Pension schemes for (semi-)government employees in the Netherlands – a national accounts perspective

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Introduction

The pension system in the Netherlands has some special features, the most striking of which is the large share of funded pension schemes – also applicable to (semi-)government employees. Recently, a number of changes, including greater reliance on average pay pensions, have been introduced to make the pension system better able to cope with the ageing of the Dutch population. This paper briefly describes both structural aspects and recent changes. It focuses on the treatment, in the national accounts, of pension schemes for (semi)government employees, taking into consideration the recent proposals for changes to the 1993 SNA and Eurostat's decisions on transactions in pension liabilities with respect to EDP notifications.

1. The Dutch pension system: structural features

The Dutch old age pension system is normally described as consisting of 3 pillars.

- The first pillar is part of the social security system, and includes pensions based on the Old Age Pensions Act (Dutch acronym: AOW), which are financed on a pay-as-you-go basis. The payment of premiums is integrated in the income tax. The AOW covers the entire population, providing a basic income to everyone beginning at age 65. Individual entitlements depend on the number of years a person has lived in the Netherlands and/or the number of years he/she has paid premiums.
- The second pillar is composed of funded employer pension schemes, which provide a pension that supplements the AOW pension. These schemes cover 90% of all employees, both in and outside of government. This very high participation rate is surpassed only by Denmark (Kakes, Jan and Dirk Broeders, eds., 2006). For the majority of employees, participation in a pension scheme is compulsory, based on collective wage agreements. There are two types of funds for implementing the pension schemes: corporate pension funds, covering single enterprises, and sectoral pension funds, covering all enterprises in a particular business sector. At the request of employer and employee organizations, the Minister of Social Affairs can make participation in a sectoral pension fund compulsory for all enterprises in the sector. Most pension funds are foundations governed by employers and employees (pensioners are conspicuously absent), with premiums being paid by both parties.

Pensions for civil servants and educational workers are covered by the ABP fund, while pensions covering healthcare and social workers are provided for by the PGGM fund. With

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balance sheet totals of EUR 200 billion and EUR 70 billion, respectively, these are giant pension funds.

- The third pillar consists of individually arranged pensions, which are (by definition) funded. These pensions are, in large part, arranged through life insurance companies.
- There is, in fact, a fourth pillar, which is generally neglected because of its rather limited size (pension payments under this scheme amounted to 0.16% of GDP in 2005). These are military pensions, which until recently were fully paid out of the Ministry of Defence budget, amounting to an unfunded system. Since 2000, this has been replaced by a mixed system in which the budget must cover all existing pension entitlements (present and future); new entitlements, however – those earned after 2000 – are funded. Consequently, the Ministry has started paying premiums to the ABP fund.

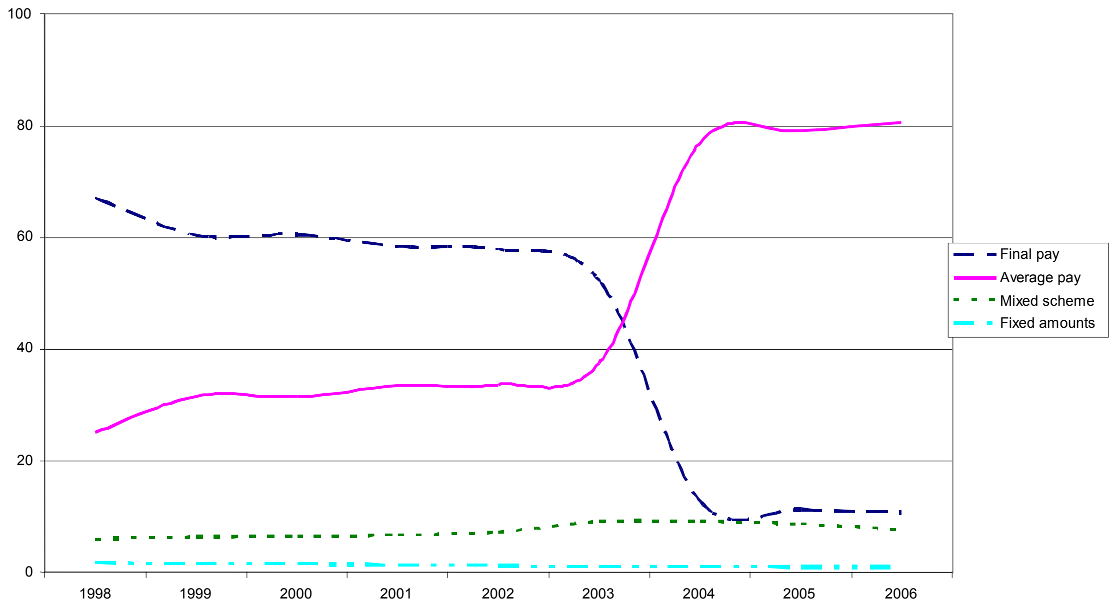
2. Recent changes in the Dutch pension system

In recent years, there has been a shift from final pay to average pay systems (Graph 1). This was one of the measures taken by boards of pension funds, with two purposes in mind: to repair the funds' financial position following the drop in the stock market, and to strengthen the pension system to deal with the ageing of the population.

