

# **CROSS-BORDER PORTABILITY OF PENSION RIGHTS**

## **AN IMPORTANT CONDITION FOR AN INTEGRATED MARKET FOR PENSION PROVISION**

### **Exploratory workshop**

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#### **WORKSHOP PROCEEDINGS AND CONTRIBUTIONS**

*28 February–1 March 2003, Brussels*

**JØRGEN MORTENSEN AND REGINA SAUTO, EDITORS**

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## Contents

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Agenda .....	1
I. Background report.....	3
1. Overall objective .....	3
2. Labour mobility: incentives and obstacles .....	4
Incentives and motives .....	4
Obstacles to and costs of mobility.....	5
Geographical mobility .....	6
Occupational mobility .....	8
3. Pension portability and labour mobility .....	11
Conceptual issues .....	11
A general descriptive analysis.....	12
Cross-frontier portability.....	14
II. Proceedings of the workshop .....	16
Session 1: Labour mobility and the impact of pension portability.....	16
Session 2: Pension portability in Europe and the United States.....	18
Session 3: Removing obstacles to portability and liberalising pension provisions .....	23
III. Round table: Setting the European research agenda on pension portability .....	27
Bibliography .....	29
List of participants.....	31

## Agenda

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**Chair: Elsa Fornero**, University of Turin, Director of the Center for Research on Pensions and Welfare Policies (CeRP)

<b>28 February 2003</b>	
9:00 – 9:30	Registration, coffee
9:30 – 10:00	Statement by the Chair: Why is portability an important issue?
	<b>Session 1: Labour mobility and its impact on pension portability</b>
10:00 – 10:45	Pension portability – Is this Europe’s future? An analysis of the US as a test case: <b>John Turner</b> , Public Policy Institute, AARP, Washington, D.C.
10:45 – 11:00	Coffee break
11:00 – 11:45	Pension choices and job mobility in the UK: <b>Vincenzo Andrietti</b> , Universidad Carlos III de Madrid, Department of Economics
11:45 – 12:30	What is the European Commission doing to promote labour mobility within the EU? <b>Ralf Jacob</b> , European Commission, Directorate-General for Employment and Social Affairs
12:30 – 13:30	Lunch (venue CEPS)
	<b>Session 2: Pension portability in Europe and the United States</b>
13:30 – 14:15	Annuities and retirement satisfaction: <b>Constantijn Panis</b> , Rand Corporation, Santa Monica, US
14:15 – 15:00	Portability of pension rights – the Danish experience: <b>Leif Kvistgaard</b> , The Danish Insurance Association
15:00 – 15:45	Pension portability in the US: <b>David Pratt</b> , Professor of Law, Albany Law School, New York, US
15:45 – 16:00	Coffee break
16:00 – 16:45	The improvement of the legal framework concerning pension portability: Is open coordination an option? <b>Yves Stevens</b> , Institute of Social Law (Instituut Sociaal Recht), University of Leuven, Belgium
16:45 – 17:30	Evaluating pension portability reforms, The Tax Reform Act of 1986 as a natural experiment: <b>Vincenzo Andrietti</b>
20:00	Dinner

	<b>Session 3: Removing obstacles to portability and liberalising pension provisions</b>
9:00 – 10:00	Presentation of the report of the CEPS Task Force on Cross-border portability of pension rights, <b>Jorgen Mortensen</b> , Associate Senior Research Fellow, CEPS, Rapporteur of the Task Force
10:00 – 10:45	Elimination of obstacles to pension portability in the EU: Where are we? <b>Chris Verhaegen</b> , Director, European Federation of Retirement Provision
10:45 – 11:00	Break
11:00 – 11:45	Liberalisation of pension fund international activity: the Bulgarian dimension, <b>Nikolai Slavchev</b> , Chief, Retirement Schemes Analyst, Allianz Bulgaria Pension Company, Sofia, Bulgaria
11:45 – 12:45	Setting the European research agenda on pension portability, <b>Vincenzo Andrietti</b> , University Carlos III, Madrid and <b>John Turner</b> , AARP General discussion
12:45 – 13:15	Conclusions by the chair
13:15	End of workshop

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### **I. Background Report**

#### **1. Overall objective**

Incompatibility of, and indeed conflicts between, pension schemes in the different EU member states is a major headache for human resource managers of the corporations operating in Europe. Employees who work in one EU country are not allowed to deduct from their taxable-income contributions to a pension scheme in another country. Furthermore, the basic rules for deduction of contributions, taxation of pension-fund income and of retirement income are not the same in all countries.<sup>1</sup> Highly mobile employees may, therefore, face a bewildering complex of acquired (or pending) pension rights or worse, the loss of pension rights owing to a move before the end of the vesting period, etc. Many multinationals, consequently, have invented internal mechanisms for compensating the welfare loss for individuals owing to the complexity of the pension schemes for highly mobile employees. The same complexity is found, but in less visible manner, in the case of mobile professionals and independents.

Insufficient pension portability may add to rigidities in the labour market, particularly for the elderly. In fact, many older workers face a severe constraint to their full integration into the labour market. Some pension entitlements are tied to the establishment where they were acquired. Older workers would lose (part of) these entitlements if they wanted to change jobs. The economic consequences are severe in two ways. First, older workers may be forced to forego job opportunities and firms may be forced to layoff workers in cases where the voluntary movement of older workers would have been the better solution. Second, the overall efficiency of the labour market may suffer.

Portability of pension rights in several EU member states remain subject to a number of administrative, social, fiscal and financial barriers. Whereas the mobility of employees who are members of a pension scheme is clearly lower than that for employees without a pension scheme, there are also indications that the low degree of portability of pension entitlements constitutes a significant barrier to the mobility of labour, not just among, but also within, member states. It is also an important feature of the quality of life of individuals in their active age as they seek to combine professional achievement with an appropriate organisation of their retirement and replacement income.

With financial support from the European Commission, DG Research, CEPS organised an exploratory workshop in February 2003 with the following specific purposes:

- ❑ Organise a discussion among researchers and representatives of pension funds, PAYG pension schemes, pension benefit experts and other experts working in close connection with the pension institutions.
- ❑ Bring together economists and lawyers to explore the economic rationale behind portable pensions and to identify the scope for improving the legal framework.

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<sup>1</sup> Not all countries apply the EET rule (exemption of contributions, exemption of pension-fund income and taxation of retirement benefits).

