



Project no. CIT1-CT-2004-506392

NEWGOV

New Modes of Governance

Integrated Project
Priority 7 – Citizens and Governance in the Knowledge-based Society

Policy Memorandum

The Influence of the Open Method of Coordination on Pensions

reference number: 1/D61a

Due date of deliverable: April 2007
Actual submission date: 30 June 2007

Start date of project: 1 September 2004

Duration: 48 months

Organisation name of lead contractor for this deliverable:
Observatoire social européen, David Natali

Project co-funded by the European Commission within the Sixth Framework Programme (2002-2006)		
Dissemination Level		
PU	Public	X
PP	Restricted to other programme participants (including the Commission Services)	
RE	Restricted to a group specified by the consortium (including the Commission Services)	
CO	Confidential, only for members of the consortium (including the Commission Services)	

Summary

This policy memorandum seeks to analyse whether the pensions OMC is compatible with or useful for pension reform in two distinct institutional and political environments. Pension systems can be differentiated and indeed analysed along various dimensions, including institutional mechanisms used to cover the old-age risk or the actors involved in devising pension reform policies. The paper does refer to two countries (France and the Netherlands), which are representative of two different pension models, their recent reform record and the potential influence of the EU coordination.

Contents

I. THE OPEN METHOD OF COORDINATION ON PENSIONS: HOW TO DEFINE ITS INFLUENCE?	3
II. DIVERGENT REFORM TRAJECTORIES IN DIFFERENT PENSION MODELS? A MIXED EVIDENCE	4
II.1 FRANCE	4
II.2 THE NETHERLANDS	5
III. THE NORMATIVE, COGNITIVE AND PROCEDURAL DIMENSION OF THE PENSIONS OMC: HOW TO ASSESS IT?	6
IV. CONCLUSION	8
V. REFERENCES	8

I. The Open Method of Coordination on Pensions: How to define its influence?

The Open Method of Co-ordination (OMC) on pensions is the specific process introduced to favour a co-ordinated response to common challenges on retirement policy. It consists of one of the softest modes of governance in action at EU level. According to the typology proposed by Treib et al (2005, 13-14), where modes of regulation are defined in terms of their legal effects (binding/non-binding) and implementation (rigid/flexible), Pensions OMC represents a form of pure voluntarism: it is based on non-binding instruments (objectives), with the indication of broad goals to be achieved, leaving it up to member states to provide their implementation. Moreover, for Citi and Rhodes (2007) this mode of coordination is characterised by a low ‘convergence capacity’, in that is based on voluntary objectives plus weak forms of benchmarking and peer pressure.

The peculiar flexible and soft nature of this governing mode implies a multi-dimensional approach to the assessment of its influence. In line with some of the key contribution to the analysis of the process of coordination in the pension field, the paper does refer to three different dimensions.

1) Normative dimension. The OMC draws upon a catalogue of common goals aimed at achieving a greater policy convergence between EU member states. Eleven objectives for pension reform have been agreed around three “pillars”: social adequacy, financial sustainability, and modernization (e.g. responding to changing socio-economic needs). While the challenges and the policy responses suggested are not novel, it is the first time that they take on a relatively clear-cut institutional form at the European level.

2) Cognitive dimension. Learning has been signalled in much of the literature as an (or even the most) important feature in the generic and issue-specific OMCs. It is argued that the learning process engendered by one or several instruments – benchmarking, indicators, the exchange of best practices, peer review, iterative reporting – could lead to changes adapted to national contexts. We can thus distinguish three different types of policy learning:

- ‘**learning with others**’, or ‘interactive learning’, based on joint processing and exchange of information and experience;
- ‘**learning from others**’, with a large element of ‘lesson drawing’ and mimicking based on the observation of the experience in other countries; and
- ‘**learning to learn**’, which consists of the creative use of benchmarking through the OMC or even outside it, but still inspired by the coordination process at the EU level.

3) Procedural dimension. The OMC is heralded as a transparent and participative policy-making tool. It contains a series of recommendations on how to enhance democracy in Europe and boost the legitimacy of the institutions. The aim is to modernise European public action. The paper looks at the key procedures related to the concrete implementation of the OMC in terms of two main dimensions:- *Transparency*. This dimension of democratic governance means that all the actors with a stake in the process (and in the policy field under scrutiny) should have access to the different phases of the coordination and to the relevant information and documents. EU institutions have thus the duty to communicate about the ‘work-in-progress’ to the general public;- and *Participation*. This dimension of democratic governance means that citizens affected by decisions should have an equal and effective opportunity to make their interests and concerns known. This through articulation in the public sphere or through direct involvement of stakeholders or their representatives.

