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THE TAXATION OF RETIREMENT PROVISION IN EUROPE

Speech by Dirk F. Hudig, Secretary General, UNICE

I. Why establishment of a single market in supplementary pensions is vital for Europe

- As businesses, pension provision is a significant cost. European companies see the removal of obstacles to the emergence of pen-European pension funds as a very important competitiveness issue.

- Demographic change obliges us to react radically and rapidly to the challenges posed by the ageing of the European population. The current ratio is three active persons for each retired person, and this figure will be almost one to one in some European countries such as Germany and Italy in less than fifty years.

- The social expenditures of Member States will also have to respond to a boom in health spending which, combined with the problem of retirement pensions, could represent an additional cost equivalent to

20% of GDP. This cannot be offset by higher taxation in a Europe where taxation already represents over 40% of GDP.

- On this subject, a recent study by UNICE shows that, with the exception of the USA and United Kingdom, the future liabilities of regimes to finance public pensions currently exceed 70% of GDP in all the industrialised countries of G7. In addition, pensions liabilities already dwarf visible public debt in France and Germany.

- The solution therefore necessarily involves a modified pensions system, i.e. establishment of a genuine single market in supplementary pension systems in order to defuse the time-bomb represented by today's demographic pressure.

- At the present time, the assets of pension funds in the European Union represent only 20% of EU GDP, whereas the corresponding percentage is 60% in the USA and 45% in Japan. UNICE therefore believes that the share of supplementary pension schemes in all sources of retirement benefit in the EU should increase considerably in the near future, as should the total volume of assets held by European pension funds.

- Here are the facts:

II. <u>Initiatives by the EU institutions</u>

- Article 56 of the Treaty seeks "to establish a single market in capital and financial services"

- The European Commission, aware of malfunctioning in the single market, recently launched an action plan for financial services. This action plan was endorsed by European finance ministers on 25 May 1999, and by heads of state at the European Council in Cologne in early June.

- As representatives of pension funds, you are probably also heartened by this wish to promote more liquid and better developed capital markets in order to optimise and secure the best possible return on savings, and therefor respond to this increased need for finance prompted by demographic changes in our societies.

- The Commission document deserves our close attention. It has important consequences for your industry since it advocates a number of measures designed to facilitate the development of pension funds in the single market.

- Following on from the consultative green paper it published in 1997, the Commission also last May adopted a communication on supplementary pension schemes in the framework of this action plan. This process is expected to result in a European directive which is of particular concern to you.

III. <u>UNICE’s views</u>

- UNICE broadly welcomed publication of the Commission’s green paper on supplementary pension schemes in the single market, a subject which is of fundamental importance for all Member States of the European Union. In reaction to demographic pressure, to liberalisation of financial services and to the trend towards contractual savings schemes, it is probable that the proportion of supplementary pension schemes as sources of retirement benefits will increase considerably in the near future (through capitalisation). Given the growing importance of such schemes, UNICE therefore deems it particularly relevant that the green paper has launched a debate on what measures need to be taken to improve the internal market in capital.

- UNICE is very attached to the present diversity of pension schemes in Member States and would be opposed to any form of supra-national regulation which undermined this diversity. It encourages the Commission to concentrate on the following actions: align the rules on investments on the treaty's basic freedoms, prevent double taxation and improve the transferability of vested pension rights.

- Remove the barriers which inhibit cross border operation of pension funds.

- The Commission's proposals prompt three comments or recommendations:

1. <u>More appropriate prudential rules</u>:

- In the area of investments, institutional players must naturally be subject to regulatory frameworks which protect the interests and rights of workers and pensioners. Thus, the criteria of prudential rules form the basis of European rules, but the principle of mutual recognition should be observed by all Member States.

- Prudential scheme management by investment funds is likely to underpin efforts to attract fresh capital into industry. In addition, it will increase the number of indirect private shareholders, which may in time lead to an increase in the number of direct private shareholders. Third, such regulation could encourage the public (workers and pensioners) to take a more positive and less simplistic view of the business world. Lastly, the market in corporate equity could be stimulated as a result.

