on other member states through the common currency by raising overall interest rates. Thus, member states with lower public deficits might have to pay for member states with budget deficits, too. Besides, old-age poverty has been successfully fought over the last decades, so that it is not seen as a problem today. In contrast to that, those who support adequacy as the guiding principle for pension reforms argue that it is not the task of old-age security systems or politics to consolidate public budgets, but to provide adequate income for the elderly. Only at second rank it had to be decided how this could be achieved most efficiently.

While agreement exists with respect to the necessity of a later retirement age and a higher employment rate, opinions differ about the kind of other reforms depending on which group one adheres. Generally, most of those who put forward adequacy prefer to prevent poverty and simultaneously achieve a high standard of living by reliance on PAYG-financed collective pension schemes of the first pillar. To cope with the financial problems ahead they favour parametric reforms of the benefit formula and the contributions paid.[8] Those which advocate financial sustainability also support such parametric reforms. However, they suggest more fundamental structural modifications of the existing pension systems. In particular, they favour a stronger reliance on funded pension schemes, and a shift in the public-private mix by giving more weight to the second and third pillar. Thus, first pillar schemes would provide mainly some kind of minimum pensions to prevent old-age poverty, while occupational and personal pensions would ensure an adequate standard of living. With a shift to more funded pension schemes labour costs are expected to decrease, while at the same time capital supply would increase. This in turn could reduce interest rates and enhance growth of the GDP. Thus, the burden of higher pension benefits could be eased to some extent. However, the possibilities for interpersonal redistribution would be reduced.

Yet, up to now it is not decided which opinion will prevail. The supporters of the more social policy point of view are mainly found among trade unions and other NGOs. In most member states these are traditionally involved not only in providing social services, but also in the political decision-making process on pension reforms. Moreover, they are able to mobilize large parts of voters. In general these groups tend to be less in favour of more structural reforms. On the one hand, this is because of the underlying belief systems and cognitive frames

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[7] Jacobsson/Vifell (2003) show this to be true inter alia for the EPC and SPC.

[8] Examples are the introduction of a demographic factor in the benefit formula; actuarial fair calculations of benefits in case of earlier or later retirement; broadening of the persons covered by the collective pension schemes; higher contribution rates; cutbacks of periods for which no contributions have to be paid (training, military service); tax-financing of periods for which no contributions are paid (unemployment, maternity).

within which such matters are usually discussed. On the other hand, it would include a loss of influence. To put less weight on collective pension schemes would quite inevitably mean more individual responsibility and more reliance on markets and less on bureaucratic and political regulatory mechanisms. Therefore, these well organised interest groups are to be expected to resist profound structural changes of pension systems on the national level. That the trade unions can mobilise large numbers of people against reform efforts can be currently observed in all member states where the government intends to implement parametric pension reforms, as it is the case in Austria, France, Germany, or Italy for example. The ensuing public opposition shows that so far the objective of financial sustainability has no broad support on the national level.

In contrast to that, advocates of the principle of financial sustainability seem to be in a stronger position with respect to the OMC on pensions. They are backed by the EC Treaty and the Stability and Growth Pact as well as by the three-pronged strategy of the BEPG (ECB 2003, 46f.). The DG Economic and Financial Affairs and its Committees are already doing quantitative projections and extensive studies on the influence of an ageing population on social security systems and public budgets.[9] Furthermore, there is strong support from the ECB (ECB 2003). Advocates of the objective of adequate pension income fear that fiscal considerations might become predominant for pension reform issues.[10] This could be reinforced, since the effects of reduced financial burdens accrue rather immediately, while the resulting effects on the adequacy of pension income can be assessed only after decades. As long as no reliable prospective income indicators exist, which allow to evaluate the effect of more structural changes on future benefits, the rather short-termed policy-making process might further favour the principle of financial sustainability.