II. Divergent Reform Trajectories in Different Pension Models? A Mixed Evidence

In the present section, we present the main aspects of recent reform trajectories in two countries belonging to two different pension regimes:

- France (with a **social insurance model**), where the state provides the greater part of pension benefits through public mandatory schemes basically earnings-related. The financing method is of a pay-as-you-go (PAYG) type: current contributions paid by both employers and employees (or revenues coming from current taxation) are not accumulated but immediately used for financing current benefits. The high generosity and coverage, and the encompassing character of public pensions crowd out private schemes.
- The Netherlands (with a **multi-pillar model**), the state has the responsibility for basic entitlements with the aim to prevent poverty through basic universal flat rate benefits, while additional benefits are provided by supplementary occupational and/or individual schemes.

For each case, the following pages first analyse the key (present and future) challenges on pension programmes. Then, they focus on reforms introduced in the last years.

II.1 France

Challenges. The French pension system has dealt with problems related to all the three dimensions outlined by the OMC process:

- Improving **financial viability** of pension regimes has been put at the top of the political agenda since the 1980s (well before the start of the OMC at the European level). This is the result of some main factors: population ageing, changes to the labour market (i.e. unemployment, atypical jobs, wage stagnation, etc.), and economic stagnation;
- the second challenge has been then related to the **adequacy** of pension benefits. While in comparative terms (OECD and EU) France has proved successful in reducing the risk of poverty among the elderly, the French welfare state has faced growing problems related to the emergence of new forms of social exclusion (i.e. atypical jobs, etc.). A further aspect of the adequacy problem is represented by inequalities between and within generations. In that respect, the French pension system is characterised by the existence of a very complex and fragmented net of schemes leading to the uneven distribution of benefits and costs;
- the third challenge is linked to the need to adapt the pension system to changing societal patterns (**modernisation**). This partly overlaps with the adequacy issue as regards the need to cover new career profiles and to reduce inequities. In France, as well as in other Bismarckian countries, pensions were originally introduced for male full-time workers. Today's career profiles, however, are more varied, including extensive female labour market participation. The growing integration of financial markets is a further aspect of the modernisation problem. More open financial markets and increased capital mobility are expected to force governments not to increase taxation. If the level of taxes is perceived as being too high by investors, they may decide to move their activities. This pressure is assumed to be particularly acute for countries like France where pensions are financed through contributions.

Reforms. In the last two decades, two main reforms dealt with the pension challenges faced by France: the Balladur reform in 1993 and the Raffarin reform in 2003. The Balladur reform had three main elements. A first measure consisted in setting up the FSV (*Fonds de Solidarité Vieillesse*). The aim was to charge non-contributory benefits (previously covered by the pension regimes, with resources obtained through contributions) to the national solidarity fund

and finance them from general taxation. To reduce the system's costs, the criteria for measuring pension benefits were modified. The reform also modified (in a more restrictive sense) the indexation criteria for calculating pension benefits. These measures aimed at increasing the financial sustainability of the system, but they were implemented for the private sector employees alone. This last element led to the uneven distribution of cutbacks between different occupational groups (part of the adequacy issue). As for the social protection administrative and financial organisation, the unions' position as managers of the system was guaranteed, allowing them to retain their key organisational resources.

Ten years later, the Raffarin reform consisted of a mix of cost-containment measures, benefit improvements (e.g. more generous indexation), concessions to particular categories of workers, equity-improving provisions, and a consolidation of the unions' co-management role. New and more rigorous measures to reduce costs were justified in terms of introducing greater equity between private and public-sector pensions (*adequacy*) and between generations. In terms of greater equity, the pension guarantee for low-paid workers was raised. A new compulsory supplementary scheme for public-sector employees will be managed jointly by the social partners as a public fund. New provisions were then introduced to favour the development of supplementary pension savings schemes. Finally, a better coverage of new careers was introduced through contribution credits and the 'buying back' option, that is the possibility to purchase missing contributions of years spent studying (more *adequacy* and *modernization*).

II.2 The Netherlands

Challenges. The challenges faced by multi-pillar systems only partly overlap with those in social insurance systems. The increase of the old-age dependency ratio in the Netherlands is not as strong as in other EU countries, it is nevertheless forecast to worsen, and to impact pension expenditures. As regards the *adequacy* issue, according to recent figures proposed by the EU, the Netherlands has fared quite well in combating old-age poverty. OECD data, however, shows that the average old-age replacement rate (the level of pension benefits in relation to previous earnings) was 45.8% in the Netherlands in 1995, lower than in social insurance systems. As far as the *modernisation* of Dutch pensions is concerned, the challenge of new career profiles has been particularly significant. As already stated for France, this challenge partly overlaps with the adequacy issue. Then, because flexible jobs concern women (more than men), their development represents a source of gender-inequality. Atypical jobs are usually less protected than traditional full-time ones in terms of social protection rights, particularly under the second and third pillars. The multi-pillar nature of Dutch pensions has finally produced important and peculiar consequences on the ability of pension programs to deal with the growing integration of international financial and capital markets. The financing of pensions being related to profits of industries in which pension assets are invested, the pressure from financial markets not to raise taxes was expected to be less dramatic than in social insurance countries.

