Households as financial asset holders in Europe[1]

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1. Introduction

The international financial crisis, started in 2007-8, was triggered by the rise of household default rates in the US subprime mortgage market. Since then, attention has been devoted to the rising involvement of households with the financial system, not only in the economies first affected by the financial crisis, such as the US and the UK, but also in other developed and developing countries. This new engagement of households with the financial sector has been explained by an array of both demand and supply factors, with social constraints to be pointed as primary factors by the bourgeoning financialisation literature. Analysis of household financialisation is not limited to debt incurred by vulnerable households, however. The social context also affects the evolution of household financial wealth, namely of the better positioned segments of this very heterogeneous sector. Diverse social standings imply different, but inter-connected, relations – in terms of access, types of assets and liabilities and costs – with the financial sector.

This paper looks at the evolution of household financial assets across Europe, in the context of growing financialisation of this sector. It will be shown that, as part and parcel of a general trend of growing household financial wealth, pension funds and insurance reserves have been taking an increasing importance both relative to disposable income and to total assets in almost all countries considered. Given the diverse income, social provision systems and inequality dynamics present in these countries, it is then argued that the relation between household financialisation and social constraints signalled in the literature is insufficient to account for these recent trends. It is argued that the European Union (EU) agenda for pension reform coupled with the constraints created with the formation of the European Monetary Union (EMU) provide important insight for the European wide entanglement of households with private finance.

We start off with a brief overview of the concept of financialisation and its application to households, which have mainly focused on the relation between income, inequality

[1] This work presents partial results of the FESSUD project (under EU 7th Research Framework programme, theme SSH, Grant Agreement nr 266800) in which the authors are participating.

and debt, overlooking the asset side of households' balance sheet. In the second section it will be shown how the growth of financial assets holdings by households is shared by most European countries, albeit their different levels and paces. We then argue that the rise of household financial wealth should be appraised against the pension reform agenda in these countries, first pushed by international organisations, such as the World Bank or the OECD, and later adopted by the EU. The EU agenda – with its shift from the overall principle of redistribution to a greater emphasis on the individualisation of pension plans – has resulted in the retreat of public provision either through the reduction of coverage ratios (statutory pension age) or the continuing fall of benefit ratios (gross replacement rates) of public systems. Such retrenchment of public provision of pension funds has been replaced by financial instruments now available across Europe due to the liberalisation, deregulation and free mobility of. Despite the vulnerability of private schemes, particularly evident during the recent financial turmoil, the current crisis has presented itself as an opportunity for the advancement of this agenda.

This privatisation programme, enhancing individual responsibility, must also be assessed against greater levels of unemployment and increasingly precarious employment relations that the current crisis has produced. Potential individual contributions and future benefits are thus to be affected in an uneven manner. The on-going financialisation of households, despite the financial wealth it deceptively creates, is thus expected to produce greater inequality and social vulnerability in old age across Europe. In the EU case, and fostered by profound institutional reforms, the financialisation of households more than being triggered by growing levels of inequality it rather seems to have crystallised extant levels of inequality in very heterogeneous relations of households with both finance and systems of social provision, producing greater inequality in old age.

2. Households Financialisation – an unexplored subject matter

Financialisation is a fluid concept prone to very different understandings. Born from the financial euphoria of the late nineties centred on the "dot.com" bubble, it envisages to characterize contemporary capitalism, highlighting the growing financial dominance of the last thirty years. One of the most popular definitions of financialisation is that offered by Gerald Epstein (2005, 3): **"**increasing importance of financial markets, financial motives, financial institutions, and financial elites in the operations of the economy and its governing institutions, both at the national and international levels**"**. The ambition posed by broad and comprehensive concepts such as this one has led to its widespread adoption by different currents with very different operational meanings, although all sharing a critical stance within economic thought.

The understanding of the roots that gave rise to such configuration of modern capitalism varies widely. Post-Keynesian theory, following the lead of Keynes, has focused on the financial sphere itself and its inherent instability and enhanced volatility. In this view, financialisation is mainly the product of profound transformations of the past thirty years, including: privatisation, which has led to the expansion of stock markets and, in the particular case of pensions, granted new streams of income to the financial sphere; liberalization, which opened markets, especially to international players; deregulation on the financial sphere enabling the emergence of new actors (such as hedge funds), products (the multitude of derivatives) and markets (e.g. subprime). Thomas Palley (2007) identifies three different conduits that are deemed to account for the increasing significance of the financial sector in relation to the rest of the economy: firstly, new and growing financial markets; secondly, neoliberal economic policy of abandonment of full employment objectives, trade and capital international liberalization, privatization of public assets and labour market reform; thirdly, new corporate behaviour based on the alignment of corporate managers interests with financial markets demands (eased by eroded union power), focusing on corporations' use of debt, share buy-backs, transforming "profit streams into interest payments streams".

Marxist political economy looks for deeper economic mechanisms behind this new process, ranging from the *longue durée* of capitalism history with its periods of financial dominance and crisis (Arrighi, 1994) to the Monthly Review approach (Sweezy, 1994; Foster, 2007) on how post second world war surplus absorption problems gave rise to financialisation, further enhanced by the supply-side financial liberalization and deregulation. Finance is thus perceived as a scape road for capital in face of absorption problems. But while financial speculation would provide new avenues of accumulation, the structures that supported it would become increasingly fragile.

The "École de la Regulation" is another very influential theoretical approach putting forward the notion of a finance-led accumulation regime that is deemed to have replaced the former Fordist accumulation regime, albeit in different scales and paces among developed countries (Boyer, 2000). Three different sources of destabilization of the Fordist regime are identified: 1) Slowdown in productivity (exhaustion of the potential for technical change); 2) Inflation and pressures on the profit rate, given the workers' militancy and governmental labour-friendly arrangements; 3) Internationalization of the economy and financial instability (due to end of the Bretton Woods agreements). In this view, these transformations have resulted in the straining of the previous wage-labour nexus. The repercussions of increased competition and financial volatility on the decisions of investment and production have thus put under pressure collective arrangements and labour protection laws, now perceived as "rigid".

Most of these seminal theoretical accounts on financialisation has, however, focused on major macroeconomic relations - on either the mechanisms of the financial sphere or on its causal links to the spheres of production, investment and social conditions – overlooking the relationships of households with the financial sector. The relation between households and finance was only considered only in a subsidiary way through the impact of financialisation on labour relations (resulting in high unemployment, precarious work conditions) and on the dismantlement of social provision (privatisation, regressive fiscal redistribution, etc.), which resulted in stagnant wages and rising inequality.

The increasing size and role of pension funds caught the attention of other scholars in the early 2000s. These new funds became a significant financial and economic agent in the Anglo-Saxon (Blackburn, 2003) or Anglo-American (Langley, 2004) capitalisms during financial booms and busts of the eighties and nineties. But these analyses of financialisation focused on the speculative practices of the financial sphere and their economic effects in light of the new opportunities provided by financial innovation and deregulation, missing the critical role of the global agenda of pension reform promoted by the World Bank (1994), its geographical reach and relevance to household financial position.

“Cultural Economy” accounts, with cross references from both political economy and post Keynesianism takes as its theoretical departure point the rise of “shareholder value” and what the authors call coupon pool capitalism (Eturk et al, 2007); (Montgomerie 2009). This approach is very much focused on the financial euphoria of the nineties, and by what has been then called the rise of shareholder value rhetoric and its variable impacts on major corporations more intertwined with capital markets. The analysis is micro-economic, based on particular case-studies of corporations and financial practices, allowing the researchers to reach a wide range of topics from corporate restructurings to household finance. Because it lacks a comprehensive understanding on what financialisation is and how it came about, it does not offer an account of the role played by households in this new capitalist configuration.

More recently, with household indebtedness to take central place on the stage of the current financial crisis, a new interest of the above critical research emerged on the relation between households and finance. Acknowledging the rising levels of household debt, this literature has related such phenomenon to stagnant income, rising inequality and the retrenchment of the welfare state. Faced with new consumption norms and real income stagnation, households were incurring in rising levels of debt in order to keep up with consumer demands emerging in an increasingly unequal society marked by the growing privatisation of public provision (among others see Barba and Pivetti 2009, Cynamon and Fazzari 2009), thereby allowing an expansion of finance to new arenas of provision (Fine, 2010). Such vulnerability, it has been argued, have forced households to engage with the financial sector in a disadvantageous position (Lapavitsas, 2009), entailing new forms of income extraction from workers (taking place not at "traditional" exploitation of labour arena but in the circuit of capital).

