Conference „The future of Pension Plans in Europe“

Session: Which future for Pension Plans? ▪ 28.02.2020

Philipp Allroggen, University of Duisburg-Essen, Germany

The Capital Marktes Union:

Saving for retirement and investing for growth

UNIVERSITÄT DUISBURG ESSEN

Open-Minded

Introduction

UNIVERSITÄT DUISBURG ESSEN

Open-Minded

Capital Markets Union (CMU) is (was) an important pillar of the "Juncker Plan"

Goals:

- Enhance Investment across Europe (remove barriers to cross border investment)
- Enable better financing conditions for companies (especially SMEs)
- Contribute to a more stable and resilient financial sector
- Better investment opportunities for (retail) investors

In the light of the topic of this conference: How does CMU help savers to prepare for retirement?

Current Issues

- Demographic changes in societies; more pensioners and less workers
- European citizens do have savings but these are invested badly
- “Home bias” of investors
- No common regulatory framework
- Low interest rate environment

Current Issues

UNIVERSITÄT DUISBURG ESSEN

Open-Minded

- 18.2 percent of older people (aged 65 and over) in the EU remain at risk of poverty or social exclusion (Pension Adequacy Report, 2018)
- Mind the gap: Across Europe people retiring between 2017 and 2057 may need to save an additional €2 trillion each year to achieve an adequate income in retirement (Aviva 2016)
- Just in Germany: 2.500 Billion euro as cash or deposits

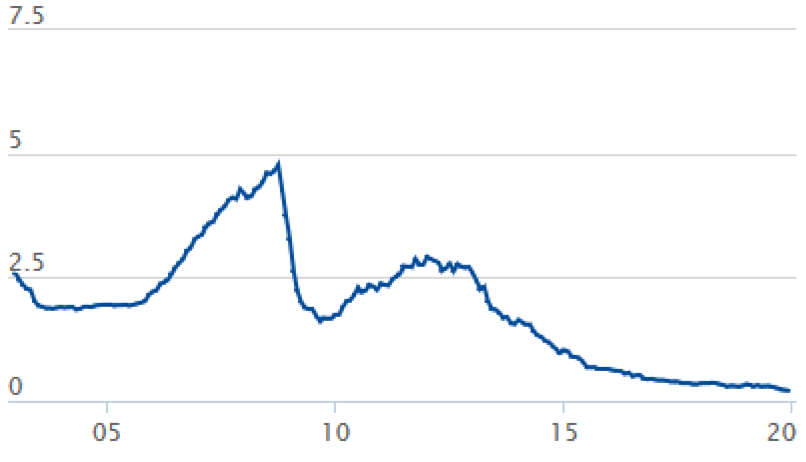
Stylized Pension System

3 Pillar System:

1. Statutory Pension System (usually pay-as-you-go)
2. Occupational Pension System (Capital based)
3. Privet retirement precaution

Unhappy times for classical savers

Euro Area Household interest rate for deposits; agreed maturity; x ≤ 1 Year



Source: ECB

From savers to investors

Results of Investor Pulse Survey—European savers and investors

	Belgium (%)	France (%)	Germany (%)	Italy (%)	Netherlands (%)	Spain (%)	Sweden (%)	UK (%)	Average (%)
Survey respondents who have savings	83	87	75	79	78	81	75	79	80
Survey respondents who invest	42	33	44	45	27	44	61	43	43

Source: Investor Pulse Survey, Blackrock 2017

From savers to investors

- 1st pillar depends on future economic development
- 2nd pillar is more effective in coping with aging but more vulnerable to financial shocks
- CMU can support the 3rd pillar of pension systems

From savers to investors

Precondition:

Citizens need access to information about their situation with in first and second pillar to derive the need to save/invest in the third pillar for themselves

How to foster long-term investment?

Overcome the “home bias”

- Non-independent advisors at banks and insurances almost exclusively promote in-house products (European Commission, 2018)
- Cross-border barriers (language, different regulatory framework, …)

Transparency on

- Costs
- Performance
- Fees

How to foster long-term investment

- (Minimum) harmonized tax incentives
- Access to information
- Better comparability of data
- (retail) investor protection
- Promote financial literacy
- Pan European Pension Product (PEPP)

Positive effects of the CMU despite Pension Plans

- Provide better financing conditions to companies, including SMEs and Start-Ups
- Deeper integration of European financial markets; attract capital from outside the EU
- In case of EMU: it proves to be harmful to conduct one monetary policy in an area with different financial practices and structures (see Brender et. al, 2015)
- Through the capital markets institutional investors with large scale investment capacity can contribute to sustainable economic growth by taking more long-term and higher-end risk investments
- Enhance overall investment (?)

Caveat

UNIVERSITÄT DUISBURG ESSEN

Open-Minded

- How much investment does the European Union really need?
- Investment declined after the financial crisis
- But is there really a “investment gap” nowadays? For instance, Gros 2014 does not find one
- Standard approach: Investment is a key driver for growth (investment itself is part of aggregated demand)
- But the ongoing demographic change implies a lower potential growth rate, which in turn implies that a lower (equilibrium) investment-to-GDP ratio is needed to keep the capital/output ratio constant.
- population growth falls but investment rates remain high, the capital output rate would increase and the return to investment would fall. The lower return to capital would then lead over time to more non-performing loans in the banking sector (Gros 2014)

Final remarks

- CMU overcomes the fragmentation of financial markets across the EU (somewhat "completing" the internal market
- Should help retail investors to better prepare for retirement
- Could improve the financing conditions for companies
- But effect on growth questionable (perhaps prior to the crisis the EU had access investment)
- (Perhaps): investment rates in the euro area are likely to remain below the more normal levels of before the credit boom, because the potential growth rate of the euro area has declined so much under the twin impacts of lower labor force growth and a fall in overall productivity which is a longer term trend whose root cause is difficult to ascertain (Gros 2014)