- ❑ Formulate policy proposals to design an economically sound, as well as legally feasible framework for legislative action within the European Union.
- ❑ More generally, stimulate discussion among researchers and the different actors in the field of retirement benefits and thereby obtain feedback in order to reformulate European research programmes in this area.
- ❑ Take stock of the research that has been already accomplished on the influence of pension schemes on labour mobility and on the state of follow-up to the 1998 Directive.

This project thus focused on an aspect of social security design that is not in the spotlight of the PAYG versus fully-funded (state) pension debate but concerns an equally important question: social security design to improve job mobility and allocative efficiency by avoiding skill mismatch. The focus was on **occupational pensions at firm or branch level**.

## 2. Labour mobility: incentives and obstacles

Freedom of movement for workers is part of the elementary (four) freedoms guaranteed in the EC Treaty. Provisions in this respect, were, in fact implemented in general terms early on in the existence of the Community. Workers are thus entitled to accept job offers throughout the internal market, to move freely to take up the offer and to stay after the job is finished when necessary.<sup>2</sup>

In practice jobs in public administration are most often reserved for nationals and in a number of professions the full freedom of movement has only been obtained (or will only be obtained) as the outcome of a difficult process of achieving agreement on the equivalence of diplomas.

### *Incentives and motives*

An increase in wage income can be assumed to constitute the main, but not the only, incentive to the change of a job and location. To escape unemployment or underemployment is no doubt an additional argument, albeit not fully independent of the main incentive. Throughout history workers have moved to other regions or countries to find a job or achieve a rise in income and standard of living (or both). Frequently, however, movements have also been motivated by a search for a different lifestyle or conceived as an escape from persecution or repression. Similarly, the inclusion into the EC Treaty of provisions concerning free movement of workers was motivated not just by purely economic arguments. Behind these provisions were also the desire to bring about a higher degree of cultural and linguistic change and thus to contribute to a consolidation of peace among the European nations after centuries of warfare.

As stated in the recently published Final Report from the High Level Task Force on Skills and Mobility,

The freedom of movement for persons is one of the founding principles of the European Union, going hand in hand with the promotion of economic and social progress, a high level of employment and achieving balanced and sustainable development. It is indissociable from the creation of an area without internal frontiers, and the strengthening of economic and social cohesion and active citizenship.<sup>3</sup>

The High Level Task Force report underlined that greater labour force mobility, both between jobs (occupational mobility) and within and between countries (geographic mobility), will contribute to meeting all of these objectives, by enabling the European economy, employment and labour force to adapt to changing circumstances more smoothly and efficiently, and to drive change in a competitive global economy.

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<sup>2</sup> For a discussion of these issues see Jacques Pelkmans, (1997), *European Integration: Methods and Economic Analysis*, the Netherlands Open University, Longman.

<sup>3</sup> European Commission (2001), *High Level Task Force on Skills and Mobility*, Final Report, 14 December, p. 6.

It stressed that a greater degree of mobility between member states will also foster closer political integration in the EU. It also underlined, however, that occupational and geographic mobility are not a panacea and that they do not come about by themselves. This is a two-way process: while mobility enhances labour market functioning and thereby contributes to growth and wealth creation, more and better jobs must be created and be available in order to make occupational and geographic mobility a reality.

It is also important to keep in mind that migration may be motivated by a search for a better climate, lower cost of living or, as is frequently the case, constitute a return to the region or country of origin after shorter or longer spells of employment in other regions or countries. Thus an increasing number of retired citizens from Northern or Central Europe settle in the sunbelt in Spain, Portugal, Italy, Greece or the South of France.

Migration may also, again increasingly, be a temporary movement in order to accomplish a spell of education in other EU member states or, not least, the United States. Thus within the EU a rising number of students take advantage of the different programmes for student exchange and mobility (Socrates, Erasmus, Leonardo de Vinci, Marie Curie fellowships, etc.).

### *Obstacles to and costs of mobility*

Traditionally, the multiplication of national and regional languages has been considered a main obstacle to cross-border mobility within the EU's internal market. Nevertheless, linguistic differences are certainly not the only and possibly not even the most important obstacle to mobility. To quote a recent Commission Communication,<sup>4</sup>

Mobility frequently does not just concern an individual but a family unit, which often has to cope with considerable obstacles when contemplating a move. Where both spouses are working – dual career families – then both must be able to find suitable work in the new location, and barriers may vary according to job type and skills, especially if entry to certain professions remains restricted. Housing and information on housing is a barrier both within and across countries. In some Member states, rigidities in the housing market due to high taxes on property transactions and discretionary planning approval by public authorities act as a constraint on labour mobility. Moving children between educational systems requires both good and reliable information, and sufficient openness and flexibility between the systems, so that mobility is not damaging to their prospects.

Furthermore, according to this Communication, tax and benefit systems do not need to be either integrated or harmonised to ensure effective mobility, but they do need to be compatible and well coordinated. Complexity, lack of compatibility and lack of transparency can create both administrative hurdles and financial concerns and costs that inhibit mobility. In most member states, there remains much scope for review of unemployment benefit systems, so that these provide efficient unemployment insurance without unduly reducing incentives to seek work.

In many instances workers or employers or both cannot obtain tax relief for pension contributions paid to pension institutions located in another member state, whereas pension contributions paid to domestic institutions would have been tax deductible. This hinders workers' mobility and prohibits employers with establishments in different member states from centralising their European pension provision.

A lack of portability of supplementary and private pensions, or the difficulty of simply accumulating the financial value of the acquired pension rights and health benefits, also creates both administrative and financial barriers – for workers and for businesses.

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<sup>4</sup> EU Commission (2001), “New European Labour Markets: Open to All, with Access for All” Communication from the Commission to the Council COM(2001) xxx final.

In several member states, the failure of wage developments to reflect local productivity and labour market conditions is linked with labour mobility issues. The resulting high regional unemployment may provide an incentive for unemployed persons to move (although they are not always able to meet the costs of doing so – relocation costs for the employed are a barrier too) since firms have little incentive to locate in regions where wages are high compared to productivity. On the other hand, highly skilled workers are also likely to find better opportunities in other regions. The failure to establish flexible wages for higher education is one of the factors in the external brain drain.