Dos Santos (2009), in his assessment on the transformations of banking business, stressing the overall income "expropriated" by banks from workers' wages, includes an overview of household financialisation, pointing not only to debt but also to assets as: "(…) the gradual privatisation of pension-provision have had a major impact on both sides of capital-markets. On the demand side, increased volumes of money have sought to buy securities. On the supply side, the scope for capital-gains generated from various 'financial engineering' measures has increased. And, across both sides, the scope for fee and other income from financial-market mediation has been greatly enhanced" (p. 185).

Nonetheless, such accounts limit their analyses to the US and the UK, where financial markets are more relevant and the embroiling of households with finance is apparently more salient and historically rooted. While stressing the relation between income stagnation, rising inequality and household debt, the latter is merely taken as an overall compensation mechanism, missing the heterogeneous and the specific contents of household debt, overwhelmingly linked to housing mortgages. It moreover overlooks household financial wealth, which, as we shall see, is a non-negligible part of the new engagement of households with contemporary finance.

The question whether the same trends have also been determinant in other variegated settings arises (Brenner et al., 2010). In the case of continental Europe, despite different historical and institutional backgrounds, the political and financial framework of the European Union (EU) and its single currency, which acts as vanguard for successive waves of neoliberalisation, must take central stage.

The analysis of household financialisation across Europe is thus necessary, not only in order to empirically assess the scale and pace of this phenomenon outside the financialised core (US and UK), but also to better grasp the role of the EU in bringing forward favourable institutional and political conditions to its unfolding. These two elements are of paramount importance to further understand the content and role of financialised households in contemporary capitalism from a political economy point of view.

3. European Household Financial Assets – An overview

This section provides a descriptive analysis of household asset holdings in the EU. A large number of European countries was included in order to account for different socio-economic realities, in terms of level of income, inequality and recent economic performance. This is critical to assess the role of socio-economic context in household financialisation.

The countries are organized into three different groups to facilitate the analysis. Despite the descriptive nature of the exercise, some non-arbitrary criterion was used to group the various countries. The groups formed correspond, roughly, to Bruno Amable's (2003) taxonomy of financial systems for Europe, which is a richer elaboration of the classic bank-based versus market-based dichotomy – a cornerstone of the literature on Varieties of Capitalism. Although this literature has been subjected to strong criticisms (see, for instance, Brenner et al. 2010), Amable's taxonomy is nonetheless helpful to organise the large number and diversity of European countries under analysis. Based on a large number of financial indicators and three relevant factorial axes – the size of the economy, the presence of foreign banks, the bank balance sheet structure or ownership –, Amable identified four different clusters of countries, one market-based and three different bank-based, notwithstanding a slow convergence to the more liberal market based model. And based on this taxonomy, three groups were here organised:

1) The 'early financialisers' comprises the Netherlands, Ireland, the UK, Denmark and Sweden. It gathers countries (UK, NL) that qualify as market-based systems as put forward by Amable in that they "are characterized by the importance of institutional investors and particularly pension funds, the importance of the stock indicated by a high capitalization relative to GNP, a well-developed venture-capital system, high mergers and acquisitions activity, and a low concentration of ownership" (Amable 2003: 145, 149). They also include some bank-based systems (IE, DK, SE) that have more developed capital markets, where "banks have a somewhat 'passive' role: bonds and securities represent a large part of the banks' assets and the debt/GNP ratio is significantly lower than in other countries" (Amable 2003: 149).

2) The second group, the 'EMU core', corresponds roughly to the bank-based ideal type, being composed by the monetary union core members, including the main continental European economies - Germany, France and Italy – as well as the peripheral ones – Portugal, Greece and Spain. They are deemed to have "a high credit/GDP ratio as well as an important share of insurance companies among institutional investors […] show(ing) little mergers and acquisitions activity, weak development of accounting standards, and a lagging venture-capital sector. Ownership is concentrated and the State plays a relatively important role in the control of some large corporation" (Amable 2003: 149).

3) The third group of the 'late comers', is mainly composed of eastern European countries – Hungary, Romania, Slovakia and Poland –, that have engaged the processes of financial liberalization and privatisation at a later stage (although at a fast pace), after the collapse of their planned economies. They also share a strong foreign banking presence that is characteristic of Amable's third cluster.

3.1 Household total financial assets

Total financial assets holdings have grown for all Euro-17 countries – from 220% of disposable income, in 1995, to 290%, in 2011. Two periods of strong growth can be identified: 1) the period between 1995-2000, corresponding to the boom of financial markets, total financial assets holdings grew from 220% of household disposable income, in 1995, to 300%, in 2000; 2) the recovery period between 2003-2007, where the weight of these assets on household disposable income grew from 290% to 318%. This trajectory came to a halt in 2008 with the international financial crisis, mildly recovering afterwards.

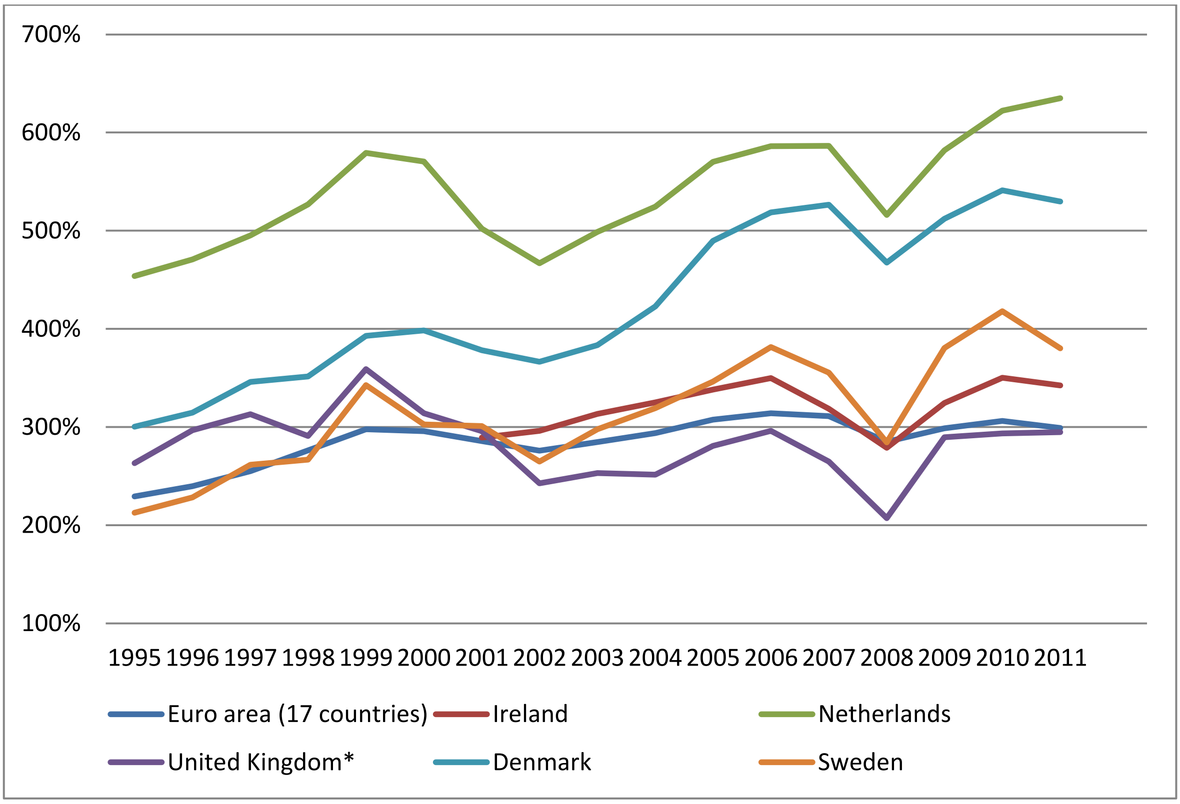
The growth of total financial assets for the Euro Area (EA henceforth) countries disguises very different situations. The first group of *early financialisers* – with the notable exception of the UK – is not only consistently positioned above the EA average, but the intensity of its periods of growth and decline are more volatile and more sharply marked than those of the rest of the European countries. A result that should not come as a surprise since more holdings of financial assets will make their aggregation more susceptible to the evolution of the financial markets both in their booming and bust periods. In this group, the Netherlands is the country with the highest starting point with financial assets reaching 470% of household disposable income in 1995 (636% in 2011), followed by Denmark that registered an intense growth, from 300% in 1995 to 530% to 2011. With the exception of the UK, all countries in this group depart further from the EA average, suggesting that early financialisers have intensified their financialisation processes, distancing themselves from other EU countries. The UK reaches the EA average in 2011 with household financial assets amounting to 290% of household disposable income (Figure 3.1a).