However, presently, the OMC primarily takes stock of the current condition of the national pension systems. By channelling the discussion about the necessity of further reforms and by directing the political discussions to certain objectives and measures, the OMC could in principle restrict the scope of national policy activities. In future legislative decision-making on the national level, the arguments provided by the OMC on pensions might gain influence in the national political debates, where it plays no role up to now.[11] In principle, the OMC might also contribute to accelerating the speed with which reforms are tackled by putting the overall objectives on the political agenda of the EU Council and thus also on the agenda of national policy-making.[12] From a decision-making point of view the OMC helps the Commission to strengthen its influence on national pension politics. By monitoring national reform processes, the Commission participates in framing the input of national policy-formation. By pushing forward certain objectives, arguments, and reform options, it might shape national pension policies to some extent in the future.

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9 See the activities of the DG Economic and Financial Affairs on the economic and budgetary consequences of ageing, http://europa.eu.int/comm/economy_finance/about/activities/ activities_consequences ofageing_en.htm, 27/05/03.

10 See De la Porte/Pochet (2002b) and Scharpf (2002) for the idea that the application of the OMC on pensions was ultimately due to that concern.

11 To the rather limited effect of the OMC on national policy formation see for Anderson (2002); Jacobsson/Vifell (2003); Jacobsson/Schmid (2002); Scharpf (2002).

12 See the priorities set by the current Italian EU Presidency, http://www.ueitalia2003.it/EN/Temi/ economiaFinanza/PrioritaPresidenza.htm, 13.07.2003.

4. The Impact of the OMC on the Reforms of Old-Age Security Systems

The growing economic and political integration in the EU influences both national pension systems and pension politics. As has been shown in *section 2* and *3*, so far this has led neither to a harmonisation of pension systems nor to a centralisation of competencies on pension politics. However, with the OMC the Commission now has for the first time a foot in the door to gain influence on national pension policies. The experiences in other policy areas like environmental or competition policy show that in the past this has always led to a shift of competencies to the EU. This raises the question what consequences the OMC might have for pension politics. Generally spoken, the more centralised the responsibilities for policy formation are, the less competition takes place among different regulatory systems which will eventually result in growing harmonisation. In the following, it is first discussed what kind of regulatory competition, if any, applies to pension reforms (*4.1*). Secondly, the effects of the OMC for mutual learning (*4.*2) and for rent-seeking behaviour (*4.*3) are analysed.[13]

4.1 The OMC, Regulatory Competition, and Pension Reforms

The economic theory of fiscal federalism extensively discusses the appropriate extent of centralisation for the provision of public goods, redistribution and taxation in multi-level governance systems like the EU (Breton 1998; Oates 1999, 2001, 2002). Closely related to this question is the issue of interjurisdictional or locational competition (Siebert/Koop 1990; Sinn 1997; Vanberg/Kerber 1994). The underlying issues are also discussed under the headline of regulatory competition.[14] Four different forms of regulatory competition can be distinguished: regulatory competition via mutual learning (yardstick competition), via international trade, via interjurisdictional or locational competition, and via choice of law (Kerber/Heine 2002). International trade and interjurisdictional or locational competition only indirectly influence national regulations, while yardstick competition and competition via choice of law directly concern specific national regulations.

In principle, for regulatory competition to be effective the same holds true as for competition on ordinary markets for goods and services. Ideally, the market mechanism helps to provide products and services best suited to the preferences and needs of consumers. It sets incentives to generate and disseminate innovations, and controls unfair market practises. A variety of diverse actions must be allowed for using the full potential of competition as a discovery procedure. Appropriate feedback mechanisms must exist which link the success (or failure) of a reform to the actions taken, so that successful outcomes can be identified at low costs. On economic markets, the price mechanism provides information about the conditions on the supply and demand side and thus promotes competition. On political markets, elections take the place of the price mechanism. To get elected politicians have to offer reform alternatives which are rewarded by voters. However, information costs are much higher on political mar-

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[13] Both the question whether regulatory competition among old-age systems would lead to a race to the bottom or to a race to the top and the factors which determine the appropriate level of centralisation of pension politics in the EU would go beyond the scope of this paper. For a general discussion of these issues see Kerber (2003)

[14] The economic analysis of regulatory competition explicitly deals with the question of the appropriate allocation of competencies for the provision of legal rules and regulations (Kerber 2003, 16f.). For an overview see Kerber (2000); Sun/Pelkmans (995); Van den Bergh (2000).

kets than in most economic markets, since political problem-solutions offered by political parties and/or governments usually are complex experience and credence goods (Nelson 1970; Darby/Karni 1973). Transparency on political markets is much lower, because both of the multitude of issues tackled, their complexity and the uncertainties of the potential reform outcomes. Therefore, the feedback on political markets is much weaker than on economic markets (North 1990a).