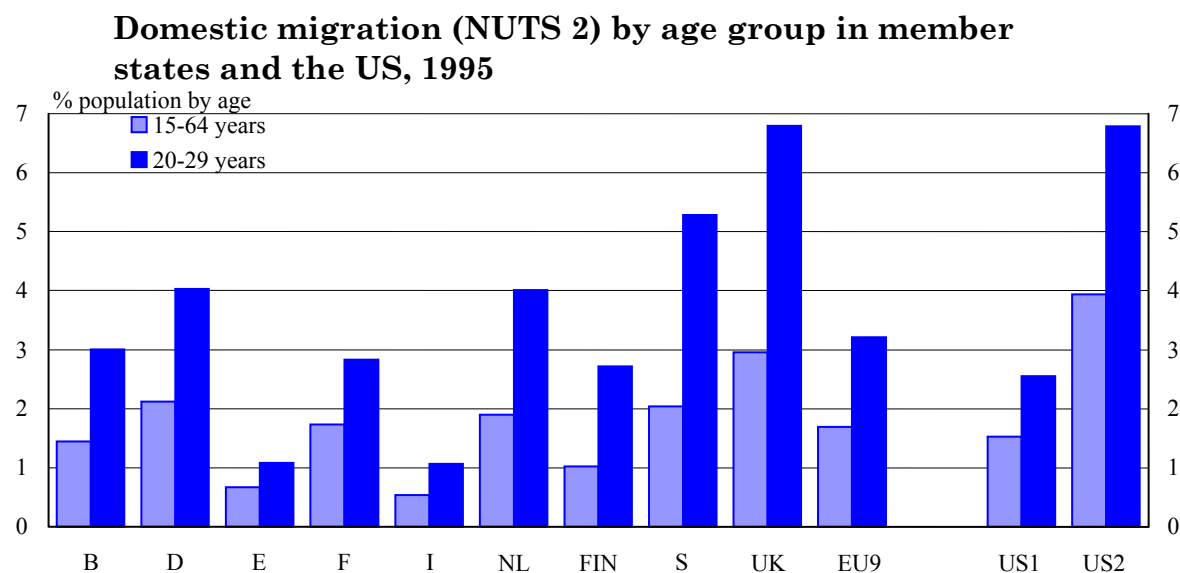
The gaps in the recognition of professional, academic and vocational qualifications from another member state constitute a particular obstacle to the mobility of individuals working in Europe. This is also the case with respect to qualifications obtained outside the EU. Guarantees limited to general principles, insufficient flexibility for temporary-service provision, lack of transparency and sometimes prolonged procedures for professional recognition mean that processes are dissuasive in character and can block or delay free movement in practice.

The Commission communication underlines that lack of adequate information on European labour markets and the European jobs pool (for both job seekers and businesses) may constitute an additional obstacle. It points out that there are other, more subtle and indirect barriers to mobility and free movement that arise from barriers and fragmentation in product and service markets.

### *Geographical mobility*

Geographical mobility indeed appears to be considerably lower in the European Union than in the United States. As illustrated in Figure 1, in 1995 in the nine EU member states for which data was available (EU9) about 1.7% of the population in the age groups 15-64 moved from one region to another within the country, or less than half the corresponding figure for the US, 3.9% (US2). Among the younger persons most frequently in search for a (new) job, age group 20-29, the rate of domestic geographical mobility in EU was 3.1% compared with 6.8% in the US.

Figure 1. Domestic migration in the EU and the US



Notes: 18-64 and 18-24; F, NL & UK 15-24; data for D, E, I, UK & US is from 1994; US1 is those who moved state within same census region; US2 is estimated NUTS 2 equivalent migration.

Sources: Eurostat, Migration Statistics; US Census Bureau, Geographical Mobility.

Among EU member states domestic geographical mobility was particularly low in Belgium, Spain, Italy and Finland and higher than average in Germany, France, the Netherlands, Sweden and the



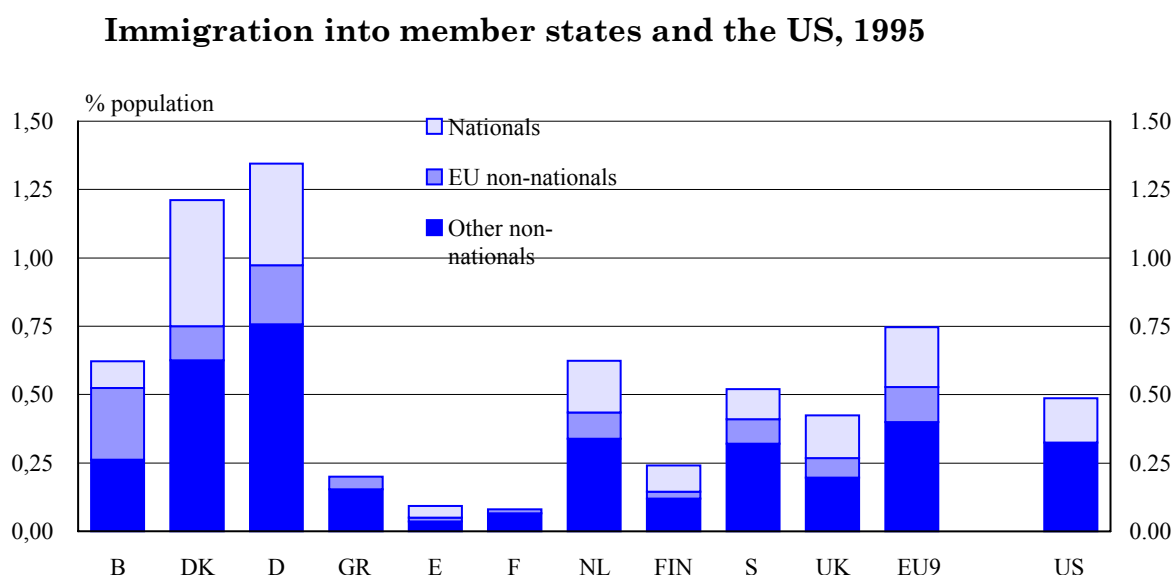
United Kingdom. Nevertheless, in all EU member states the geographical mobility was lower than in the US in both age groups. The remarkable exceptions to this rule were the mobility in the age group 20-29 in Sweden and the United Kingdom, which were almost at level with that of the US.

Both in the EU and the US, international mobility is far smaller than domestic mobility. As illustrated in Figure 2, total immigration into the EU in 1995 amounted to 0.75% of the total population compared with 0.48% in the United States.

Within this overall total, immigration of nationals into EU member states amounted on average to 0.22% of total population or only moderately higher than the corresponding figure for the US, 0.16%. Immigration from outside the EU amounted to 0.40% of the EU population compared with 0.32% immigration of non-nationals into the US.

Immigration into EU member states of EU nationals amounted to only 0.13% or significantly less than the immigration from outside. Comparing the data in Figures 1 and 2, it is evident that cross-border migration between EU member states in 1995 corresponded to only some 8% of the domestic migration (0.13% in proportion to 1.7%).