The *EMU core* countries follow closely the EU average, with outliers such as Italy above the average (314% against an average of 290% in 2011), and Greece far below average (148% in 2011). It should be noted that, despite the expected drop after 2008, the Greek position was already well below average even before the crisis. During the period 1995-2011 the countries in the core diverge, with Greece, Spain and Germany distancing from the EA average, especially after 2008 (Figure 3.1b).

The group of the *late comers* registers a slow but steady growth, remaining well below the EA average. Differences of pace are also noticeable among countries, where Hungary and Poland clearly stand out, particularly the former in that household financial assets grow from 53% to 193% of household disposable income. It should also be noted that, with the exception of Hungary, there is no trend of convergence among these countries with the euro average. They roughly keep their distance throughout the period (Figure 3.1c).

To sum up, despite a common trend of growth in households' holdings of financial assets there is no distinguishable pattern among the countries considered. The *early financialisers* grew faster than the *late comers* that followed still far behind the EU17. More interestingly, after 2008 we observe a growing divergence among countries within each group, reflecting, perhaps, the differentited impact of the crisis on these countries. Thus, while the general trend of growth in household holdings of financial assets may signal a shared economic and institutional environment, the diverging paths after the crisis may instead indicate different national conditions to withstand the impact of the crisis, where the Dutch and the Danish households continued to accumulate financial wealth, while the Spanish and the Greek decreased theirs.

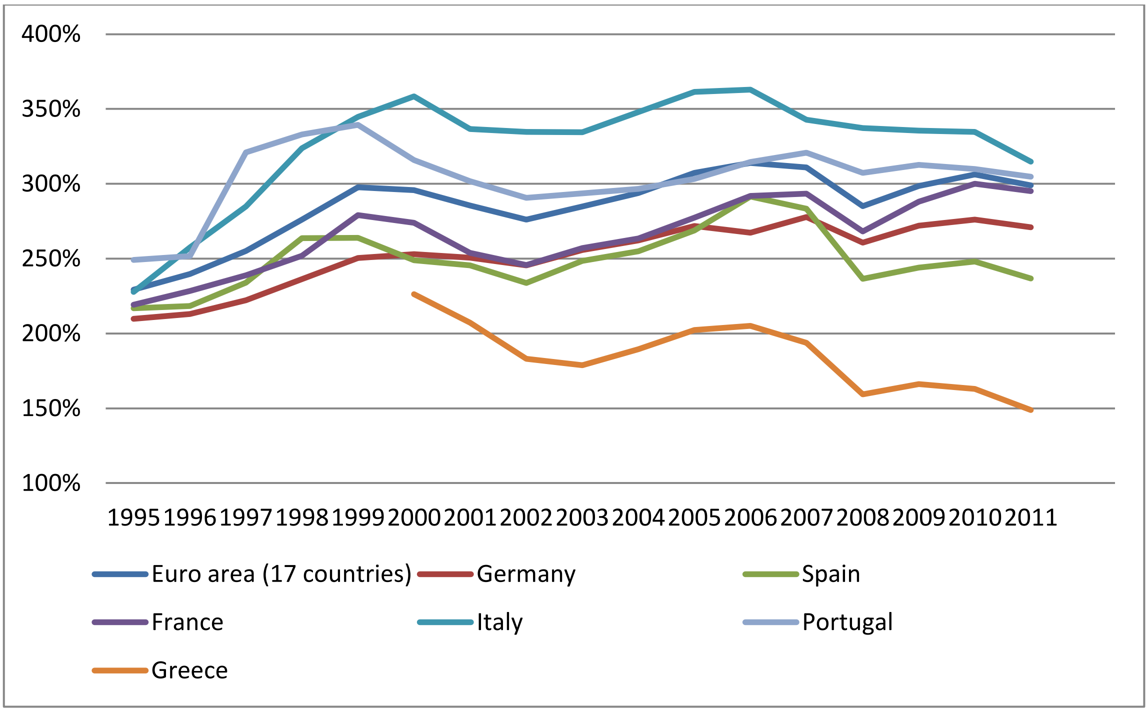
Figure 3.1 Total financial assets to disposable income (%) (Source: Eurostat and ECRI)



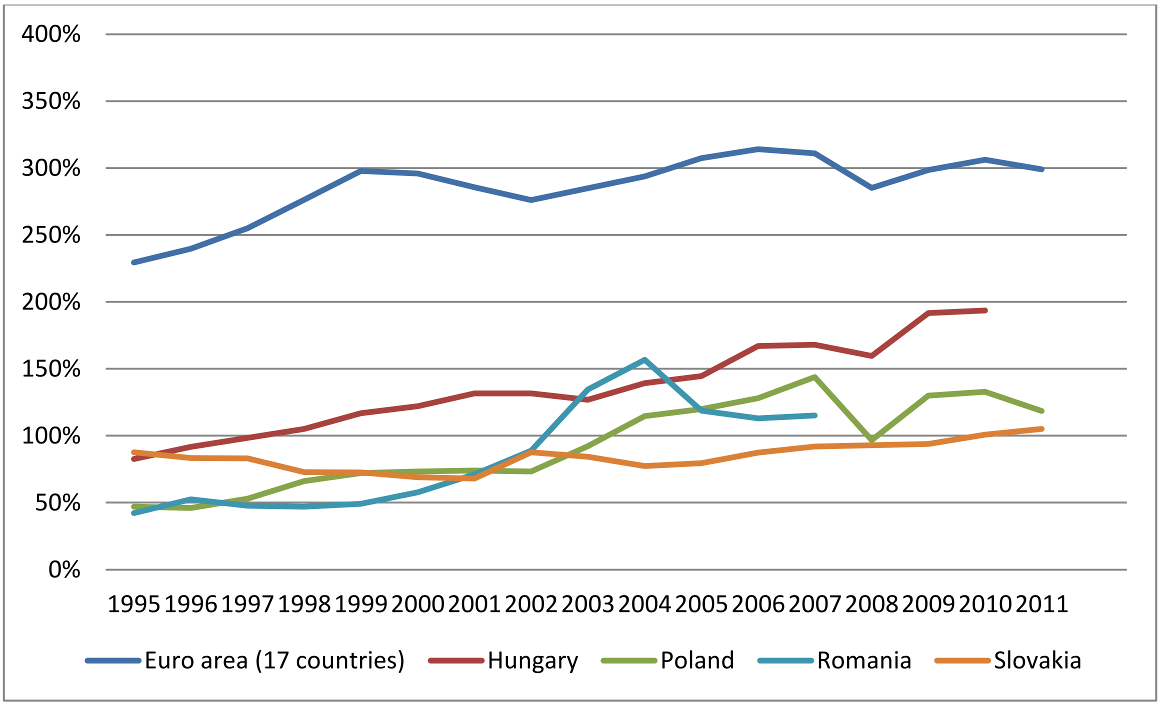
a) Early financialiser

Figure 3.1 Total financial assets to disposable income (%) (Cont.)

(Source: Eurostat and ECRI)



b) EMU core



c) Late comers

3.2 Net equity in life insurance and pension funds

"Net equity in life insurance and pension funds" is the most relevant financial asset of our analysis in that this is the only class of assets that grows steadily in most countries – from 45% of disposable income in 1995 to 90% in 2011 in the EA – being almost unaffected by the financial crisis of 2001 and 2008.