Reforms. On the base of different problems, *multi-pillar* systems have shown a peculiar reform trajectory (if compared to social insurance systems). In the Dutch case, after early innovations, in the 1980s and early 1990s, on early retirement and disability benefits, no major reforms on old-age pensions were put in place. But a number of minor changes have produced important consequences for different problems.

As to the **financial viability** of pension schemes, it has been achieved by broadening the revenue base and by cost-containment as well. On the one hand, the reduction of unemployment rates and the increased employment level (from 64.7% of the working age population to

74.1% in 2001), have helped to increase revenues for the pension system (and reduced costs for disability and early retirement). On the other hand, the Conditional Indexing Adjustment Act of 1992 allowed indexation to be suspended in case of a rapid rise in the number of benefit recipients as a percentage of the employees. That was the case in the period 1992-95.

As regards **adequacy** and **modernization**, at the beginning of the 1980s, the government started to end discrimination of working married women in both disability and old-age provisions. As to the first pillar, pension rights were individualised, unrelated to earnings, and based on citizenship. As to the second pillar, hour limits to enter occupational pension funds were ended by the 1990 Pensions and Savings Act. Since 1994, it has been illegal to exclude part-time workers from supplementary schemes. The *1997 Covenant* between the government and social partners represents the most important intervention on pensions in the last years. First of all, a public pension saving fund was introduced to tackle future growth of pension spending. As regards supplementary fully-funded schemes (second pillar), there have been a series of measures directed to reduce costs by limiting the impact of wage increases on pension benefits, to improve labour force participation, to reduce the impact of early retirement, and to extend pension coverage to more flexible jobs without further pension costs.

III. The normative, cognitive and procedural dimension of the Pensions OMC: How to assess it?

The comparison of recent reform records in two pension clusters reveals mixed evidence, confirming some degree of convergence, although national pathways remain distinct in terms of actors and institutions. In theory, then, there is room for direct co-ordination of national schemes in line with broad reform goals, such as those proposed under the pensions OMC.

The analysis on the **normative dimension** of the pensions OMC has shown that its objectives are relevant, but also that reforms have been on-going well before the introduction of Pensions OMC. Its impact on national debates and agendas of pension reform are questionable. Up to now, it has produced consensus (at least among governmental elites) to strive towards common goals. But, such a broad objectives have been implemented through different concrete strategies at the national level. As to *financial sustainability*, major reforms have been implemented in France, where the challenge of ageing has been identified as acute. These are new and more restrictive indexation measures and the increase of the retirement age, together with new provisions to favour the growth of supplementary fully-funded schemes. In the Netherlands, no major old-age pension reforms have been introduced. As a consequence of less dramatic demographic trends and only partial maturation of old-age pension programs, policy makers have adopted path-dependant reforms. However, where financial problems were particularly alarming (e.g. disability pensions), policy makers implemented more effective measures already in the 1980s. New measures mainly consisted of the increase of the active population through new forms of jobs (increase of revenues) and of the rationalisation of pension programs (reduction of costs). The freezing of indexation mechanisms contributed to put old-age spending under a certain control. As to *adequacy*, in France reforms to improve the coverage of old and new risks included contribution credits for periods of inactivity and the possibility of ‘buying-back’ missing contributions. Aside these measures, the inequity issue has been in the political spotlight. In the Netherlands, innovations had essentially sought to increase the coverage of second pillar systems to include a-typical career patterns. Yet, flexible jobs are still not fully protected for periods of inactivity. This has produced intra-generational inequity, with a big gender differentiation.

The objectives under the modernization axis represent both economic and social concerns. They are to adapt to more flexible employment and career patterns, to meet the aspirations for greater equality of women and men, to make pension systems more transparent and demonstrate their ability to meet new challenges. The integration of financial markets represent a considerable challenge to social insurance pension programs, as reflected in the French case. In the Netherlands, by contrast, the weight of social contributions is not alarming, and the presence of pension funds transformed global capital markets into an opportunity. The Dutch case, however, shows that, as mentioned for the adequacy pillar, high rates of atypical (especially part-time) jobs that characterise the labour market in the Netherlands are associated with new social risks.