Figure 2. Immigration in the EU and the US



Notes: For GR & F there is no data for nationals; for L the data is too small; EU9 excludes GR, F, IRL, I, A and P; data for the US is from 1994.

Sources: Eurostat Migration Statistics; US Census Bureau, Geographical Mobility.

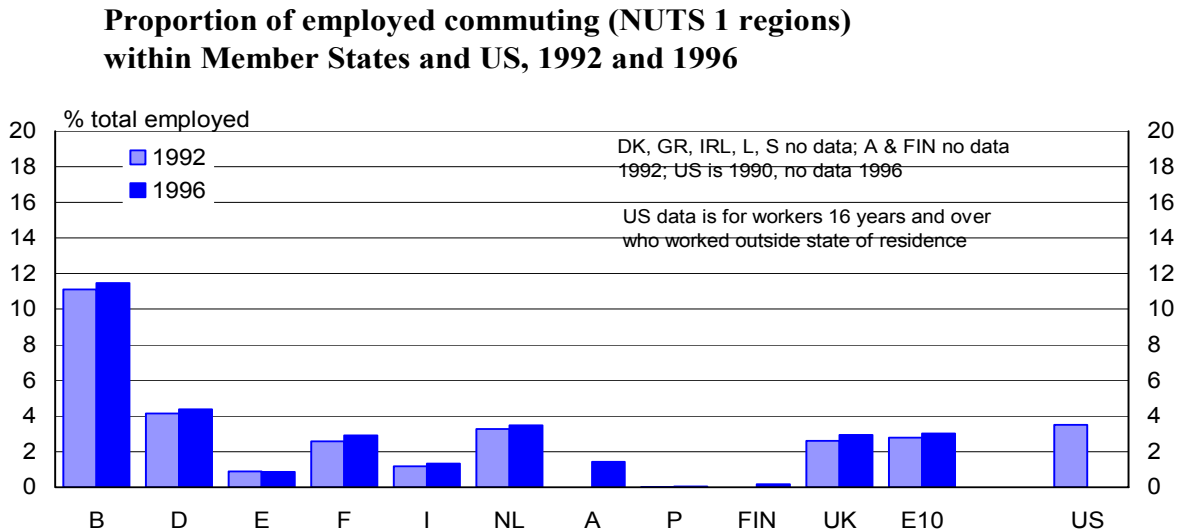
It should, however, be stressed that the 1995 migration data for the EU are strongly influenced by particularly high immigration into Germany of citizens of the former Soviet Union supposedly of German origin.<sup>5</sup> In fact, in 1995 immigration into Germany amounted to almost 1.1 million or almost two-thirds of the total immigration into the EU (1.667 million). Immigration of non-EU nationals in the EU as a whole amounted to 1.178 million of which 0.792 million, or some two-thirds immigrated into Germany. This particular category of immigration is known to have dried out and data for more recent years would show figures for immigration for both Germany and the EU on average much more in line with or even below the level for the US with regard to the immigration of non-nationals. It should be noted however that there are indications that the rate of illegal immigration is somewhat

<sup>5</sup> At that time, Germany still applied the rule that anybody of German origin independently of the place of birth would have the right to German citizenship.

higher in the European Union than in the United States. Consequently, the overall rate of immigration (legal and illegal) may not be very different in the two economies.

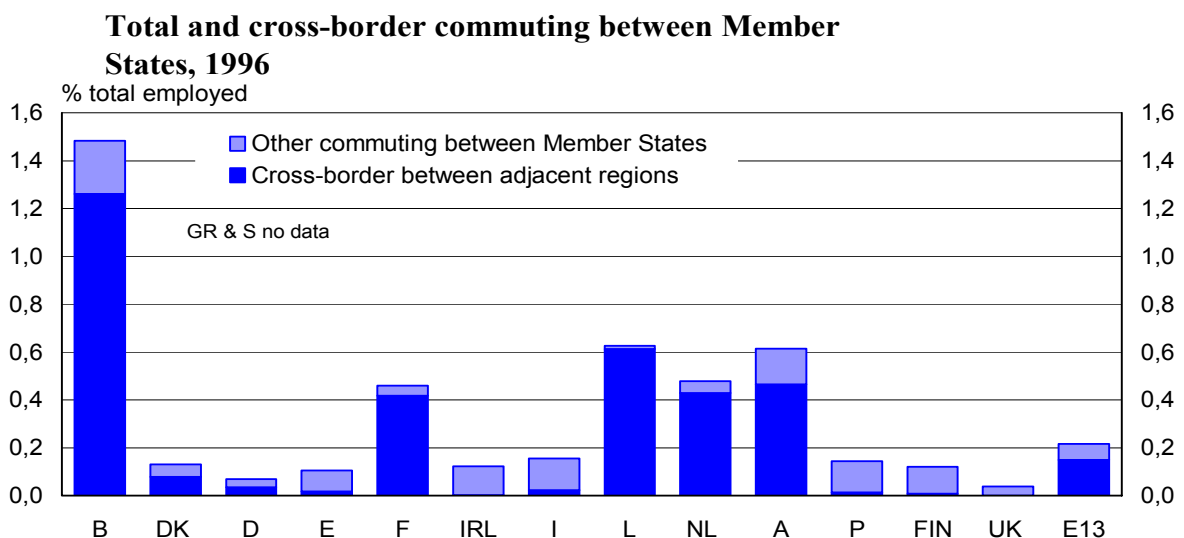
When distances are not excessive, commuting may be an alternative to actually moving from one region to another. Definitions of regions vary considerably from one EU member state to another and data on commuting may therefore not be fully comparable among member states or between the EU and the US.

Figure 3. Commuting between regions



Sources: Eurostat, Migration Statistics; US Census Bureau, Geographical Mobility.

Figure 4. Commuting between EU member states



Source: Eurostat, Community LFS.

In the rather densely populated EU, commuting between EU member states could conceptually be a source of labour-market flexibility. Yet only a tiny proportion of employed persons work outside their country of residence. As shown in Figure 4, those who commute between member states correspond to

only about 0.2% of the number of employed persons. Among these commuters, by far the largest proportion commutes across the frontier to an adjacent economically dynamic region. Cross-border commuting is consequently found mainly between Germany on one side and the Benelux countries, France and Austria on the other side.

### *Occupational mobility*

Whereas geographical mobility concerns movement of individuals between regions or countries, occupational mobility is a generic expression covering movement between jobs or movements into and out of unemployment or into and out of the labour market. Occupational mobility is consequently a much more complex phenomenon than geographical mobility.