This class of financial assets is the most important for households belonging to the *early financialisers* group. All these countries have percentages above the EA average throughout the period, with the UK registering the most stable pattern, contrary to Denmark, Sweden and Netherlands that have had considerable high growth rates. The Netherlands is clearly an outlier, starting with 239% of disposable income in 1995 to reach 387% in 2011. Denmark has steadily grown from 130% in 1995 to 237% in 2011. The other countries have more or less stabilized after the post-2008 crisis with households holdings around 150% of household disposable income (Figure 3.2a).

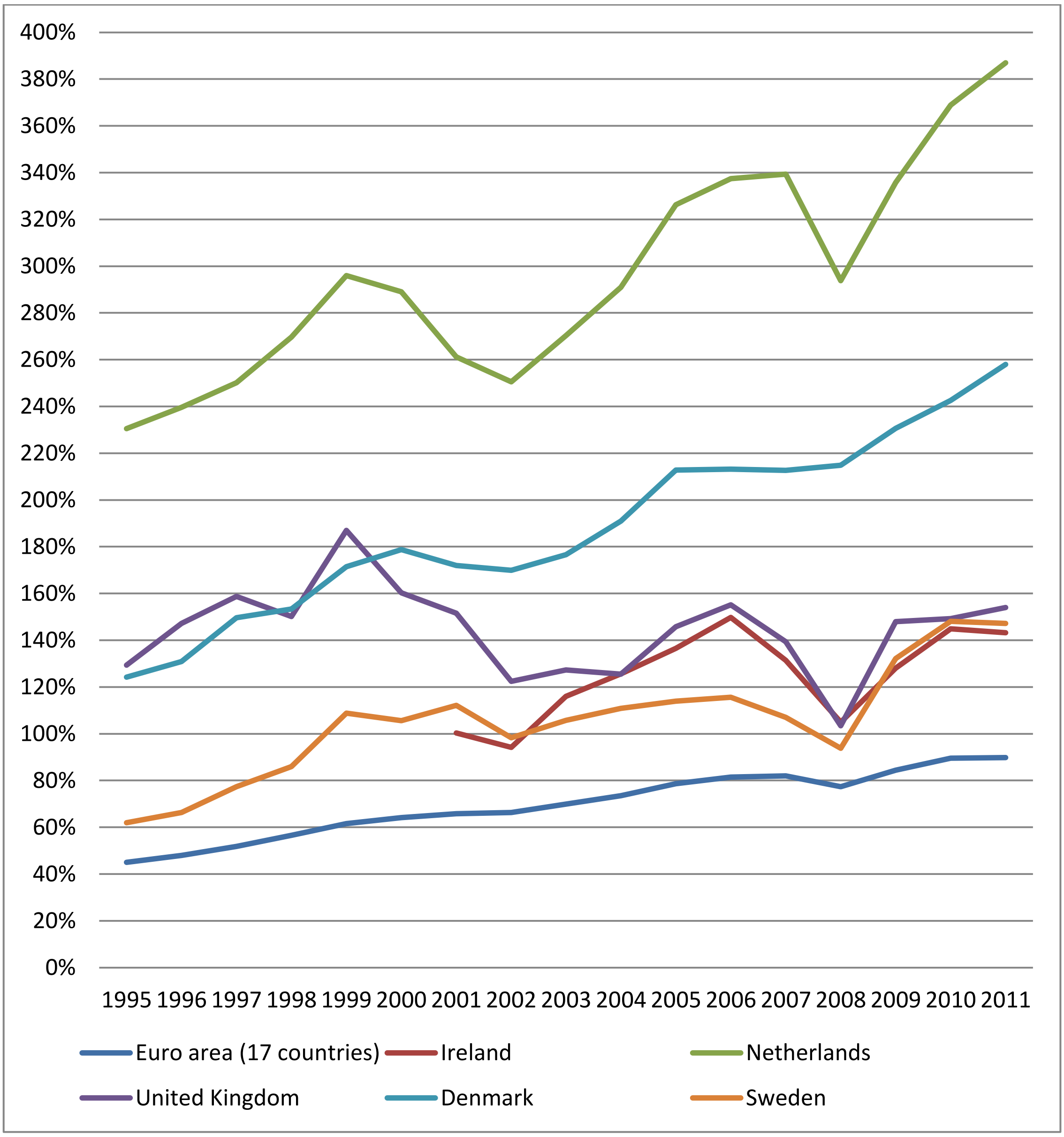
In the *EMU core* group, Greek households stand out for not having significant holdings of net equity in life insurance and pension funds. France and Germany are above the European average while Portugal, Spain and Italy fall below the average throughout the whole period. The latter two do not progress for most of the 2000s. Italy is below the EA average (with 55% of household income), which might help explaining the higher levels of holdings for the other assets (namely securities other than shares) (Figure 3.2b).

While well below average, households in the group of *late comers* also started to acquire a higher proportion of life insurance and pension funds from 2000s onwards, remaining below the EA average, with holdings less than 40% of household disposable income. Romanian households barely possess this kind of assets (Figure 3.2c).

The distinctive trend of this class of assets compared to other categories of financial assets – steady growth and resilience to financial volatility – suggests that the evolution of these assets might be more directly related with shared institutional changes, namely those driving reform in pension systems. Moreover, not only has the relative weight of net equity in life insurance and pension funds grown for all the European countries considered, with the exception of Ireland, but these assets have become the second most relevant category of financial assets (with 30% of total assets in 2011), almost reaching the first most secure asset, deposits and currency (36% in 2011) (Figure 3.3).

Figure 3.2 Net equity in life insurance and pension funds to disposable income (%)

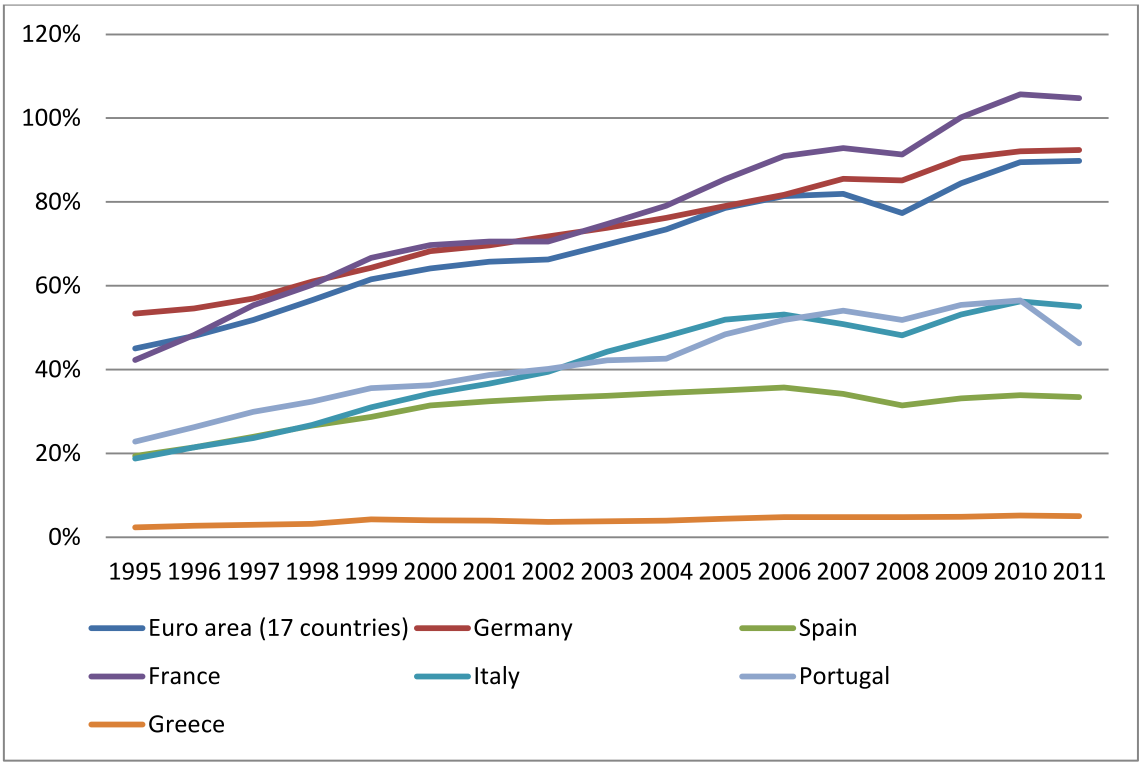
(Source: Eurostat and ECRI)