Graph 1

Types of pension arrangements: the pension base

Percentage



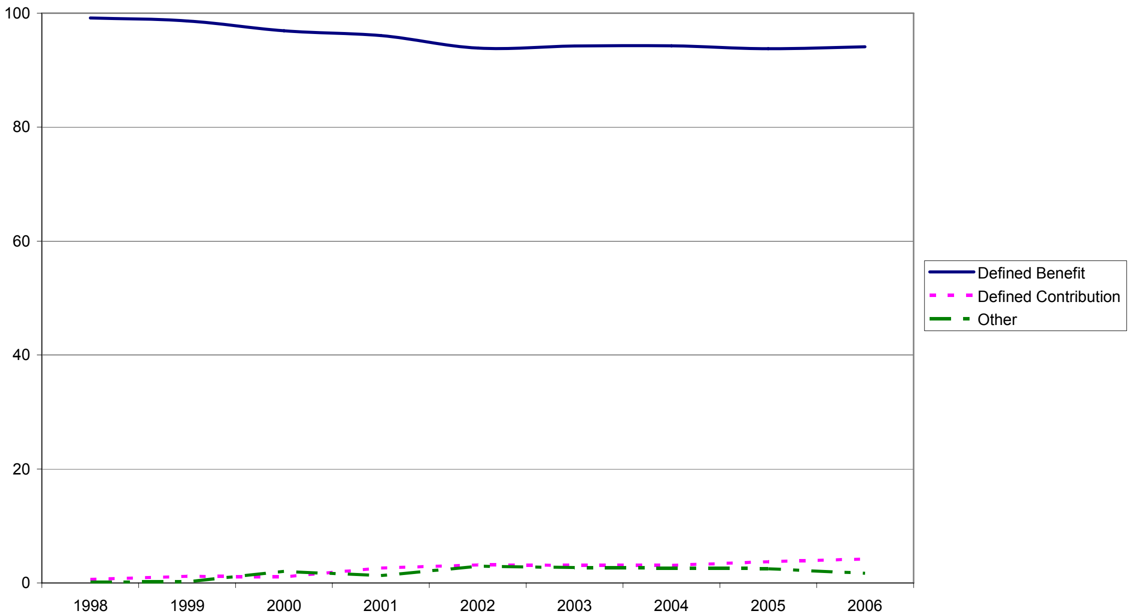
Source: De Nederlandsche Bank, Statistical Bulletin, Table 8.6.

In a substantial number of countries, there was a shift to defined contribution schemes. Although the number of defined contribution schemes as a proportion of all total pension arrangements in the Netherlands has increased slightly in recent years, defined benefit schemes are still the favoured arrangement.

Graph 2

Types of pension arrangements: financing schemes

Percentage



Source: De Nederlandsche Bank, Statistical Bulletin, Table 8.6.

3. Eurostat's decisions on pension funds

Over the past years, Eurostat has taken a number of decisions on the application of ESA 95 rules to the recording of transactions by pension funds in the national accounts. Some of these decisions were strongly contested, both on theoretical grounds and because they strongly affected government deficit/surplus and the government debt figures. Governments of EU countries are required to report the relevant key indicators to the European Commission, in the framework of Excessive Deficit Procedure (EDP) notifications, and they may not exceed certain limits. The government deficit, for example, may not be higher than 3% of GDP.

In October 2003, Eurostat took a decision on the issue of lump sum payments by public corporations concerning the transfer of *unfunded* pension obligations to government (Eurostat, 2003). According to ESA 95 rules, such pension obligations are not recognized in the System of National Accounts. As a consequence, Eurostat argued, the counterpart transaction to the lump sum payment is an unrequited transfer – in this case a capital transfer. The government deficit/surplus is positively affected; government debt is not affected. Not everyone agrees with this reasoning. The justification for the lump sum payment is that pension obligations are transferred to government. The amount of the lump sum is determined by the present value of the future pension claims that are transferred. So in effect, the payment is a financial transaction. Eurostat's decision was identical to the decision it had taken in a notorious case in 1996, which related to the transfer of a lump sum payment by France Télécom to the French government. At that time, however, ESA 79 rules applied.

In February 2004, Eurostat published another decision on a similar issue. This one was related to lump sum payments involving the transfer of *funded* pension obligations (Eurostat, 2004a). Again, Eurostat decided that these lump sum payments should be considered capital transfers. The reasoning behind this decision is slightly more complicated. Clearly, funded pension obligations of public corporations are recorded in the national accounts. However, the pension obligations become unfunded after having been taken over by government. In Eurostat's view, the pension obligations must be deleted in national accounts bookkeeping through an entry in the "other changes in assets" account before the lump sum payment is recorded. To this author, however, it seems more logical to take a different view, in which the lump sum payment is a financial transaction – without effect on the government deficit/surplus – given that pension obligations are transferred from the public corporation to government. Consequently, being unfunded, these obligations are deleted in the government accounts, in conformity with System of National Accounts methodology.