Furthermore, as underlined by Davis, Haltiwanger and Schuh,<sup>6</sup> labour market movements may be viewed from the point of view of firms (job reallocation) or from the point of view of the employee (worker allocation). Job reallocation involves essentially creation and destruction of jobs (openings) whereas worker reallocation includes retirement of older workers, withdrawals into inactivity or inability, entry of young workers into the labour market after spells of unemployment, etc. Viewed in a narrow sense it may be argued that the concept of ‘occupational mobility’ would concern essentially job reallocation. Nevertheless, the overall rate of labour market flexibility will also to some extent be determined by the capacity to accommodate movements into and out of activity and by the nature of unemployment (cyclical or structural). Overall occupational mobility may therefore cover more aspects of labour market movements than the concept of job reallocation and include some aspects of worker reallocation.

Job and worker reallocation is defined as gross (and net) movements between two points in time. Consequently such changes cannot be revealed by static data on employment at discrete points but only by tracking the changes in specific jobs and movements of workers between these two points (longitudinal data) or acquiring information about the labour market situation of a certain person, say a quarter or a year before a survey, etc.

Data tracking the direction of gross changes in employment are in the United States compiled in the “Longitudinal Research Database” located at the Census Bureau’s Center for Economic Studies. In the early 1990s, this database contained data for 300,000–400,000 manufacturing plants for the years 1963, 1967, 1972, 1977, 1982 and 1987 and annual data for a sample of plants in each year from 1972 to 1988. This database has been utilised by Davis, Haltiwanger and Schuh for the extensive study referred to above, covering both general basic facts about job creation and destruction, and allowing analysis of developments over the business cycle by industry and size.

In Europe statistics on gross changes in employment are more scattered and are not systematically collected even when the basic statistics are available. Furthermore, owing to constraints with respect to confidentiality of the micro-data, studies normally need to be undertaken strictly within the national statistical institutes or survey organisations. Without access to the micro-data it is consequently almost impossible to generate EU aggregates or averages in practice.

Within the EU, micro-data on gross changes in employment are mainly available in countries that operate relatively efficient business registers and thus are in a position to follow the movements in employment in the same firm over several periods (and also track the births and deaths of enterprises and their employment). This is particularly for France and the Nordic countries. For other countries certain sample surveys have, however, also allowed the compilation of data on job flows. In general such data suggest that as far as occupational mobility is concerned the differences between Europe and the US are not as pronounced as with respect to geographical mobility.

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<sup>6</sup> Steven J. Davis, John C. Haltiwanger and Scott Schuh (1996), *Job Creation and Job Destruction*, Cambridge Massachusetts: The MIT Press.

As seen in Table 1, total annual job creation in the countries, industries and periods covered amounted to, on average, 12.2% of employment. Job destruction amounted to 11.9%, resulting thus in a net creation of jobs of 0.4% of employment.

*Table 1. International comparison of net and gross job flows*

Country	Period	Coverage	Creation	Destruction	Net creation	Reallocation
US	1973-88	Manufacturing	9.1	10.2	-1.1	19.4
US	1976-85	Pennsylvania	13.3	12.5	0.8	25.8
Canada	1979-84	Manufacturing	10.6	10.0	0.6	20.5
Canada	1979-84	Tax-paying firms	11.1	9.6	1.5	20.7
France	1978-84	Private, non-farm	11.4	12.0	-0.6	23.3
Germany	1978-88	Private	8.3	7.7	0.6	16.0
Sweden	1982-84	All employees	11.4	12.1	-0.8	23.5
Italy	1984-89	Social security	9.9	10.0	-0.1	19.9
Australia	1984-85	Manufacturing	16.1	13.2	3.9	29.3
New Zealand	1987-92	Private	15.7	19.8	-4.1	35.5
Denmark	1983-89	Private	16.0	13.8	2.2	29.8
Finland	1986-91	Private	10.4	12.0	-1.6	22.4
Norway	1976-86	Manufacturing	7.1	8.4	-1.2	15.5
Colombia	1977-89	Manufacturing	13.2	13.0	0.2	26.2
Chile	1976-86	Manufacturing	13.0	13.9	-1.0	26.8
Morocco	1984-89	Manufacturing	18.6	12.1	6.5	30.7
Average	–	–	12.2	11.9	0.4	24.1
Average EC6	–	–	11.2	11.3	-0.1	22.5

*Sources:* Davis, Haltiwanger and Schuh, op. cit. (Table 2.2). Data have been obtained in particular from OECD Employment Outlook September 1987 and July 1994 and studies by Boeri & Cramer (Germany), Contini & Revelli (Italy), Borland & Home (Australia) and Roberts (Chile, Colombia and Morocco).

The data for individual countries and particular sectors presented in Table 1 show large differences with respect to the rate of job creation, with the figures ranging from 7.1% in Norway to 18.6% in Morocco. For the six EU countries represented in this table, job creation, in most cases for a large segment of the private enterprises for the mid-1980s amounted to 11.2% on average per year.

Destruction of jobs also showed a considerable disparity among the countries included within the annual rate of job destruction, ranging from 7.7% in the private German economy during the ten years from 1978-88 to a high of 19.8% in New Zealand during 1987-92. Among the six EU countries included in the table, the highest level of job destruction was found in Denmark; but as the creation of jobs was also higher – and considerably higher than the job destruction – Denmark nevertheless encountered the highest rate of net creation of jobs among these EU countries: 2.2%.

If it could be assumed that all countries experience rather similar pressures for structural change and technological innovation, a combination of high job creation and job destruction, that is, a high level of job reallocation, could perhaps be taken as an objective measure of the degree of flexibility and mobility in the economy. On this account the data for the different countries, industrial segments and periods included in the table range between a low of 15.5% in Norway and a high of 35.5% in New Zealand. Among the six EU countries included here, a particularly low level was found in Germany (16%) and Italy (19.9%) while France, Sweden, Finland and notably, Denmark show a comparatively higher level of job turnover.

A relatively low level of job turnover in Europe compared with the United States was also found by Burda & Wyplosz in a study of gross worker and job flows in 1987.<sup>7</sup> As seen from Table 2, inflows and outflows on average for the three EU countries studied were only about two-thirds of the level in the US. Furthermore, the level in France included also job-to-job reallocation and could therefore be biased upwards. Somewhat surprisingly the level of job turnover appeared excessively low in the United Kingdom but is not discussed by the authors.

*Table 2. Gross job flows*

Inflow into and outflow from employment, % of stock, 1987

% of average stock	Inflows	Outflows
France (1)	28.9	30.7
Germany	22.3	21.5
UK	6.6	6.6
Total EU3	17.9	18.0
US (2)	25.3	26.5
Japan (2)	9.3	8.7

*Notes:* (1) Including job to job reallocation.