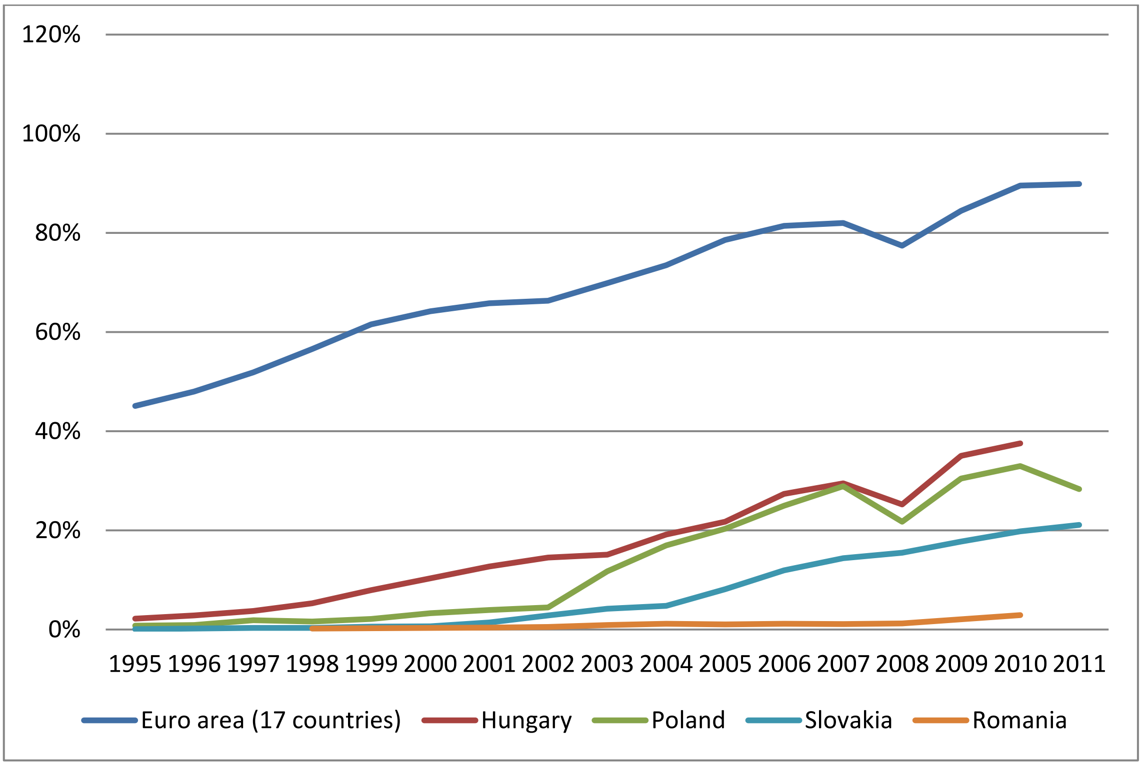
a) Early financialisers

Figure 3.2 Net equity in life insurance and pension funds to disposable income (%)

(Source: Eurostat and ECRI)



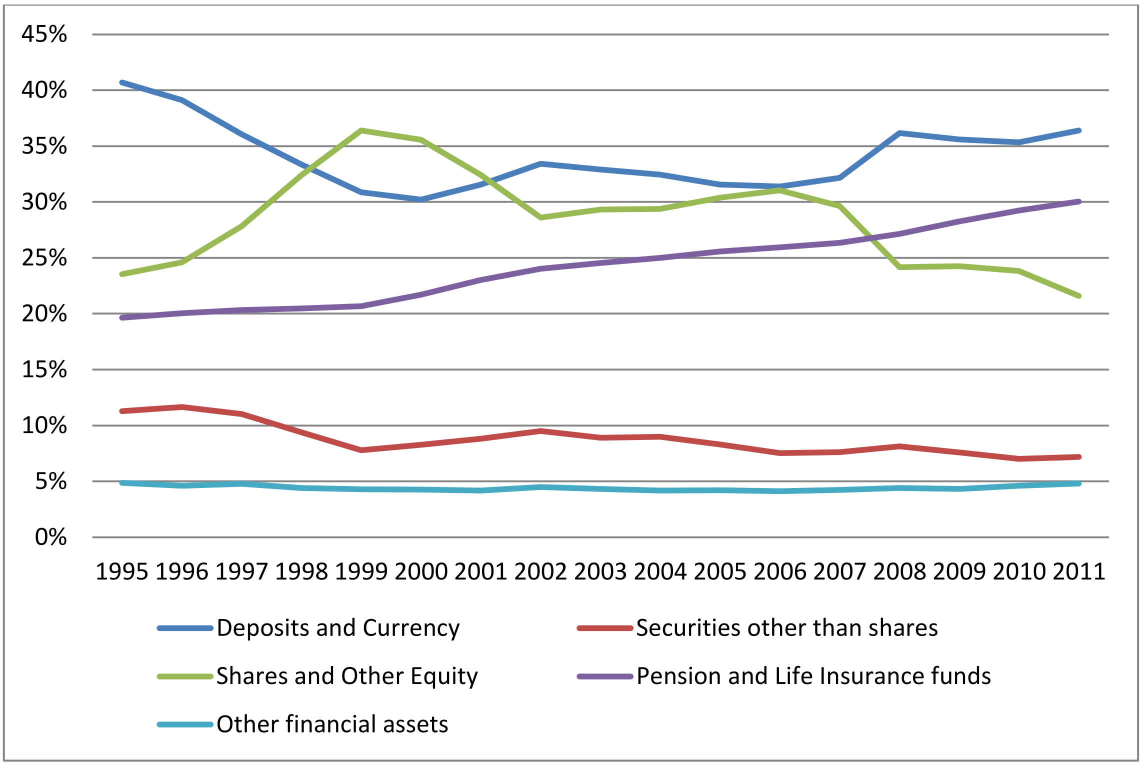
b) EMU core



c) Late comers

Figure 3.3 Household Financial Asset Composition for EA-17 (%)

(Source: Eurostat, ECRI)



The importance of these assets varies widely. Countries such as the Netherlands or the UK have more than 50% of household wealth held in these type of financial products. On the other hand, the importance of pension funds and life insurance seems to be small, albeit rising, in Greece and in the late comers group. These common trends and disparities put in perspective the hypothesis of a more risky investment profile of households, resulting in their increasing direct involvement in capital and debt markets as financial agents.

Although the trend of rising weight of pension funds and life insurance reserves relative to disposable income and to total assets is shared by almost all countries, with the exceptions of Greece and Romania, there is no evidence of convergence among these countries.

The rising importance of pension funds and life insurance reserves in countries with very different social structures and economic performance, and radically different starting points, suggests the presence of common factors pushing the expansion of these financial assets. The recent reforms of pensions systems led by the EU, as well as the fiscal constraints introduced with the inception of the Monetary Union in Europe, may be one of these factors underlying the scope and synchronisation of the remarkable growth of pension funds across Europe. As we shall see below, these have been critical to the erosion of Public pension schemes and their replacement by private financial provision.

4. Recent trends in pension reforms in Europe

4.1 Background

The recent evolution of pension reforms in the EU follows broader international trends, initially promoted by organizations such as the World Bank, the OECD and the IMF, which have launched discussion on the need of starting structural reforms of public pension systems to deal with demographic and fiscal challenges (WB, 1994, OCDE, 1996). These institutions have been successful in turning this into a global agenda, reaching middle-income countries in Latin America as well as European Nordic countries known for their robust welfare states (Orenstein, 2005).

Taking as point of departure the pressure of an ageing population on government budgets, and its alleged impact on the sustainability of pension provision, the main policy target was the control of public expenditure on pensions. By fixing budget constraints as the goal that is to guide pension reforms, the proposals turned pension architecture as the variable of adjustment.