This second Eurostat decision was, in fact, a two-in-one decision. First, as in the decision of October 2003, it determined that the transfer of pension obligations can be an unrequited transfer. Second, it determined the sequence in which entries are to be made. In this case, funded pension liabilities are deleted before becoming the subject of a transaction, because in the National Accounts they are not recognized as a liability for the sector acquiring them. The decision might as well have been to delete them after the transaction, however, and Eurostat does not give a rationale for the treatment it prescribes.

In March 2004, Eurostat published a number of decisions regarding the classification of funded pension schemes in cases of government responsibility or guarantee (Eurostat, 2004b). One of the decisions was that a defined contributions funded scheme cannot be classified as a social security scheme. Another was that where a government simultaneously manages a funded and an unfunded scheme, two different institutional units must be distinguished, each classified according to the applicable rules. These decisions strongly affected the national accounts recording of pension reforms in a number of EU countries. Therefore, Eurostat allowed a gradual introduction of the effects on government deficit and debt figures in the EDP notifications.

Eurostat's decisions on the recording of pension fund-related transactions in the national accounts did not affect the Netherlands, due to the features of its pension system. There are no public corporations or other enterprises with unfunded pension obligations. Thus, there is no possibility of transferring such obligations. Moreover, there is no desire to transform funded obligations into unfunded obligations. The Dutch cherish their funded pension system. If there is any change, it is in the opposite direction, as proven by the change in the funding for military pensions. Finally, defined contribution schemes have gained no popularity in the Netherlands.

It is worthwhile to look more closely at the transformation of military pensions. As an alternative to the present solution, the government might have opted for making a lump sum payment to the ABP in order to fully fund military pensions. In this imaginary situation, it is still not clear how Eurostat's ruling would have to be applied. Would this be a capital transfer, since unfunded pension liabilities are transferred? Or would this be a financial transaction because the pension liabilities that are transferred are funded in the accounts of the insurance corporations and pension funds subsector. One continues to be puzzled about the wisdom of Eurostat's decision. What is lacking is a theory on the sequence of recording transactions and making entries in the "other changes in assets" account. It is unfortunate that Eurostat has not attempted to devise a theoretical approach. The economic rationale for paying lump sum amounts is that the pension obligations that are transferred have economic value. Given this, it is illogical to treat the pension obligations as not existing when they become the object of transactions between different economic sectors. This view is relevant to unfunded pension obligation transactions between different sectors, and more strongly so for transactions in which funded obligations become unfunded (or, alternatively, unfunded obligations become funded) after the transaction.

4. Revision of the 1993 SNA

One of the most important elements of the forthcoming revision of the 1993 SNA is the change in treatment of unfunded pension obligations. The somewhat arbitrary distinction between unfunded and funded pension schemes will be abolished. In this way, national accounts data become more relevant for the analysis of ageing. Moreover, economic statistics and international accounting standards are better harmonized. How this change will be dealt with in the presentation of national accounts data is still under discussion. Some are in favour of implementing the new rules in the core accounts; others – mainly representing EU countries – advocate representing pension obligations of unfunded schemes in supplementary tables only. Pension claims that are part of social security still are not recognized in national accounts.

The effects of the new rules on the recording of Dutch pension schemes will not be significant. With a minor exception, the Dutch pension system is fully funded. So in this respect there is no change. The treatment of military pensions, however, is affected. The unfunded portion, which is covered by the budget, should be treated as if it were funded. A particular feature is that no new pension entitlements are being built up and no premiums are being received by the fund. The benefits paid by the virtual fund are equal to the benefits paid out of the budget. In addition, the rendering of financial services is recorded.

The effect of the new treatment – if fully applied in the core accounts – is to make government deficits/surpluses more comparable. For the EU member countries, this is highly relevant in the context of the EDP notifications. In countries like the Netherlands, where civil servants' pension schemes are funded, the government deficit/surplus has been affected for many years, because premiums are paid to the ABP fund. Compared to a system of unfunded pensions, the effect on the year-to-year government deficit/surplus may be negative or positive. On one hand, premiums may be higher than benefits – more heavily in a phase where pension entitlements are being built up. However, a funded pension fund also receives income from the investment of its assets, and may benefit from price increases in its invested assets. Both of these situations result in lower premiums. Government debt, of course, will tend to be higher to the extent that government has contributed to building up the pension funds' assets.

The new SNA treatment also has consequences for Eurostat's decisions on lump sum payments. As the difference in national accounts treatment of funded and unfunded employer schemes is abolished, the lump sum payments cease to be recordable as a capital transfer, unless the pension obligations transferred become fully a part of social security. However, when it comes to "creative accounting", nothing can be excluded, and therefore it is still worthwhile to devise clear rules for the sequence of recording transactions and making entries in the "other changes in assets" account.

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