SCIENTIFIC EDUCATION

Journal of Business Economics and Information Technology

http://scientificeducation.org VOLUME III, ISSUE 5, Octomber 2016

Coordinated European reform of pension systems through capitalization. The use of private pension schemes at the level of countries of the European Union

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ABSTRACT

In Europe further emphasis is placed on the diversification of pension systems, which involve a more rigorous approach to this topic, in terms of finding the best solutions, each depending on the system existing at national level.
Pension systems of European States are different, especially in terms of how they are financed. However, they are based on the two models, "Bismarck" model based mainly on the precise purpose, contributions to social security and the "Beveridge" model advocated by the duties of the general collection. In countries like Denmark, Ireland, the Netherlands, Sweden and the United Kingdom, private pension systems play an important role until the early 1990s, due to the fact that the existence of limitations imposed on pensions of distributive type at the level of basic pensions to calculate the standard type for everyone, has led to the development of private pensions in the form of pensions dressed guy occupational or individual insurance contracts for retirement, has led to the development of private pensions took the form of occupational pension type or individual insurance contracts for retirement.

KEYWORD: public pension systems, reform of pension systems, private pensions, compulsory private pensions, the pension schemes of the PAYG type, minimum guaranteed pension, active aging, mixed pension systems.

Introduction

The first State in the early 1980s in the public system of insurance for retirement was the United Kingdom[3]. It has taken a number of measures which have reduced the degree of protection against the risk of old age, by encouraging the active population to invest in insurance products for private, individual or collective. Considered a model of the social-democratic State, Sweden,

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[3] *** National Institute of scientific research in the field of labour and social welfare, "The reform of social security systems in the context of the accession to the European Union-security in diversity", 2006, www. ince.ro, accesd in 29 October 2014

radically reformed the public pension system, despite the fact that this process took very long and was started in the end of 1998. The new Swedish system, linking more closely the size of pension rights, the contribution of the universal benefit by the pension insurance subject to residence and the existence proof of resources.
Another category of States is that States use to a limited extent on private financing and does not intend to change this, although there was a certain degree of increase in marginal coverage through pension schemes private type. Mention of these States, Spain, France, Luxembourg and Malta. At present, the total contribution to public pension pillar ranging between 16% of gross earnings in countries like Belgium, France and Luxembourg, and over 30% in Italy, Hungary and Romania.
States that have reformed recently guaranteed pension systems represent a special category by including compulsory private pensions, financed through the reallocation of a percentage of the overall contribution to social insurance. These countries, of which Bulgaria Estonia, Latvia, Lithuania, Poland, Romania, Slovakia, and Hungary, provide that in the future a significant share from the suitability of pensions should be attributed to these systems that intend to help prevent poverty and to the creation of an income replacement.
A final category is represented by countries such as Germany, Italy, Austria and Belgium, which hold the pension schemes of the PAYG type revenue transfer, but a significant share from their expectations with regard to the adequacy of pension systems, which have been refinanced privately, newly established or existing ones. Thus, France and Germany have operated in their successive reforms of the pension systems by increasing on one side the contribution period required for a full pension and on the other hand, less generous revalorized. At the same time, were privileged programs considered the second pillar to support the retirement income protection, by providing tax incentives.
In consequence, the contribution of private pension systems to pensioners income fluctuates a lot in the European Union, especially since the pre-funded pension systems were introduced in the last decade and they need 30-40 years to evolve. The current pensioners system of private pension share remains quite low and in high developed countries represents one third of the total pensioners income. The main reason is that a only limited part of the current pensioners are insured in such systems, and most systems are still in a develop process.

Comparative analysis of public pension systems in EU countries[4]

A common point is that almost all Member States have established a minimal form of compensation income acquired through retirement, for that part of the population who does not fullfil a retirement condition in the public system and who neither fit under another pensions system. It is called the "*minimum guaranteed pension*" and is offered through the income testing procedure, supported either through public pension system in countries such as Czech Republic, Poland, Bulgaria, Estonia and Spain, either by the national social assistance system in Germany, Belgium, Italy, Ireland, Hungary, Lithuania, the Netherlands, Hungary and Romania. The main difference between public pension systems of these countries is given by the types of rights granted, most of them offering retirement pension, early retirement, descendent pension or disability pension.