The control of public expenditure with pensions was to be achieved in two different ways:

1) Changing the balance between the active and retired populations through the prolonging of working lives: by increasing statutory pension ages, by dismantling incentives to early retirement and by introducing changes in the incentive structure to motivate delaying retirement (introducing tighter qualifying conditions to early retirement, greater benefit penalties for early retirees and greater pension increments for people retiring after the normal pension age). This is, however, deemed insufficient.

2) Changing the balance between contributions and entitlements, reducing the rate of return of public pensions, which require developing supplementary schemes of pension provision.

These changes introduce a major shift in the philosophy of public provision where the redistributive function of public pensions will be gradually concentrated on ensuring a minimum standard of living of the most vulnerable. The smooth transition from work to retirement life will instead be guaranteed by supplementary schemes based on individual contributions, such as pension funds and life insurance reserves referred to in the previous section. These reforms are producing diversified pension systems, mixing public and private provision, that combines pay-as-you-go and pre-funding as sources of finances. And it will imply that the cost of providing for pensions as life expectancy increases is to be borne by individual retirees, who will not only have to work for longer but will also have to contribute more for a lower pension in retirement.

4.2 Reform in Europe

Pension reform across Europe has been a pressing topic in policy debates since the early nineties. Social contributions were pointed as hindering competitive wages, being thus responsible of “Eurosclerosis” – high unemployment and low growth – that characterized European economies at the time. Moreover, the introduction Maastricht criteria for accession to the Monetary Union pressed members to cut social expense in order to comply with the 3% of GDP deficit threshold defined by the treaty. From the mid-nineties onward, major economies, such as France, Germany and Italy tried to cut public pension benefits. Such initial efforts were nonetheless met either with unexpected social upheaval (as in France during the “Juppé” Government) or strong political resistance (Germany, Italy), thus undermining its objectives (Blackburn, 2004).

Although not having a binding policy in what concerns social policy, the EU itself embraced the pension reform agenda. The first step towards the reform of the pension systems was taken in 14 July 1999 with the Commission Communication on “A Concerted Strategy for Modernising Social Protection’ (COM(99)347 final). At the time, the call for reform of social protections system was framed in the broader context of the changing nature of European society and the need of social protection systems to adapt to “the new social and economic circumstances in which they operate: the changing nature of work, demographic ageing, the new gender balance and developments in relation to the free movement of workers”. Social protection systems should then be capable of adjusting to these challenges, with a strong emphasis on its becoming employment-friendly, in that they should “help workers to embrace new forms of work organisation and working time arrangements as well as to acquire new skills, thereby enhancing adaptability within the labour market”. At the time, the sustainability of social protection system was to be tackle in its intersection with the European Employment Strategy through the removal of incentives for older workers to withdraw early from labour market.

Based on these grand common objectives, the role of the Commission was then to coordinate the exchanging information and monitor the process of reform so that member states could learn from each other reflections and experiences, thus promoting policy transfer among its members.

A series of studies and reports have since been commissioned and soon the issue of the sustainability of public finances in the light of ageing population became a key topic in EU political agenda. The Göteborg European Council in June 2001 stressed the need for a comprehensive approach in order to meet the challenges of an ageing society and endorsed the three broad principles for securing the long-term sustainability of pension systems: (1) to safeguard the capacity of pension systems to meet their social aims of providing safe and adequate incomes to retired persons; (2) to ensure the financial sustainability of pension systems; and (3) to enhance the ability of pension systems to respond to the changing needs of society and individuals. In short, the reforms would have to promote the adequacy of pensions, the financial sustainability and the modernisation of the pension provision.

At the EU level, the action would then be based on the setup of an integrated framework for the exchange of information on national strategies for securing adequate and sustainable pension provision in the long run. A critical aspect in this process was the setup of *open method of co-ordination* (OMC) on pensions that would involve setting common objectives, translating these objectives into national policy strategies and, finally, as part of a mutual learning process, periodic monitoring on the basis of commonly agreed and defined indicators.

Progress towards the objectives were to be measured periodically by developing appropriate indicators which should aim at providing comparable information on the major economic, financial and demographic trends affecting the long-term sustainability of pensions, as well as on the progress of pensions reform and its likely impact. National strategy reports on pensions were to be periodically submitted and assessed by the commission.

Notwithstanding geographical disparity, the first report concluded that “[a]ll Member States ensure that most people earn pension rights and provide a minimum level of income to older people who earned insufficient pension entitlements” and that pension systems “provide good opportunities for most Europeans to maintain their living standards after retirement”. The major issue of concern in many EU Member States was long-term fiscal sustainability and, thus, “financial challenges have been the main driving force for reforms” and “[a]n approach based on raising employment rates, reducing public debt levels and re-forming pensions systems […] has been widely incorporated in Member States’ strategies”. The implications of the reforms for the aspirations of citizens and their increased responsibility for maintaining their standards of living were already foreseen in that it was then perceived as urgent to “give clear signals to citizens about what they can expect from their pension systems and what they have to do to achieve an adequate living standard in retirement” (EC, 2003: 6-9).

Along with the general concern and the general guidelines to ensure the sustainability of pension systems in the face of ageing populations, perhaps more importantly, the fiscal criteria imposed since the Maastricht treaty – public debt below 60% of GDP and public deficit below 3% of GDP, further pressured these reforms. Although designed for the countries that adhered to the Single Currency, these criteria were mandatory for all EU countries, including the ones that opted-out of the Euro, such as the UK. Such criteria, later reinforced by the Stability Pact of 1999, resulted in a continuing pressure on public spending across Europe, with Member States forced to redesign and cut social spending, where pensions have a significant weight.

In 2006, in its first annual progress report 'Time to move up a gear', the Commission comes to recognizes globalisation and ageing, and in particular, the reform of public pension systems, as one of the main actions to be undertaken in Europe (EC, 2006). In the second round of the open method of coordination in the field of pensions, the summary report based on the national strategy reports submitted in 2005, confirmed that "there has been substantial progress in reforming pension systems since the 2003 Joint Report" (EC 2006b: 11). Besides the measures proposed to curb public expenditure by prolonging working lives and strengthening the link between contributions and benefits, in this second report the development of private schemes that complement or partially replace public pension provision is reinforced. In this regard, Denmark, The Netherlands and the UK stand out in the bigger role given to private pension provision. Other countries, have gradually increased the importance of private provision trough the introduction of a funded tier of statutory schemes (SE, PL, HU, EE, LV, LT and SK) or by increasing provisions for occupational or private schemes that complement public pensions (DE, IT, AT). While the public pay-as-you-go pension schemes remains the principal source of income of pensioners, the expected contribution of privately-managed pension schemes is projected to increase in the coming decades.

Over the last decade most Member States have reformed their pension systems to improve their medium and longer-term sustainability and they have been deemed effective to the extent that "public pension schemes have become much more able to withstand the pressures of population ageing and their future contribution to pension incomes is better assured" (EC, 2012b: 13).

Four major trends in pensions reforms have been highlighted (EC, 2010, 2012b):

1) Tightening the link between contributions paid into the system and benefits paid out: using lifetime earnings as the basis for benefit calculation (instead of final pay or best years), thus requesting a number of contribution years instead of solely on

reaching a pensionable age and increasing the number of years required to receive a full pension.

2) Increasing the pensionable age and remove incentives to early retirement, which will produce a convergence to 65 by 2050 for both sexes (were pension eligibility ages at the present is 63 for men and 62 for women).

3) Adoption of mechanisms for automatic adjustment or periodic review of pension schemes as demographic and economic conditions change, namely:
   (i) pension eligibility ages and/or pension benefits in line with gains in life expectancy,
   (ii) the valorisation of entitlements and/or the indexation of benefits in line with the economic performance in terms of GDP growth and/or labour market performance,
   (iii) contribution rates in line with the indexation of benefits,
   (iv) the valorisation of entitlements and indexation of benefits to ensure the financial balance of the pension system after external shocks.

4) Enhancing pre-funding through:
   (i) introduction of new defined-contribution (DC) schemes (either mandatory, with automatic enrolment or voluntary with tax incentives);
   (ii) expansion of existing occupational schemes;
   (iii) setting up of pension reserve funds; or
   (iv) paying down of national debt.

