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Europe's Pension Crisis Yet to Come of Age

By: Hester Plumridge **June 7, 2012**

There are three types of European pension shortfalls. First, from governments, the EU's main pension providers: Sweden, Denmark and Poland set aside money to part-fund state pension liabilities, but in most countries they are financed by tax contributions. Pension deficits are typically left out of public debt figures, but the average EU country would need to set aside 8.3% of GDP a year to fund current pension policies, the National Center for Policy Analysis estimated in 2009. Deteriorating growth and lower interest rates since then will likely have swelled that figure.

Aging populations are a further strain. In 2010, the average EU pensioner was supported by almost four workers; by 2050 it will be two. The current average retirement age is 61, but may need to be as high as 75 to make state pensions sustainable, estimates JLT Pension Capital Strategies. The boldest proposal, in the U.K., is 68 by 2046. Switzerland and Greece have now cut pension deficits, the latter reducing monthly payments by up to 40%.

Company deficits, the second type of shortfall, also have grown. The Netherlands and the U.K. have large defined-benefit pension plans that are part-financed by employers. Here, investment performance has disappointed: Real annual returns for pension funds in most Organization for Economic Cooperation and Development countries were negative from 2008 through 2010. In the U.K., pension plans are sitting on an estimated £217 billion ($334 billion) shortfall. Corporate sponsors will need to pour in 13% of their cash holdings to plug the gap in coming years, a recent survey of trustees estimated.

Individuals are the third source of concern. In France, Cyprus and Luxembourg, private pension provision is low, but as governments struggle with rising debt, more countries are shifting the pension burden onto workers, encouraging them to pay into defined-contribution plans in which returns depend on investment performance. Countries like the U.K. also are continuing to shift from defined-benefit to defined-contribution plans. Yet today's low-yield environment offers little incentive to save. Household savings rates have fallen to 11.4%, from 13.4% in 2009, Eurostat data show.

Today's workers would need to set aside an extra €3,100 ($3,860) a year to adequately fund their retirement in Italy and €12,000 in the U.K., estimates insurer Aviva. That's on top of their state pension, assumes a 5% return on investments, and an income equivalent to 70% of their

preretirement earnings. Some of the biggest needs for individual savings are in recession-hit countries like Ireland and Spain, where boosting savings rates would be a further hit to growth.

That's a problem to tax even Europe's wisest old heads.