[4] Mihai Seitan, Mihaela Arteni, Adriana Nedu Study: "Demographic and long-term sustainability of the pension system," National Commission for Prognosis, www.cnp.ro, accessed October 25, 2014

Many countries have reformed their pension systems, increasing the legal retirement age by encouraging active aging as a result of increasing life expectancy being the first measure taken. Despite all efforts sustained for achieving a high level of protection against poverty, these reforms will lead to lower replacement rates[5], which creates many difficulties in maintaining the adequacy of pensions. Discrimination by gender and age on the labor market represents another problem[6], an important reform part is to increase labor market participation of women and older workers. Recently, the employment rate among those social groups experienced an important depreciation, being below 50% at EU level. Regarding the employment rate of the population aged between 55 and 65, there are substantial differences between Member States, thus in Malta this indicator was situated to a value of 30.2%, while in Sweden reached superior values of about 70.5%. Also, the employment rates among older women reached lower levels (38.6%) than men (54.6%). Progressive reforms of pension systems, already adopted in Member States, could increase the participation of the elderly on the labor market, if proper measures will be taken in the future.

EU terminology of the pension system provides in addition to the public aspect which contains capitalization elements (reformed Pillar I), occupational schemes (second pillar) and individual pensions (pillar III). In the new countries that joined the EU: Poland, Hungary, Slovakia and the Baltic States, the first pillar has been partly replaced by mandatory individual accounts schemes (up by capitalization) corresponding to pillar II, but were called Pillar I twice, to distinguish them from occupational pensions. These countries have chosen a partial privatization, maintaining a reduced social security pillar (PAYG), which is complemented by a pillar mandatory individual capitalization. But this solution requires high costs. There are also countries that have tried to break away from weak defined benefit schemes and have introduced defined contribution systems favored by taxes. They focused on the saving responsibility of individuals and employers.

As appears from a study[7] conducted by Principal Financial Group * in 2004, even in developed countries, reforms have not been implemented the way, due to resistance from citizens and unions, due to the lack of consequent education on retirement and lack of information and advice from the competent organisations. In countries such as Italy and Spain, the first pillar is represented by pension system which requires urgent reforms, due to the fact that combine high pensions level with high growing rate of dependence. If these countries maintain their current level of PAYG funding, by 2050 the overwork of contributing population will be solid.

The vast majority of Member States of the OECD[8] have developed systems of mandatory private pensions (pillar II) and several countries, including Romania, have encouraged the development of private pension system, achieving a transfer from the public fund, the redistributive type, to

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[5] *** Eurostat "indicators" subgroup study of the Social Protection Committee on Theoretical replacement rates in the period 2008-2048, www.euuropa.eu, accessed October 24, 2014

[6] The European Commission, "White Paper. An Agenda for Adequate, Safe and Sustainable ", Bruxelles, 16.02.2012 COM (2012) 55 final, page 7

[7] *** Principal Financial Group, "The Principal Global Financial Well -Being- Study" 2004 access January 11, 2015, www.businesswire.com,

* Principal Financial Group, financial group, a leader in global investment management, providing retirement services, insurance solutions and asset management. Founded in 1879, member of the FORTUNE 500, the financial group is present in 18 countries in Asia, Australia, Europe, Latin America and the United States

[8] *** OECD-international forum founded in 1961, currently headquartered in Paris, currently in 30 countries worldwide, of which Romania does not belong. The central objective of the OECD is the "economic development, systems strengthening and expanding free trade market" http://www.mmssf.ro, accessed March 25, 2015

the private sector. The fiscal constrains have resulted from the financial crisis, highlighted mainly by inversions of contributions flow from the private to the public, or interruptions of the percentage increase expected for the second private pillar, such as in other countries from this region, including Romania.

Pension systems and reforms from developed states of the European Union

In an attempt to limit the impact of demographic change on economic and budgetary situation, member states of the European Union made a number of adjustments in their pension systems in order to reduce the deficits in the public pension systems and to reduce the value of future pension compared to the benefits granted by then, switching from defined benefit systems to defined contribution ones. To get an overview of the situation of the European pensions system and draw relevant conclusions on how its organization and functioning, they did an analysis at the level of representative developed European countries.