- So that European capital markets can absorb the future growth in the investments of pension funds and life assurance companies, it is crucial that these markets should function efficiently.

- It is important not to apply unduly restrictive investment rules, as has been the case in the past, to the detriment of fund performance. If funds' rates of return were improved thanks to a diversification of assets, this could reduce management charges or increase pension levels, and at the same time inject fresh dynamism into our equity markets.

- The advent of the euro must act as a catalyst for integration of financial services in Europe, and the latter would be ill-served by unwieldy and outdated regulation which would ultimately jeopardise the performance of our supplementary pension schemes.

- We should draw inspiration from the USA which, in the 1980s, created a favourable regulatory framework which has proved to be an incredible godsend for innovative SMEs. I do not need to remind you that 50% of jobs created in the USA have been in the service sector, and in particular in high-tech businesses. It is therefore essential that the regulatory framework for supplementary pensions should also make its due contribution to development of our most dynamic companies, and therefore to employment.

2. Safeguard supplementary pension rights of crossborder workers

- Great importance should be attached to the remaining obstacles to labour mobility in the EU. One of the fundamental principles must be the equal treatment for a European citizen moving to another EU country as for a citizen of the host country.

- It is also essential – and this is still a major shortcoming – to facilitate the payment of pensions due under complementary schemes in other Member States. Lastly, secondments to another EU country should not systematically involve a break in membership of the supplementary pension scheme in the country of origin.

- However, UNICE would like to point out that supplementary pension schemes develop to reflect the specific features of each country, and notably the characteristics of their statutory social security regimes.

- UNICE doubts whether it is possible to find a harmonised European solution to these problems. It therefore considers that the Commission should encourage Member States to remove obstacles to the development of supplementary pension schemes as part of the necessary reforms in social protection systems, but without seeking to impose a single solution for the whole of the EU.

3. Remove tax obstacles for migrant workers and prevent double taxation

- The differences between the national tax regimes applicable to supplementary pensions constitute one of the main obstacles to completion of the single capital market. Their only point in common may lie in the fact that all Member States, in their own way, encourage supplementary pension schemes through tax incentives. However, the differences in level of deductibility and other conditions may lead to tax discrimination (double taxation) which impedes the free movement of workers. From an employer point of view, removing these tax anomalies would contribute to improving the management of key human resources.

- Bearing in mind the principle of subsidiarity and Member States' tax sovereignty, UNICE believes that the best solution to these obstacles would be to focus on a multilateral approach, with the Commission acting to facilitate a consensus on the most appropriate tax regime. Another solution could consist in agreeing a treaty which Member States could ratify if they so wish.

- In UNICE's view, the EET mechanism (exempt, exempt, taxed) – currently the most widely used – seems to be the best basis for consensus among Member States. Under this mechanism:

    * worker and employer <u>contributions</u> into an approved fund or scheme are exempt from tax;

    * the <u>yield</u> and <u>capital gains</u> on investments in such funds or schemes are exempt from tax;

    * the <u>benefits</u>, in the form of income, are taxed at the time of payment.

This mechanism would have the general effect of deferring taxation to the time when payment of the pension falls due, thereby preventing double taxation without the need to harmonise the level of taxation levied on pension payments.

- **In conclusion**, if it has to be noted that Europe still suffers from rigidities on its labour, product, service and financial markets, the most recent EU initiatives (Cardiff, single market action plan) tend to prove that there is a political will to remedy these malfunctions which Europe cannot afford to leave in place. Establishment of a genuine single market in financial services, insurance but also supplementary pension schemes to meet a demographic challenge is absolutely essential to lay the foundations of an open, competitive and successful economy which does not undermine the credibility we have worked for and efforts we have made to put the euro in place.

- We call on the Commission to take its responsibilities under Article 56 of the Treaty and remove the barriers to the freedom of movement of capital, and especially pension savings.