(2) Based on labour force survey.

*Source:* Burda & Wyplosz, op. cit.

### 3. Pension portability and labour mobility

#### *Conceptual issues*<sup>8</sup>

As pointed out in a survey by Stuart Dorsey of the literature on pension portability and labour market efficiency, a key issue in assessing the labour market impact of pension schemes is the perception of the nature of the relationship linking the employer and the employee.<sup>9</sup> If the labour market is perceived as similar to an auction market with continuous clearing, efficient allocation of workers across jobs would call for minimising costs of job changes and thus rendering pensions fully portable. If, on the contrary, the labour market is perceived as the locus of implicit contracts between the employer and the employee, barriers to the portability of pensions may constitute a productivity-enhancing incentive, encourage firm-specific training programmes (to enhance the human capital of the firm) and help to reduce ‘shirking’ (reduced endeavour at work).

Barriers to the portability of pensions thus may discourage excessive resignations when productivity in the economy in general or in other branches increases. Nevertheless, such barriers (penalties) may become an impediment to efficient job mobility in the occurrence of firm-specific productivity declines. The general conclusion of Stuart Dorsey is that, on balance, the literature supports the view that *incentives established by non-portable pension benefits do enhance firm-specific productivity.*

<sup>7</sup> Michael Burda & Charles Wyplosz (1993), *Gross worker and job flows in Europe*, CEPR Discussion Paper No. 868, November.

<sup>8</sup> Although this report is mainly concerned with the portability of pensions within the EU’s internal market, the main academic references are drawn from the rich debate in the United States. Despite the fact that the portability of pensions is likely to be more important for labour mobility in Europe, sadly the European academic literature is strikingly poor. It is limited in fact to the outcome of the work of a very small number of researchers such as Vincenzo Andrietti, whose work has been used as background research for the present report.

<sup>9</sup> Stuart Dorsey (1995), “Pension portability and labour market efficiency: a survey of the literature”, *Industrial and Labor Relations Review*, Vol. 48, No. 2, January.

First, according to Dorsey, the role of pensions in enhancing productivity is a plausible prediction of models that have proven useful in explaining other labour market outcomes. Second, a substantial amount of indirect evidence is consistent with the positive productivity effects of pensions. Perhaps, based on Dorsey, the strongest evidence is the repeated findings of large wage premiums for pension-covered workers across several data sets. Furthermore, other studies indicate that employers are more reluctant to discharge pension-covered employees than uncovered employees and that the pattern of coverage across workers and firms is consistent with predictions from the firm-specific training and shirking models.

Consequently, Dorsey argues that policymakers need to consider the possibility that requiring greater portability would have adverse productivity effects. His argument is, however, to some extent weakened by two aspects: first, to be efficient, pension termination penalties must be flexible in so far as rigid pension termination penalties can become obsolete and impede mobility out of declining industries. Second, an overall assessment of portability issues must also take account of the ongoing shift in favour of defined-contribution schemes, where portability in general is higher than in defined-benefit schemes.

The main conclusion by Dorsey is that the implicit contract model provides the most appropriate description of the modern labour market, which is also accepted by Ippolito in his influential study of the labour market effects of pension plans published in 1997.<sup>10</sup> According to Ippolito, developments in the pension literature are consistent with a concise model of the labour contract. Workers and the firm implicitly agree that workers will pay for a real pension, indexed to the final wage. Departure from the firm either 'too early' or 'too late' breaks the contract and triggers pension penalties. The pension bonds the worker's promise to stay with the firm and hence attracts those who anticipate staying for the long term (p. 17). Ippolito thus argues that the implicit contract theory is the basis for the 'productivity theory of pension'. By establishing a policy that returns workers' implicit pension contributions *conditional* on their fulfilling certain tenure, the firm has a tool to influence the tenure and retirement decisions of its work force.

Ippolito, however, also points out that the implicit contract paradigm is challenged by the rapid rise of defined-contribution plans (notably the 401k plans in the US). More precisely, he argues that in fact the wage cost of defined-benefit plans are higher than hitherto considered in the literature, making them vulnerable to cheaper substitutes such as 401k plans. Further, 401k plans are not neutral to productivity in the firm: they can effect the composition of the firm's workforce by encouraging the early exit of lower-quality workers and encourage long tenure of higher-quality workers. According to Ippolito, these 'sorting effects' are an important feature of the pension productivity model (p. 89).

### *A general descriptive analysis*

Deeper quantitative analysis of the possible causes of job changes was initiated in the United States in the 1980s and 1990s using in particular a Survey of Consumer Finances (SCF), a Panel Survey of Income Dynamics (PSID) and a National Longitudinal Survey of Mature Men (NLS), and, later, a Survey of Income and Program Participation (SIPP).

All these surveys reveal the basic phenomenon underlined above: 1) relative mobility from non-pension jobs is considerably higher than it is from pension jobs; and 2) the mean wage of non-pension jobs is considerably lower than for pension-jobs.

As illustrated in Table 3, according to the SCF 59.1% of workers without a pension moved between 1978 and 1983 whereas only 8.6% of those with a pension moved during this period. Based on data from the SIPP, 19.5% of those without a pension left between 1984 and 1985 compared with only

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<sup>10</sup> Richard A. Ippolito (1997), *Pension Plans and Employee Performance: Evidence, Analysis and Policy*, University of Chicago Press.

6.1% of those with a pension. Finally, according to data from the PSID, 57.8% of employees without a pension left between 1984 and 1989, while 32.4% of those employees with a pension left.<sup>11</sup>

Table 3. Pension provision and job mobility

	No pension in initial job	Pension in initial job
<b>Survey and item</b>		
<i>SCF, 1978-83</i>		
Movers, % of total	59.1	8.6
With pension in 1983, %	38.6	43.8
<i>SIPP, 1984-85</i>		
Movers, % of total	19.5	6.1
With pension in 1985, %	13.8	35.8
<i>PSID, 1984-89</i>		
Movers, % of total	57.8	32.4
With pension in 1989,%	37.0	53.2

Source: Alan L. Gustman & Thomas L. Steinmeier (1995),  
*Pension Incentives and Job Mobility*, Upjohn Institute for  
Employment Research.