United Kingdom

It is one of the first countries in the world that has developed private pension systems based on formal arrangements (early XVIII century) and also one of the first countries which started a process of reducing the state device, systematically unfunded, to support the provision of a private funded system. The current pension system in the UK is the result of lengthy series of reforms introduced in the last three decades.
In UK, the pension system is based on three components:

- ✓ public pensions, which are based on contributions to the social insurance system and the second state pension determined by income;
- ✓ private occupational pension based on individual funding;
- ✓ individual pension schemes, with particularly important role for the development and adequacy of pension system.

Employees can choose for the second state pension or a private pension funded individually, the majority focusing on the second option. Pensioners with reduce level of pension receive a special kind of assistance.
Despite all pension systems reforms, UK "has one of the lowest statutory pension in the EU."[9]
Achieving an adequate pension depends on the saving culture in the private system, but unfortunately, the number of those who can afford to participate in this system remains quite limited. According to the report conducted in 2012 by the European Commission the percentage of employees who contributed to a private pension that year was below 60%, which can increase the risk of poverty to which retirement population was exposed. To improve this situation, the UK should consider optimizing efficinet revenue testing methods belonging to vulnerable social groups and at the same time, promote a sustained way on individual saving in private system.

- Pension represented by the first pillar does not depend on taxpayers income level and contribution period was 39 years for women and 44 years for men, following to be changed to 30 years for both sexes, starting with 2012, in accordance with "Pension act 2007 ".
- Occupational pensions have a fairly high percentage, over 50% of employees taking advantage of them. DB schemes remain dominant and accounts for over 80% share of

[9] *** OECD "Pension at a Glance" 2013 www.oecd ilibrary.org, accessed May 4, 2014

occupational pensions. Within these DB schemes, the taxpayer can get a maximum of 66% of final salary after 40 years of activity. They can take advantage of taxes benefits applied to contributions and investment increase, the benefits obtained being considered as income and taxed.

- The third pillar of the system is the largest in Europe and consists mainly personal pensions offered by insurance companies. Personal pensions are designed according to the DC principle, 25% of the amount can be withdrawn at the end of their working life and the rest as annuities. The maximum contribution is about 5.450 euros per year. Regarding this pillar reforming, the government introduced "stakeholder" pensions to encourage the development of private pensions market. Although it resembles with traditional private pensions, they involve lower costs and yet have failed to attract significant funds. Simplification of pensions legislation (2005) led to an increase of personal pension, giving wide choice of investments to the citizens. UK is known for having the largest market of private pensions in Europe, the main reasons that determined its development are the low level of pensions offered by the state (about 35% of final average salary) and generosity benefits schemes defined by pillar II, whose forecasts pointed to further sustainable development, driven by increases in investment.

Netherlands

Have a mandatory insurance system for all 15 and 65 aged citizens, the size of the income from the state system representing only 40% of average income. In some sectors occupational pensions are mandatory, and others have voluntary pension scheme. Nearly 95% of employees are covered by the Pillar II, which is not required by law but continues to attract a high number of participants. In the Netherlands there are two types of self administered pension funds, those in the industry and the companies. Related pensions sector are the most important and own about 70% of total assets and a significant number of members and participation is mandatory for companies within these sectors.
Regarding the second pillar reform, the government intends to update the existing legislation by introducing minimum guarantees for funds with DC devices, minimum benefits and indexation for all funds. By introducing tax deductibility applied to the third pillar contributions, up to 10,000 euros, the government is trying to revive the system, however, the size and attractiveness of the second pillar will try to limit the development of the third pillar. Netherlands private pension market is the second largest in Europe, having regard to compulsory and voluntary pension schemes from the pillar II, is a mature market, with a high degree of saturation and a low growth rate, about 2%. Considering the small size of pillar II pension, its development is still quite limited, but providing growth of the industries schemes.

Ireland

The retirement age benefits of the first pillar are among the lowest in Europe and represents almost 30% of the average income of employees. Pension income depends on the contribution period, the government providing pensions for those with insufficient income. In 2001, under Pillar I was created a reserve fund to finance one third of this pillar pension expenditure. Its development was affected by the weak performance of equity investments in the period 2001-2002, but in 2003 this fund recorded a revival.