4.3 Reform Impact

Naturally, the positive impact of the reforms on the sustainability of public pensions in most Member States, in terms of curbing public expenditure, implies a detrimental effect on the future adequacy of pensions. The control of public expenditure has been achieved by introducing tighter eligibility conditions (e.g. higher pensionable ages, longer required contributory periods), reducing the coverage of the public system, and by reducing the amount of the pension (e.g. benefit calculations based on full career averages rather than the more favourable last period, introduction of life expectancy adjustment factors in benefit calculations).

This effect is already evident in the expected impact of the reforms on public pension expenditure, coverage and benefits, considering the relatively moderate growth in public expenditures until 2060 (Figure 4.1), and that this is to be obtained at the expense of the coverage ratio, i.e. the number of pensioners to population over 65, and the benefit ratio, i.e. the value of the average pension with respect to the average wage (Figure 4.2).

Figure 4.1 Change in Gross Public Pension Expenditure over 2010-2060 (in p.p. of GDP) (Source: Commission Services (DG ECFIN), EPC (AWG)

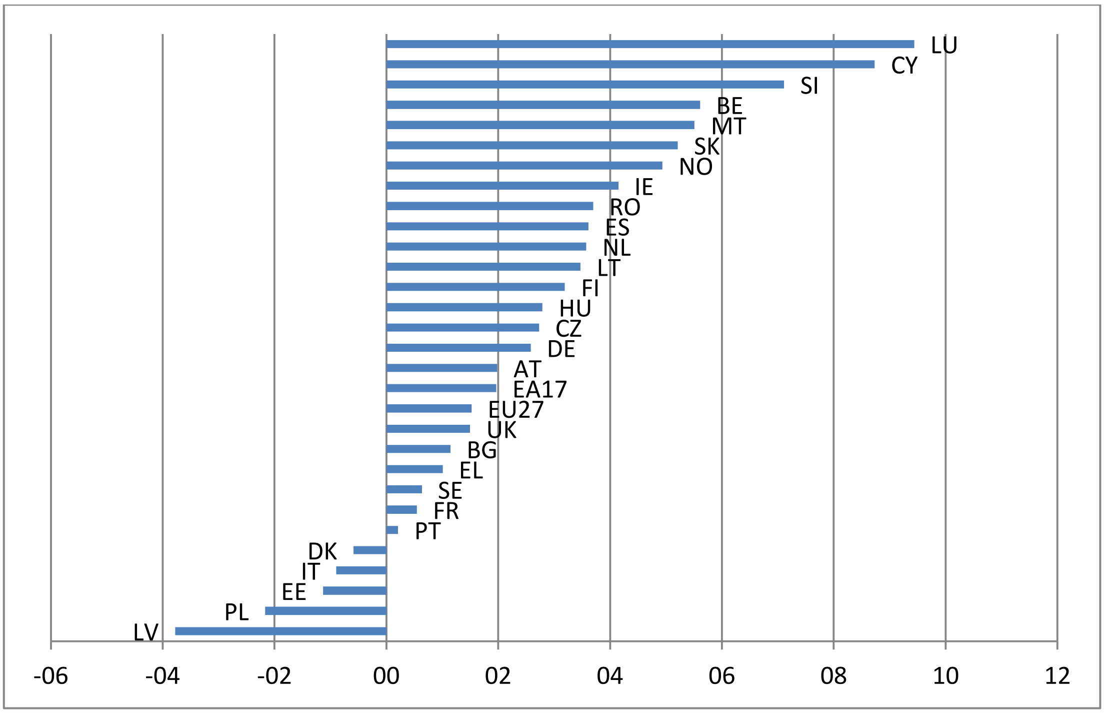
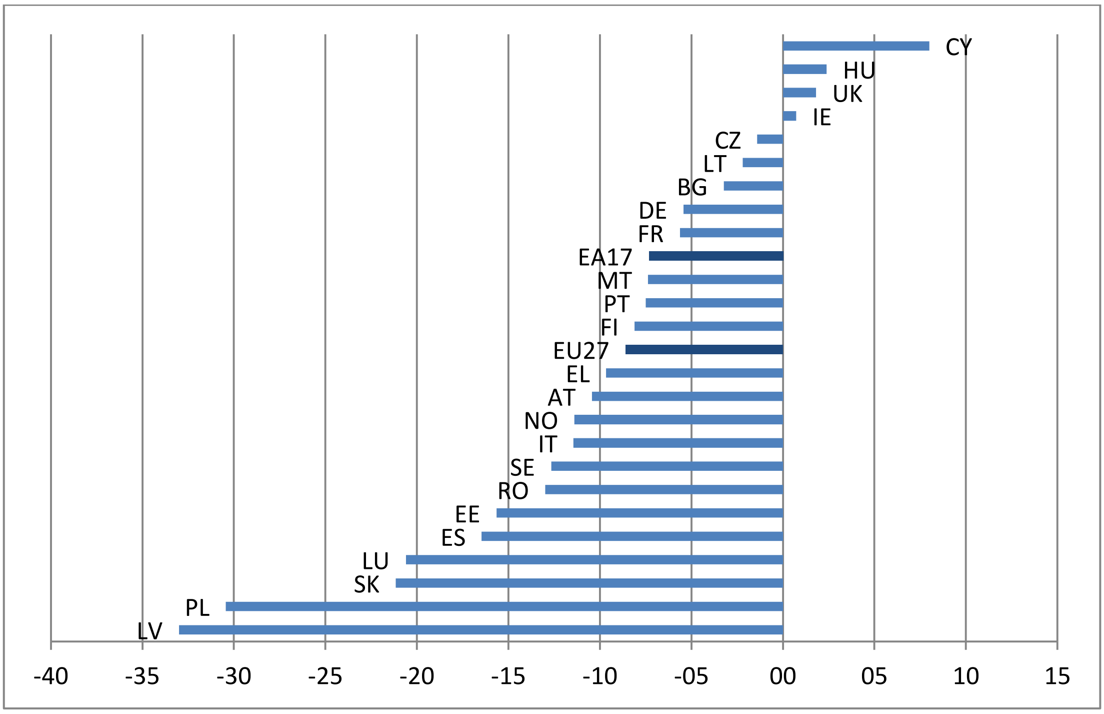


Figure 4.2 Change of gross replacement rates at retirement 2010-60 (%) (Source: Commission Services (DG ECFIN), EPC (AWG)



These reforms will mainly affect the current working population as the changes introduced are phased out. While European pension systems have been more or less capable of guaranteeing a minimum level of income to older people who earned insufficient pension entitlements and allowed the maintenance of the living standards after retirement, i.e. the adequacy objective of pensions, the reforms seriously compromised these two adequacy goals.

The impact of the reform on adequacy outcomes, measured as replacement rates of previous income, means that achieving adequate income in old age is more dependent on people's working lives and on supplementary pension schemes, which, in turn, depend on returns and volatilities in financial markets. This means that not only has the higher sustainability of public pension expenditure been achieved at the expense of pensions' adequacy, but also at the expense of pensioners' security for they "will have to shoulder a larger share of the particular and systemic risks of their future pensions" (EC, 2012b: 34). The financial and economic crisis introduces further strains on future pensions through the effects of lower growth prospects and rising public deficits and public debt levels. Future pensioners will then not only be affected by prolonged unemployment periods and thus lower contribution careers, but also by poorer returns in financial markets (in case of funded schemes), and pension reforms introducing more demanding qualifying conditions.

The expected evolution of gross replacement rates - measured by the Theoretical Replacement Rate (TRR)[2] - for different income brackets is far from clear. Countries vary between a progressive TRR (higher for low income earners) and a similar TRR for all income groups (EC, 2012). These results should be taken with caution since the TRR assumes a stable career of contributions, with no or few years of unemployment. It is to be expected that low-income earners will be in more disadvantaged position that these measures suggests since they are more likely to be unemployed and to participate in atypical work relations (part-time, temporary, self-employed). From this it follows that the present reforms (linking all career contributions to pension income) will magnify and prolong labour market inequality to retirement.