Moreover, transmission mechanism must be at hand in the case of the only indirect effective regulatory competition via international trade and locational competition. In this cases, pension policy regulations compete only indirectly via their impact on the prices of goods and services which are internationally traded and via the incentives set by national governments to attract mobile factors (esp. firms, capital, and scarce labour skills). Contributions to collective public pension schemes affect the international competitiveness of an economy through taxes and factor costs. Nevertheless, the competitiveness of an economy is also influenced by a multitude of other factors, so that the respective effects can be only in part assigned to pension policy reforms. Therefore, there is only a rather weak link between the economic competitiveness of a member state and the structural and parametric design of national old-age security systems.

Besides, pension reforms are the outcome of political decision-making and thus of competition on the political market. Since political markets are still national markets, successful pension reforms of other member states only indirectly enter competition on national political markets. However, the OMC might help to intensify yardstick competition which directly aims to particular policy reforms. Political yardstick competition requires that "the performance of the governments in various jurisdictions becomes sufficiently comparable so that the voters can alleviate the agency problems by making meaningful comparisons between jurisdictions" (Bodenstein/ Ursprung 2001, p.4). The OMC on pension politics lowers information costs about policy options and outcomes. The National Strategy Reports as well as the Joint Report reduce the costs of information acquisition, procession and dissemination about pension systems and policies of other member states. By applying common objectives and indicators the comparability of the performance of different pension systems is improved. Thus, the OMC might intensify the more direct yardstick competition of pension reforms in addition to the only indirect effective regulatory competition through economic competitiveness.

4.2 The OMC, Mutual Learning and Pension Reforms

The main objective of the OMC is to foster mutual learning from the experiences of pension reforms in other member states and to promote the imitation of successful policy reforms. In general, workable competition allows to achieve not only allocative, but also dynamic efficiency (North 1990b, p.81). On economic markets, if there are no barriers to market entry and exit, both innovators and imitators are attracted by the profits of successful innovations. Thus, if the intensity of competition is high, consumers will profit from a wide variety of products supplied at low costs. However, to realise the gains from dynamic efficiency, competitors must be free to generate and imitate innovations in a trial-and-error process. Scope for different actions must exist. Heterogeneity characterizes such markets. On political markets, to get (re-)elected or to stay in power are the predominant incentives for offering innovative political problem-solutions. They are the main driving force equivalent to the profits which can be gained on economic markets from successful innovations. Since politicians only have incomplete knowledge about the best policy solutions, yardstick competition might be a means to foster trial-and-error processes which result in innovative regulations (Kerber 2003).

While on economic markets, usually there is always scope for product variations, within one member state there is only one overall old-age security system, with compulsory membership in the collective public pension schemes of the first pillar for most persons.[15] Besides, the scope for trial-and-error processes in pension reforms is strictly reduced because of the long-term nature of pension systems. Since they affect decisions about capital formation, savings and labour supply over the life cycle of an individual, they must allow people to build stable expectations. Thus, they cannot be changed arbitrarily and in the short term without damaging the trust necessary for their incentives to work in the long run.

By lowering information costs, the OMC might also contribute to the generation and imitation of innovative policy solutions for old-age security. It broadens the input of pension policy formation by granting low-cost access to the experiences made with different policy options in other member states. Thus, the variety of innovative problem solutions discussed within a member state should increase. In addition, it reduces the costs of gaining experiences with pension reform options, since appropriate problem-solutions of other member states can be imitated without taking all the risks involved in implementing genuinely novel solutions (Orenstein 2001).