Since 2025 a rate of about 50% of the workforce will benefit from revenues provided by the second pillar, which is the dominant form of private pension system, this share being expected to grow. About 80% of the second pillar assets are owned by DB schemes, providing about 66% of final salary after 40 years of contribution. The impact of changing accounting law led to mutations of the DC to DB schemes. Pillar III remains fairly limited, creating the fund "Personal Retirement Savins Account" (PRSA) in order to encourage the accumulation pension fund for low-income earners with fixed term contracts and giving certain tax advantages onto those with their own businesses.
In light of 2050s, the Irish government will face an increase in state pension expenditure up to 9%, this percentage remains relatively low compared to that in other European countries. It will require further changes or other measures aimed to stop demographic problem, which tends to reach a peak around the year 2050. The government also intends to rapidly increase the percentage of occupational and voluntary pension receivers, increasing coverage supplementary pensions by up to 70% in the future.

France

French pension system is one of the most complex in Europe, based on the "pay as you go", without having a clear delineation between the first and second pillar. Thus, "Les Regimes complémentaires Obligatories" accounted mandatory supplementary pensions (pillar II) and were subordinate to the state system. Tax regime in France is complex and unstable, creating pressure on the need to reform the pension system. The Pillar I benefits are generous and represents about 70% of the share of wage income, taking into account the average of the highest payouts in professional careers for a period of 19 years
Most of occupational pensions were included in Pillar I. The system covering private sector represents 68% of the labor force and provides 50% of salary at retirement. Other complementary systems, mandatory, are ARRCO and AGIRC, which have merged and are included in the state pillar. They have a contribution rate of around 6% of salary and are divided in the ratio 60% - 40% between employer and employee. The public system covers about 75% of salary. Although voluntary arrangements are insignificant in France, the people who have their own businesses rely on them for basic pension, thus constituting the majority of small private pension sector. Thus it is necessary to develop a market for Pillar III, the first step being made since 2004 by the establishment of funds "Plan d'Espagne relive Populaire" (PERP) and "Plan d'Espargne Pour la retraite Collective" (PERC). Both of them benefit from tax deductibility and income received under the principle of annuities with a 28% taxable (PERP) and tax-free withdrawals when buying property taxpayers. Reforming first pillar is not radical enough, there is no political will in this regard. PERP and PERCO funds have some impact on the French market, but it is insufficient to create a strong pillar III.. However, the tax benefits offered by these funds, suggest that there is potential in the long term, without having to draw significant assets.

Germany

It is a state with a social market economy characterized by significant traditions of solidarity, public social security system is generous and comprehensive, which overshadows development

of the pension funds of companies and individuals. Go pension systems are appropriate to income, but they are based on a minimum threshold of social assistance for the low income.
The level of pensions of civil servants is set by the state and their payment is made directly from the state budget, while pension schemes for liberal professions have a special character.

- Pillar I covers about 80% of the income of the employed population[10]. State pension calculation is based on the points system, determined in relation to personal income consistent with the medium. Point pension is adjusted annually by a coefficient called "composite index". The calculation of fist pillar pension is based on contribution period, the average level of income, the retirement age and the type of retirement. The benefit obtained after a period of contribution of 45 years amounts to about. 70% of the average net income. The incomes from pensions are indexed to the increase of wages and prices. The reforms introduced after 2005 will lead to a reduction from 70% to 64% of net revenues. This reduction will be offset by private pension fund offered by Riester.
- Pillar II (also called Riester pension, occupational pension type) is subsidized by the state and has many advantages fiscal. Both the Pillar II and Pillar III based on the principle of defining benefit (DB) or of contributions (DC) and have a minimum acceptable level.

The degree of aging of the population is above the average European level, it is estimated that the population over 65 will hold a share of 59% towards 2060, a figure which places this indicator at a level above the average of 53% of the European Union)[11] .
Average pension for women is far below that of men. However, expect a harmonization of these discrepancies by standardizing the retirement age. The main risk of the pension system "is that of ensuring long-term sustainability of public finances"(S. Dobre, S. Ioniță, D. Marinache, 2012). About 65% of german employees belong to occupational pension funds, the largest being those of companies Bayer, IBM, Hochst (Aventis), BASF and Allianz. German companies have sought to reduce costs through pension schemes (eg Commerzbank has reduced contributions to the pension plan for about 24,000 employees as of January 2004) which had negative consequences on growth assets second pillar in recent years .Tax benefits created by legislative reforms, had the effect of reinvigorating occupational pensions. Since 2001, a consortium of banks and insurance companies (Allianz, Victoria, BHW and West LB) offers pension fund for all employees in the electronics industry, metal and engineering. In Germany there is a tradition of personal savings, which places it third in Europe in terms of the life insurance market, however, life insurance premium per head as a percentage of GDP, is totaling only half the European average Insurance contracts are an important form of saving for retirement, the number of contracts exceeding the massive number of specific private pension ...However, the government decided in 2003 to withdraw many of the tax benefits offered by them. Under the new legislation, the first contracts concluded since 2005 are no longer tax deductible and benefits are fully taxable, which led to a shift towards private pensions market related third pillar, taxpayers seeking alternative advantageous for tax purposes.