The surveys, however, also reveal that a significant share of those moving from jobs without a pension actually had acquired a pension after the move. Thus, according to the SCF, 38.6% of movers without a pension in initial job (1978) in 1983 moved to a job with pension. Approximately the same proportions were found in the PSID covering the period 1984-89. On the other hand by far all those moving from jobs with pension went to another job with a pension scheme: 43.8% according to SCF and 53.2% according to PSID. *Therefore, according to all the surveys, moving jobs was a significant cause of loss of pension rights.* In Europe, the European Community Household Panel Survey (ECHP), collected since 1994, show the same tendency for mobility to be considerably lower for workers with pensions than for workers without pensions.

As seen in Table 4, based on data extracted from a study by Vincenzo Andrietti and the study by Gustman and Steinmeier (see the indication of source in the table), for the six countries on average (unweighted) included here, 11.4% of those without a pension in the initial job changed job between 1995 and 1996. Among employees covered by a pension scheme in the initial job only 5% changed their jobs between these two years.

The study referred to in the table covered essentially countries where occupational pension schemes count for a relatively large share of overall retirement arrangements and where the nature and portability of pension schemes may exert an impact on labour mobility. Whereas some consideration of the position of other countries may show rather different positions, the table reveals rather striking differences between the five EU member states and, for each country individually, vis-à-vis the United States.

First, there are large differences both with respect to the mobility as measured by the percentage of movers, ranging among workers with a pension from a low of 1.6% in Germany to a high of 10.9% in Denmark and with comparatively high levels in Ireland and the Netherlands. Among workers without a pension, the lowest mobility is also found in Germany (6.1%) and with Denmark at the high end of the range with a mobility of 16.5%, followed closely by the Netherlands at 16.0%.

<sup>11</sup> According to Gustman & Steinmeier, the significant difference between SCF and PSID with respect to the share of movers among those with a pension in their initial job could be due to the fact that in the SCF individuals with a job in 1983 who did not report a job in 1978 were assumed to have been in a job without pension. The mobility rate from pension jobs might thus have been biased downwards.

*Table 4. Mobility and pensions in Europe and North America*

<b>% of movers 1995 to 1996</b>	<b>No pension in initial job</b>	<b>Pension in initial job</b>	<b>With pension in initial job %</b>
ECHP (1995-96)			
Belgium	7.2	2.7	54.5
Denmark	16.5	10.9	76.4
Germany	6.1	1.6	37.4
Ireland	13.8	6.7	39.3
The Netherlands	16.0	5.8	79.6
United Kingdom	8.9	2.2	50.3
Average (unweighted)	11.4	5.0	56.4
Memo: US SIPP (1984-85)	19.5	6.1	63.7

*Sources:* Vincenzo Andrietti (2001), *Employer Provided Pensions Portability in OECD Countries: Country Specific policies and Their Labour Market Effects*, (mimeographed), OECD Private Pensions Unit, May; Alan L. Gustman and Thomas L. Steinmeier, op. cit.

*As previously highlighted, there is a clear tendency for labour mobility to be lower for workers affiliated than for workers not affiliated to a pension scheme. Yet there is a contradictory tendency for mobility to be rather high in countries where a large proportion of workers are affiliated to a pension scheme. As seen in Table 4, a particularly high turnover of jobs was observed in Denmark and the Netherlands where a high proportion of workers were reported to be covered by a pension scheme. In contrast, a low turnover of jobs was observed in Germany where the proportion of workers covered by a pension scheme was significantly lower.*

These contrasting observations suggest that a high degree of caution is warranted before drawing conclusions concerning the link between labour mobility and portability of pension entitlements. In particular, there is a clear need to examine the nuts and bolts of each pension scheme to determine its potential impact on labour mobility.

### ***Cross-frontier portability***

With respect to cross-frontier portability, the main barrier is attributable to conflicting tax schemes.

First, in several EU member states contributions to a pension scheme are only accepted as a legitimate professional expense for the employer and/or accepted as deductible from the taxable income of the employee if they are paid to a pension institution or a life insurance company located in the same country as the employer. Second, in several EU member states, a change of residence of the employee to another member state will trigger a tax charge on his future pension income as if he had taken early retirement. Third, structural differences in the tax receipts of member states may result in a situation of double taxation (or of no taxation of the pension benefits).

The Communication from the Commission of 19 April 2001 endeavours to address some of these issues. Its scope, however, is limited. It proposes, in essence, to maintain (at least, in practice, to a very large extent) the status quo for 'sedentary workers', that is workers residing in a member state wishing to join a pension scheme in another member state. Yet this category of workers is far more numerous than non-sedentary workers, who belong to a local, approved scheme in their country and who, usually temporarily, move to another member state.

Another factor that needs to be considered is the risk of distortion of competition among occupational pension schemes provided by institutions for retirement (as defined in the proposal for a Directive of 11 October (see below) and those provided by life insurance companies, which may be subject to



indirect taxes not levied on the pension institutions. This issue is addressed from a regulatory perspective only by the 11 October proposal but not by the 19 April 2001 Commission Communication.

In the EU the present legal state of matters is as follows. A Council Directive on pension portability for persons moving within the Community was adopted in 1998.<sup>12</sup> The aim of this Directive was to protect the rights of members of supplementary pension schemes who move from one member state to another, thereby contributing to the removal of obstacles to the free movement of employed and self-employed persons within the Community (Article 1).

In accordance with this Directive, member states should introduce laws, regulations and administrative provisions necessary to comply with this Directive not later than 36 months following the date of its entry into force. Furthermore, member states should communicate to the Commission not later than 25 January 2002 the text of the provisions of national laws, which they have adopted in the field covered by the Directive.

At the Lisbon European Council, Heads of State and Governments of the EU member states stressed the need for taking further steps to integrate financial services and markets within the Union. The conclusions of the presidency, in particular, stressed the need for giving priority to removing the remaining barriers to investment in the field of pension funds. In a follow-up to this request, the European Commission adopted a draft Directive in October 2000 aiming at establishing a common prudential framework for the activities of a number of retirement institutions dealing with occupational retirement provisions ('second pillar schemes'). This Directive was adopted by the Council in November 2002.

The Directive includes an important explanatory memorandum and contains mainly provisions concerning items that are (or in recent years have been introduced as) 'normal' features of pension fund operations in EU member states:

- ❑ legal separation between the sponsoring undertaking and the IORP;
- ❑ basic rules of operation, such as technical provisions and obligation to provide information to members;
- ❑ the drawing-up of annual accounts;
- ❑ disclosure of investment policy principles;
- ❑ information to be provided and powers of intervention of the competent supervisory authority;
- ❑ the setting up of regulatory own funds and rules of investment;
- ❑ free appointment of asset managers and custodians; and
- ❑ notification of cross-border activities.