As to the **cognitive dimension**, we look at some aspects of the OMC that may have ‘learning capabilities’. First, concerning benchmarks and ‘**learning with others**’, there are few that give clout to pensions OMC, although there is an on-going work to develop this dimension in the indicators working groups of the Social Protection Committee (SPC) and the Economic Policy Committee (EPC). Yet, some progress have occurred. According to the agenda proposed in the co-ordination process, the Indicator Sub-Group (ISG) of the SPC has published a series of interim reports dealing with that challenge. Much of the effort of the ISG focused on the definition of theoretical replacement rates (the ratio of an individual’s average pension to his/her average income before retirement), as a correct indicator to measure the income situation of the elderly population. Second, as for ‘**learning from others**’, the peer review session devoted to the presentation and discussion of the National Strategy Reports (NSRs) is two days long and there is no specific peer review programme for the exchange of “best” practices as there is for labour market policies. The real value of this exercise for the exchange of best practices is questionable as no issues could be discussed in-depth. At best, it could be a forum for the (superficial) exchange of ideas. As far as the third aspect of the cognitive dimension, ‘**learning to learn**’, two recent events in France seem to be consistent with a broad influence from the EU. The first was a meeting of trade unions leaders from five European countries at a conference on the issue of pension reform. It was organised by the French Cfdt and Cgt confederations in Paris in January 2003. At the same time, the French Minister of Social Affairs did a ‘European tour’ to meet his colleagues/peers in Germany, Sweden, Finland, and Spain to compare different national experiences.

If the pensions OMC – objectives, peer review, joint report - is not visible in the national arena, it is not likely to have any impact. This is where the **procedural dimension** of the OMC comes in as an important feature for the success of the OMC. In theory, it seeks to be transparent and to involve a broad range of actors, but in practice both of these dimensions have been weak. The first and only round of national reports presented by the Member States to date were in most cases written by central governmental actors, with varying degrees of inter-departmental co-operation. There is no requirement to involve other actors in the process - social partners participated in line with national traditions and practices. Concerning parliamentary involvement, there is no requirement to keep the EP informed and the role of the European Parliament in relation to the OMC is unspecified. The redaction of the national reports, which should represent the transposition of the European level objectives to the national level, does not involve all or even most of the players with an interest in pension policy. Instead, a limited number of governmental actors write the reports, which suggests that it is above all a technocratic rather than a political and iterative process. What is more, contrary to national pension reform processes, often flooded by media attention and public debate, pensions OMC is not mentioned in the media or the object of public debate. Exploratory research on media coverage in the two countries under scrutiny indicates that there has been no mention at all of the process.

IV. Conclusion

The parallel analysis of pension politics that we undertook in this article reveals the complexity and national rootedness of pension reform and seems to leave little room for the European coordination. Common challenges interact with national welfare institutions inherited from the past and thus produce different trajectories of policy innovation. The countries under scrutiny also reveal different degrees of success of the strategies adopted to respond to the main pension problems. Yet, crucially, the two countries do converge as far as the overall policy direction, along the three axes of the pensions OMC. The pensions OMC could thus support Member States in their reform efforts if the reports, that do already integrate these differences to some degree, change from reports on past activities to forward-looking policy documents.

From a normative perspective, the eleven objectives of the pensions OMC are not entirely off the hook – indeed they emerge from the recognition of existing challenges and broad reform needs. From the cognitive perspective, the structural features of the OMC in this area are weak and are in actual fact over-ridden by initiatives for learning by other important actors in the national context. These last efforts can be however, interpreted as the effect of what we have called ‘learning to learn’. In procedural terms, there is no public debate and no involvement of key actors. The first round of national reports was clearly not the result of an iterative learning process and not particularly transparent.

Some remarks for practitioners:

1. ‘learning as such is neither a sufficient nor a necessary condition for policy change’ (Schludi, 2003: 13), too many expectations on cross-national benchmarking risk to lead to much disappointment;
2. political and technical limits to the development of the effective coordination of pension policies made this field particularly difficult for coordination;
3. despite the lack of decisive outcomes from the first implementation of the OMC, some first (but limited) results should suggest to continue: in particular the cognitive dimension of the process seems to provide useful tools for the potential increase of exchange of information between members.
4. procedural problems must be dealt with, especially after Enlargement, through better internal articulation of the process, more participation of national parliaments and more effective integration of this OMC in the EU socio-economic governance.

V. References

- Citi, M. and Rhodes, M. (2007): ‘*New Modes of Governance in the EU: Common Objectives versus National Preferences*’, European Governance papers (EUROGOV), n. N-07-01
- Schludi M. (2003): ‘*Chances and Limitations of ‘benchmarking’ in the reform of Welfare State Structures – The case of pension policy*’, Paper presented at the Amsterdam Instituut voor Arbeid Studies, May 2003
- Treib, O., Bahr, H. and Falkner, G. (2005): ‘*Modes of Governance: A Note towards Conceptual Clarification*’, EUROGOV working paper, N. 2/05.