Italy

[10] *** European Commission, "Joint Report on Social Protection and Social Inclusion", 2009 www.ec.europa.eu, accessed January 19, 2014
[11] ** European Commission, "Joint Report on Pensions -Country Profiles", 2010, www.ec.europa.eu, accessed January 19, 2014

A similar situation is encountered in Italy, where statutory work covers the entire population. Type BD old system was replaced with one type of CND, which apply to people entering the labor market since 1967.The contributions based on "notional defined" is established based on the multiplication of indicators that transforms the retirement age to life in expectancy refresh retirement in three years. An important role plays and Occupational Pensions type that are represented by pre-funded schemes, kind of voluntary. They are of three kinds: either regulated pension through collective agreements and negotiated through them; either open-end funds, managed by financial intermediaries who can join to the groups or persons engaged individually; for pensions or insurance policies.

The main long-term risks involving current pension system are given: failure to ensure the sustainability of public finances, due to an aging population, the existence of an excessive deficit and considerable public debt. Now, the adequacy of pensions of future retirees is challenge which is mainly due to increased life expectancy and delayed entry of young people on the labor market and the increase of atypical work and the low number of participants in private pension schemes.

Sweden

It is a certain country typology rather in the category of market economies in northern Europe, with Denmark, Finland and Norway, characterized by a great generosity factor public towards individuals with a share of the middle class about 85% and an occupancy rate higher than the population, this differentiation from the Anglo-Saxon economic model. Sweden, in 1999, implemented the state social insurance system, which consists of three components:

- NDC pension type, which relates to income levels by indexing it based on the degree of determining the annual sustainability
- Fully financed pension scheme contributions by type DC called premium pension;
- Pension funded by charging for DB, which is based on a benefit guaranteed minimum. In the first two of the three types of pension, the contribution is 18.5% of gross income.

Private pension schemes for occupational type to complement the public system based on the definition contributions. These schemes are established through collective labor contracts and include over 90% of employees. The Sweden risk is a relatively low risk and long term are the wage replacement rate reduction through retirement, from 65% in 2008 to 48.2% in 2048.This decrease will particularly affect the young people, whose pensions will be increasingly small in comparison to the previous salary retirement age. However, given that the financial sustainability of Sweden is quite high social security system will not be greatly affected compared to other countries.

Conclusions on European pension systems

Making a comparison between EU countries reveals that most public pension systems have BD type, and a few have public systems NDA type or based on points. While demographic problems are the same for all these countries, public pension expenditure in GDP suffers quite large deviations from the EU average (10%), representing 6% in Ireland and 15% in Italy

Currently, progress towards recovery potential employment before retirement age persons, remain at an insufficient level. A fixed retirement age, combined with the possibility of early exit from the labor market, will create growing imbalances between active years and the period of

retirement. The role of pension reforms in increasing participation in the labor market will be essential increasing the chances of stimulating economic growth and development of a pension system viable, modern and appropriate.

To achieve the objectives of pension reform at EU level is necessary to avoid solutions like increasing contributions, decrease benefits or increase the level of public debt. This involves ensuring the level of benefits without increasing the financial burden of contributions. For this purpose were planned and proposed a series of measures such as:

- reducing the generosity of existing pensions pillar;
- improving occupational pension schemes;
- growing importance of funded pension schemes based on voluntary contributions (Pillar III).

This analysis finds the predominant character of the optional private pension schemes and a relatively low presence of occupational pension schemes type. Private pensions are more developed and diversified in the countries of Western Europe, being either occupational pension type volunteer in the UK or almost mandatory as in the Netherlands and result in an increased level of coverage by a pension of about 88%.

European pension reform underlines the necessity to put in a mixed pension systems that combine the advantages of each landing and diversify risks. The basic pension should be further ensured through the public by redeployment and the complementary schemes based on capitalization by public or private.

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