Furthermore, the OMC allows better coordination and thus utilisation of expert knowledge on pension schemes, policies and reforms which in turn might enable to better realise economies of scale and scope. While among pension experts there is broad consensus on both the underlying problems and the general reforms necessary to cope with it, this does not hold true for the electorate which has the ultimate power to vote for the direction of pension reforms. Thus, the OMC might also assist in the low-cost dissemination of expert knowledge to a wider part of the population. Since many reforms are deemed to be the more effective and the less costly, the sooner they are implemented, the OMC could thus contribute to overall efficiency.

But the OMC might also negatively affect the scope for mutual learning from pension reform experiences in other member states. As it also strengthens the position of the Commission in proposing reform options and in assessing the provisions implemented by the national governments, the Commission might eventually become an opinion-leader for the kind of reforms realised. In the extreme, the Commission could gain the competence to prescribe the objectives and measures to be taken by the individual member states. By setting narrowly defined quantitative targets and imposing strict limits on the range of permitted reform options, for example, search efforts for innovative pension reform policies would be restricted to a narrow subset of possible alternatives. As a consequence reform efforts could tend to become more homogeneous. In this case, the intensity of yardstick competition would be reduced due to more centralisation of competencies to the supranational level.

However, it is not to be assumed that the OMC will actually result in standardised pension policy provisions. Even national pension systems, which seem to be rather similar at first glance, differ widely in details, since each has evolved in a path-dependent way. Therefore, to

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[15] Due to the path-dependent evolution of old-age security systems in most countries there exist also particular pension schemes for certain socio-economic groups (like for civil servants, farmers etc.). However, again, membership is compulsory, there is no explicit competition among these different pension schemes. For Germany see Schmähl (2002).

reach the same objectives, different provisions have to be implemented. Furthermore, specific national modifications will quite inevitably have to take place, because *ex ante* not all possible effects of reforms can be foreseen. In part, this is because of the complexity of pension systems and their interdependence with other policy areas (esp. with tax policy, health provisions, long-term care). Besides, the reactions to such reforms are only partly predictable. Adverse incentives might occur which make follow-up modifications necessary. Thus, even with commonly agreed upon objectives and best practises according to the OMC, national pension policies will not become uniform. The rather gradual path-dependent evolution of national old-age security systems will continue.

All in all, as long as common objectives and best practices to achieve them are not prescribed through the OMC by the Commission in a uniform way, the OMC will rather broaden the spectrum of possible reform alternatives on national political markets. In this way, successful pension reforms could disseminate far more easier than it is the case with the only indirectly effective regulatory competition through international trade or overall economic competitiveness.

4.3 The OMC and Rent-Seeking Behaviour

Nevertheless, as experience with national pension reforms shows, there are strong forces at work which favour inertia. Despite the consensus among experts, powerful interest groups tend to defend the existing pension systems and thus their privileges. However, yardstick competition promoted by the OMC might be a way to weaken their influence. On economic markets, free market entry and exit as well as appropriate competition rules prevent unfair market practises and the undue exercise of market power. On political markets, asymmetric information results in a multiple principal-agent relationship between the electorate, political parties/ the government and public administration. Because of the asymmetric information politicians have discretionary scope to follow their own self-interest. It allows well-organised interest groups to influence political decision-making and thus to extract rents. Moral hazard and adverse selection are ubiquitous.

The growing economic integration in the EU enhances competition in the common economic markets. It also reduces the discretionary scope of governments and interest groups within the individual member states. Therefore, it intensifies indirect regulatory competition and serves as a control mechanism for political power on the national level. Thus, both economic as well as political market-power is decreasing on the national level. By intensifying political yardstick competition in the field of pension policies, the OMC enhances transparency about the quality of the different pension systems. As a consequence, national governments might come under growing pressure to justify their pension policies, especially if they are in favour of special interest groups.

However, the growing economic integration within the EU goes along with a gradual shift of political competencies to the supranational level of the EU. Complaints about a democratic deficit of EU institutions and thus a lack of control of political actors are well known. This holds especially for positive integration, which is about setting up regulations on the supranational level (Scharpf 1999, 45).[16] The more the Commission intervenes in national policies,

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[16] With respect to negative integration, that is the removal of obstacles to the common market and the implementation of the four basic freedoms, the competence of the EU is widely undisputed (Scharpf 1999, 43ff.).

the more relevant this lack of control becomes, since it allows well organised interest groups to gain uncontrolled access to policy-making on the EU level (Hodson/Maher 2001, 731f.; Höreth 1999). Moreover, there is a tendency to integrate interest groups like the Social Partners, NGOs, trade associations etc. in the decision-making process through Committees, which altogether reduces transparency.

