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A Transatlantic Crisis for Pension Plans: Italy, Ireland, and Greece Are Just the Beginning

BY GEORGE M. KRAW

Pension plans and other retirement programs in the United States and Europe are major victims of the economic crisis that began in 2008. Retirement ages are going up, benefit payments are going down, and plan sponsors, both governments and companies, face financial obligations they do not have the wherewithal to meet. Steps taken to address the crisis will worsen the financial condition of pension plans worldwide. On top of this, pension plans on both continents operate under restrictive regulatory regimes that provide insufficient flexibility for the plans themselves to address the current difficulties they are facing.

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Demographic, Economic Causes

Demographic and economic trends made worse by the 2008-2009 financial crisis are at the root of the pension problems in the United States and Europe. European countries that have not already raised the retirement age are under heavy pressure to do so by international agencies, despite the political unpopularity of such measures. Calls for richer countries such as Germany to help finance the workouts of Greece and other countries on the European periphery have led to increased scrutiny of the weaker countries' retirement and other social programs.

To combat the economic crisis, governments and central banks have maintained artificially low interest rates while tolerating extended periods of high unemployment to prevent inflation. This response has had a doubly disastrous effect on pension plans, which at their core are saving programs that rely on investment returns to meet future liabilities. When they become underfunded, pension plans look to current and future employer and worker contributions to make up the shortfall. When economic growth is slow, interest rate returns minimal, and unemployment high, plans find themselves in the worst of all possible worlds.

Inevitably, many pensions will be reduced, either through reduction in promised payments or by general economic inflation, which acts as a silent benefit cut.

Emergency Piggy Banks. Equally ominous for pension plans is the willingness of governments and international agencies to view pensions and other institutional investments as emergency piggy banks. In its rescue package for Ireland earlier this year, the International Monetary Fund made the Irish national pension fund

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commit around 10 billion euros for the 85 billion euro bailout, forcing the Irish fund to sell assets to meet the obligation.

Hungary, which is not a member of the euro zone, effectively nationalized private pension savings to cover budget shortfalls. The Polish government, also not a euro zone member, proposed decreasing government pension plan contributions that are funded by payroll taxes and diverting the savings to reduce its budget deficits, along with increasing the retirement age. Greece now faces an austerity plan imposed by an international ''troika''—the European Union, the European Central Bank, and the International Monetary Fund—that will drastically cut government and private pensions. Pension participants face benefit reductions of 10 percent or more.

More Adjustments

As the most recent contagion has spread to major European economies, ever more drastic measures loom. Italy, with the world's ninth largest economy, was forced to form a new government of technocrats led by Mario Monti, a former investment bank adviser, who immediately set about to implement a politically unpopular austerity program the prior Silvio Berlusconi government had bequeathed the new government in one of its final acts. According to the *Financial Times,* Mariano Rajoy, the new Spanish government leader, is promising his own version of financial ''shock and awe'' in an attempt to impress skeptical Spanish government bond buyers, and thereby help Spain avoid defaulting on its sovereign debt. Commentators speculate that the European Central Bank will be forced to cover these obligations and then monetize the bank's debt, an action often described as ''printing money'' even in this age of electronic finance.

Possible U.S. Tax Changes. Proposals to change the tax advantages of pensions in the United States are politically controversial, but remain a possibility as long as the federal government's budget deficits worsen. U.S. pension plans are under regulatory pressure to ''fully fund'' by increasing contributions, which will increase labor costs. By increasing labor costs, those efforts could have the perverse effect of reducing employment and, ultimately, weakening the long-term outlook for pension plans. This situation has encouraged plan sponsors in the United States to abandon defined benefit plans, for which an obligation to pay a lifetime annuity leaves plan sponsors on the hook for future shortfalls. Current policy encourages private companies to move to defined contribution plans, which provide more limited social protection to workers in retirement.

Public, Unionized Survivors. In the United States, only government and unionized industries remained committed to defined benefit programs. The percentage of participants in single-employer defined benefit plans who are active workers has declined from 78 percent in 1980 to 41 percent in 2007. Active participation rates are now less than 50 percent for multiemployer plans, which are sponsored by joint boards representing labor and management.

The Pension Benefit Guaranty Corporation, which insures single and multiemployer plans, has been designated ''high risk'' by the U.S. government watchdog that monitors the agency's finances. Unless new participants or new sources of income, or both, are brought into the defined benefit system, a crisis is inevitable for private defined benefit plans and the agency that insures them. State and local government plans, buffeted by similar economic forces, are under similar financial pressures.

Denying the Problem

The first step to fixing the pension crises in the United States and Europe is to recognize the extent of the problem and acknowledge that some retirement promises have been made that will not be kept. This should happen before significant private or government defaults occur, but political realities being what they are, it may be necessary for pension plans to fail before government leaders are willing to admit the depth of the crisis.

Second, ways must be found to save benefits for the largest number of people without making the larger economy worse. Mandates that fund private pensions by raising labor costs, thereby increasing industry unemployment, are counterproductive.

Third, the United States must develop a national retirement policy, and Europe must develop a policy for the entire European Union, which includes countries not in the euro currency zone. These policies will need to address how to provide for future retirement in an age of austerity and how to address current funding shortfalls in both public and private plans.

National Options. These difficult times require a greater willingness to address the problems of retirement with government options, including broader, more flexible, and more accessible national plans. A greater number of significant pension insurance schemes will have to be developed than currently exist, including programs that allow the merger of troubled private pension plans with national programs. The inevitable defaults in pension plans will have to be managed in a way that fairly distributes the difficulties such defaults cause.

Retirement advocates at the beginning of the 20th century struggled to provide workers with pensions and other programs that would guaranty dignity in retirement. Many of the early achievements in that era were undone by war and depression.

Achievements Threatened

The collapse of pension schemes and other social protection programs in Germany and Austria after World War I were part of a general economic collapse that contributed to the rise of antidemocratic regimes. Today, destruction of retirement and other social protections, when combined with continuing high unemployment, threatens to become both a symptom and a cause of broader economic instability with wide ranging political consequences. For contemporary advocates of pension plans and other supporters of retirement social protection, the struggle now is to save what their forebears achieved.

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