In 2010, the policy option advocated to mitigate the problem was quite straightforward: "giving people the incentives to compensate this by working more and longer and/or by building supplementary entitlements and savings in occupational and personal schemes" (EC, 2010: 75). But this emphasis on labour market activity and on the promotion of private or semi-private schemes must face the problem of the unequal participation in these complementary schemes due to income inequality:

[2] The current theoretical replacement rate measures a base-case scenario of a male worker who retires now with 40 years of contributions. Prospective theoretical replacement ratios project the evolution of pension income for the same base-case scenario.

“the proportion of income coming from occupational or statutory funded pensions is lower for low wages earners and higher for high-wage earners. This is because benefits usually are earnings-related and statutory PAYG schemes with their redistributive features play a more significant role for people with lower earnings (EC 2012, p. 57).

Moreover, the promotion of private funded schemes usually results in a higher coverage for higher income deciles. Even in countries, such as the Netherlands, where private schemes are almost universal, lower income brackets do not have the same coverage level (approx. 65%), (EC 2012). Unequal coverage also affects women, who earn less than men and are disproportionally in atypical jobs. But this is not as yet a significant effect given the relatively new role of private pensions. The impact of pension reforms on inequality is to be materialized in the future, when the current working population retires. At the present, the percentage of individuals receiving benefits from private arrangements is still significantly lower than the percentage of active workers covered by such schemes – ranging “from less than 2% in ES and IT to more than 60% in NL and UK (EC, 2012).

4.4 Private pension provision

Private provision of pensions has been rising across Europe, particularly in privately managed occupational (DC) schemes as was already seen in the above sections. According to the OECD (2012) the weighted average asset-to-GDP ratio for pension funds increased from 67,3% of GDP in 2001 to 72,4% of GDP in 2011. A rising trend confirmed by the collected data on these assets to household disposable income for the EU.

Private provision arrangements vary across countries. In the Netherlands they are part of collective agreements and quasi-mandatory, and thus they cover more than 90% of the labour force. In other countries, such as Germany, UK and Ireland, where private provision is significant, coverage ranges from 41% and 53% of the labour force (EC, 2012). On the other hand, individual contributions are higher (above 20% of income) in countries that have above average household holdings of financial assets, particularly pension and life insurance funds. This is the case of the Netherlands, Denmark, UK and Sweden. The catching-up of eastern European countries, in turn, is explained by the recent introduction of private schemes coupled with mandatory enrolment requirements in some of them (as in Poland), strongly supported by World Bank interventions in these countries (Orenstein, 2005). The countries with more mature private pension schemes are deemed to be “moving ahead” while the countries most affected by the financial crisis (e.g. Hungary and Portugal) are falling behind other OECD members.

The rise of pension funds and life insurance reserves over the last two decades is not to be solely explained by the (expected) erosion of pensions that has led households to find supplementary pension income in the financial markets. The liberalisation and deregulation of financial markets also expanded the supply of new financial products targeted to the households. The liberalisation of capital accounts, the standardisation of financial practices and the gradual retreat of the State from the financial sector (perceived as an hurdle to free competition), that the EMU promoted, might as well explain the relatively synchronized growth of these new agents and products across Europe, making pension funds available for the wealthier segments of the population, both in countries with emerging and more mature financial markets. As pointed out by Hartmann et al. (2003): "More permissive regulations of investment and pension funds, as well as tax advantages for investors in life insurance products, played some role in these developments. The introduction of the euro might have further strengthened the movement away from traditional bank deposits, given that the disappearance of currency risk has facilitated cross-border diversification of portfolios, thus increasing the demand for securities (…)" (p. 12).

The growing relevance of pension funds and life insurance in household financial wealth represents increased individual and collective risk. Although many of these funds have an investment profile where foreign assets are relevant, in all countries the domestic share of assets is considerable – from 99,5% in Poland to 24,6% in Estonia (OECD, 2012). This means that risk cannot be wholly transferred to the individual since these assets contain an element of "sovereign" risk, which can ultimately compromise the goals set for public debt if governments are to offer public guarantees when these pension arrangements derail. It also means that private schemes may not be more resilient to the evolution of the domestic economy than public statutory schemes.

Relatedly, the discussion on private systems does not address their future sustainability. Focusing on the current or recent returns in investment, it ignores the fact that the level of benefits to be paid will too grow as the current working population retires. Given the relatively novelty of these schemes, at present the level of contributions surpasses the benefits paid, even among the EU countries with higher pension funds benefits relative to GDP (e.g. Finland, Netherlands, Denmark). But the ageing problem at some point might as well impact private pension funds when the contribution/benefit paid ratio reverses, affecting the value of financial assets and future pensions/supplements, additionally fostering the instability of these instruments.

4.5 The impact of the current crisis

Many of the assumptions assumed in EU projections have dramatically changed with the international financial crisis. This means that both the sustainability and adequacy of future pensions are at greater risk. This is acknowledged by the EC (2010). Of major concern is the contagion of the crisis to the "real economy", particularly to employment and governments' fiscal positions. The rise of unemployment to unprecedented values and its persistence threatens the adequacy of future pensions due to its detrimental impact on contributory careers. On the other hand, the eventual need of additional measures of fiscal consolidation "stemming from bank rescues" (p. 46) advice the speeding up of pension reform to ensure the sustainability of pension systems. This means that the pressure for reform is escalating in this new context, with a new emphasis: it is now part of the strategy for economic recovery. The question is "whether the crisis will weaken the incentives for structural reform and thereby affect potential growth further, or whether it will provide an opportunity to undertake far reaching policy actions" (p. 46). Surprisingly, the impact of the crisis on the market value lost by pension funds is not considered very troublesome since they had "been able to recoup some of their losses in 2009 and early 2010" (p. 7).

The European Commission insists on the same policy options defended before the crisis: pensionable age and contribution rates increases for PAYG schemes; regulatory easing; and a "greater sharing of risks between scheme members and employers" (p. 57) for DB and hybrid schemes. DC schemes are however taken with complacency. Although DC members are identified as being more vulnerable to unemployment as contributions either fall or are suspended in such situation, concern is devoted to the public costs that migration from DB to DC schemes pose. In light of the deterioration of public fiscal positions, the entailed public costs are perceived as a potential hurdle for the migration process.

A more proactive stance for financial regulation should be expected with the financial crisis impact on the value of pension funds. However, financial market instability is taken by the EC as an exogenous factor, "volatility is a fact of life" (p. 57), where public policy has no significant role to play. Policy recommendations address instead transparency and the promotion of smarter investment strategies such as "life-styling" – higher investment risk when scheme members are younger – in order to minimize the losses of those entering retirement age in periods of financial crisis.

A new reform impetus is to be expected since fiscal constraints have been deepened. The deterioration of fiscal balances across Europe, particularly in the countries struck by the Euro crisis, and the recent European agreements on stricter fiscal policy - the "six-pack" legislation that imposes European surveillance on national budgets and the "fiscal compact" treaty which imposes the 0,5% structural deficit golden rule in the future – provide a new institutional framework to exercise further pressure on national governments to speed up pension reforms.

5. Final remarks

This paper analysed the evolution and composition of household financial wealth in Europe. It highlighted the rising relevance of pension funds and insurance reserves relative both to disposable income and to total financial wealth. It also showed that despite the increasing relevance of these financial assets, the various countries kept their relative positions. The growing relevance of pension funds and insurance reserves puts in perspective the role of other financial assets, and the participation of households as independent financial agents with direct access to equity and debt markets.

The analysis of household financial wealth supplies another standpoint from which household financialisation can be assed. The synchronised growth of pension funds and insurance reserves over the last two decades in countries with very different socio-economic starting points brought to the fore the role of pension reforms across Europe, introducing other variables than income stagnation and inequality in the analysis of the relation of households with the financial sector.

In the case of Europe, household engagement with the financial sector calls for the scrutiny of EU policy, both economic and social. If, on the one hand, the construction of the European Monetary Union has led to the expansion of the financial sector, on the other hand, EMU constraints has imposed synchronised reforms in the social domain that are particularly favourable to the financial sector.

These very preliminary findings thus invite a more detailed examination of the various and many forms that household financialisation may take, both in household dealings in debt and financial asset markets, and the various and many sectorial policies that promote households new financial dealings. This approach should enable not only a more comprehensive perspective on the various dimensions of financialisation, but also a more accurate view on the distributive effects of these various aspects among different socio-economic segments.

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