This concerns also the OMC on pensions. The Commission has gained an institutionalised access to take part in pension policies (*section 3*). Well organised interest groups like the Social Partners and trade associations of financial services demand to also participate in the OMC procedure (Hix 1999, 188ff.; Olson 1965). On the one hand, this might improve the quality of political solutions, since more and better information enters the policy-formation process (Breton 1998). On the other hand, transparency is lowered with respect to the interests involved. Because of the complexity of pension reforms and of the multitude of actors involved, information costs for voters increase. Quite contrary to the growing weight of the EU in policy-making, it becomes more and more difficult to recognise at low costs which politician and/or interest group is responsible for which particular regulation. As a result, not only might interest groups get uncontrolled access at the EU level, but political competition on the national level might be further weakened. This would result in a renewed increase of the influence of interest group within the member states.

All in all, it might be doubted that the OMC on pensions will strengthen the control function of regulatory competition and help to effectively reduce rent-seeking behaviour. Under the current institutional design quite the opposite effect is to be expected. However, the democratic deficit of the EU institutions is a central issue of the coming European Constitution, where it is also discussed to include the OMC as a general policy measure. Depending on the precise design, the lack of political control on the EU level might be reduced.

5. Summary and Outlook

Currently, the EU has competencies mainly with respect to the second and third pillar of occupational and personal pension schemes (*section 2*). Since they mainly rely on markets, the implementation of the four basic freedoms and the EU competition rules shape their performance. Up to now, there is no influence worth mentioning on the design of the first pillar of collective public pension schemes, despite the co-ordination of entitlements of migrant workers.

As has been shown in *section 3*, the OMC on pensions does not change this profoundly. However, while the final responsibilities and the implementation of reforms remain with the national governments, the Commission gets a foot in the political decision-making process. Since the Joint Report which also includes the evaluation of national pension policies is drafted and agreed upon by the Commission, the Commission will also influence the input of national policy-making in the field of first pillar pension schemes. At least, national governments will have to respond to the critics and proposals made in the Joint Report. Yet, up to now not all prerequisites for fully applying the OMC on pensions are met. In particular, much more work on data and indicators has to be done to appropriately compare the different pension schemes. Only then, the OMC on pensions will fully develop its potential.

In *section 4* the impact of the OMC on pensions for promoting pension reforms was discussed. It was shown that the OMC is a means to promote yardstick competition for pension regulations. While currently competition among different national pension systems takes place only very indirectly, the OMC increases transparency about the working of pension reforms. This will eventually lead to more direct competition. The OMC might promote mutual learning and the generation and diffusion of innovations in the field of pension policies. However, it is not to be expected that the OMC on pensions will trigger off profound structural changes, since at the national level strong interest groups still hamper such changes. The impact of the OMC in reducing such rent-seeking behaviour seems to be only of a very limited range. But if pension reforms are already on the political agenda, the OMC might improve the kind and quality of information used in the national policy-formation processes. As a result, it might shape the direction and speed with which reforms are decided on and implemented.

Currently, no statements can be made whether we will realise more centralisation by a further shift of competencies for pension policies to the EU level. But because of the imminent problems due to the demographic changes, it might well be that the EU will gain more importance. An important actor like the ECB already advocates a more profound shift of influence on national collective pension schemes to the EU level because of their importance for public budget deficits and thus on the common currency. While acknowledging that “national governments remain exclusively responsible for implementing reforms”, the ECB expresses the opinion that “institutional incentives may need to be strengthened” (ECB 2003, 51) to shape the direction and speed of such reforms. Therefore, the same may apply to old-age security policy as to other policy fields, for which the EU incrementally expanded its responsibilities by widening and deepening its influence. In the end this might cumulate in more centralisation of competencies and a profound loss of responsibilities of national governments on pension policies.

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