Whereas the adoption of this Directive entails a considerable clarification of market conditions and integration of the pension market, its provisions will only marginally contribute to a general rise in the portability of pension rights within member states and across frontiers. There is, consequently, still a need for examining and finding ways of increasing labour mobility through the introduction of supplementary measures and schemes for removing as many as possible of these remaining obstacles to labour mobility within the Union.

The Commission's Communication of 19 April 2001 on the elimination of tax obstacles to the cross-border provision of occupational pensions reviewed the different tax obstacles to transferability of pension entitlements. It invited the Council, the European Parliament and the Economic and Social Committee to make some progress on the application of the Mutual Assistance Directive of 1977 and

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<sup>12</sup> Council Directive 98/49/EC of 29 June 1998 on safeguarding the supplementary pension rights of employed and self-employed persons moving within the Community (OJ L 209, 25/07/1998, p. 0046-0049).

to improve the exchange of information on membership of occupational pension schemes. Finally, it invited exploration of the scope for creating pan-European pension institutions and for reducing the diversity of taxation of pension schemes.

## II. Proceedings of the workshop

The workshop, chaired by **Elsa Fornero**, University of Turin, Director of the Center for Research on Pensions and Welfare Policies (CeRP) and Chairperson of the CEPS Task Force on Pension Portability, organised its work along three main axes:

1. labour mobility and the impact of pension portability;
2. pension portability in Europe and the United States; and
3. removing obstacles to portability and liberalising pension provision.

**Prof. Fornero** introduced the workshop debate referring to the joint report from the Council and the European Commission on adequate and sustainable pensions. This report outlined three main objectives of the European pensions systems: adequacy, financial sustainability and modernisation. The issue of pension portability is mentioned under the third objective.

Pension portability reforms are justified on basis of their impact on job mobility. It is however difficult to prove empirically that the loss of pension wealth when changing job hinders labour mobility. It is therefore an important task for the research community to analyse the main obstacles to labour mobility.

When thinking of means to enhance portability, it is necessary to keep in mind the trade-off between DC (defined-contribution) and DB (defined-benefit) pension plans. Although the first of these does not generally present portability problems, they put more risk on the worker.

### Session 1: Labour mobility and the impact of pension portability

**John Turner**, from the American Association of Retired Persons (AARP), discussed ways in which pension portability had been achieved in the United States. He described relevant aspects of pension law and surveyed the existing portability arrangements that pension plans provide. (For a more in-depth discussion, please see [Pension portability – Is this Europe’s Future? An Analysis of the United States as a Test Case](#), John Turner, Public Policy Institute, AARP, Washington, D.C.)

Portability of occupational pensions is an important issue in the US, owing to the high level of job change and relatively low level of social security benefits. Traditionally, pension portability was defined as the ability to carry a pension from one pension plan to another. More recently, it is understood as the ability to preserve the value of pension benefits when changing job. There are two possible reasons for an employer to promote portability: either it is mandatory by law, or employers want to promote job change in the sector.

Mr Turner described some of the portability problems of both DB and DC plans in the US and some of the solutions adopted. The portability issue differs in DC and DB plans. DC presents less portability problems than DB, but it also pulls all the investment risk on the employee. He recalled that in the US pensions are legislated at national level. In 1974, a pension law set maximum vesting periods. This maximum is currently five years for both DC and DB plans. Law also requires DB plans to be covered by insurance. This insurance is not mandatory in DC plans.

Among DB plans, portability is more problematic in single employer than in multiemployer plans. Multiemployer DB plans are however only possible in sectors with a strong labour union or in the not for profit sector. Another option is the use of cash balance plans, which accrue

benefits in a way similar to DC plans, while remaining DB plans that credit a fixed-interest that is not tied to the investment earnings in the underlying assets.

A transfer across plans is easy in DC plans. In DB plans, the discount rate and mortality rate assumptions used to calculate the value of assets are specified by law. Both DC and DB plans' participants obtain statements on the evolution of the value of their pension. In last years, the value of DC plans decreased, while that one of DB plans maintained.

Mr Turner stressed that as a consequence of lack of portability, a person could lose his/her accrued pension, being unable to find the employer from whom to claim pension benefits (it could happen if the firm changes location, name, is bought by another firm, goes out of business). In the UK and Australia, this problem is solved through the establishment of national registries. Yet these do not solve the problem of workers unaware that they are eligible to receive a pension. He proposed the following policies aimed at improving portability:

- to promote plans that encourage portability – DC plans, multiemployer plans, cash balance plans;
- to reduce vesting periods to three years; and
- to reduce possibilities of backloading.

Yet it must be considered that portability can make voluntarily provided pension plans unattractive for companies to offer.

Mr Turner concluded that, in some respects, the United States might provide a relevant case study for European pension portability. In a way, the wish to facilitate labour movement among and within EU member states resembles the US discussion on how to facilitate pension portability among and within its 50 States.

**Vincenzo Andrietti** (Universidad Carlos III, Madrid Department of Economics) presented his paper [Pension Choices and Job Mobility in the UK](#).

The issue of portability on occupational pensions has been in the UK agenda for the last three decades. Although the vesting periods in the UK are usually short (maximum vesting period of two years), one important obstacle for portability is the backloading in DB plans. There are, however, few empirical studies on the effect of portability on job mobility, and these few do not regard the 'endogeneity bias' of occupational pensions in job choice.

Studies in the US have documented a significant negative correlation between participation to occupational pension plan and job mobility. Recent studies have given three different explanations: pension portability losses in DB plans, better quality of pension covered jobs and self-selection of 'low discounter' workers into pension jobs.

In the UK, workers can opt-out from the public pension system and enroll in an occupational or personal pension scheme. The membership of occupational pension schemes has decreased over the past decade, although the distribution has kept rather stable, with most employees (more than 80%) choosing DB plans.

The paper presented by Andrietti analyses the impact of occupational and personal pension arrangements on voluntary job mobility. It deals with the endogeneity problem using an instrumental variable representing the occupational pension offer rate by industry, union coverage and firm size. This variable is expected to bear a positive and significant correlation with occupational pension coverage and participation, while being unrelated to job turnover. It uses data from the British Household Panel Survey (which does not distinguish between type of pension – DC or DB), and covers private sector full time employees aged 30-50. The observed variable is the change of job and the random variable the period an employee stays with current employer.

Estimates are done using a simple hazard model. Results show that workers offered an occupational pension (whether they decided or not to join it), are significantly less likely to quit their job. Portability losses are not significant. When the regression is done differentiating between transitions in and out of occupational pension jobs (in contrast to transitions between occupational pension plans), workers having been offered an occupational pension (independently of whether they have joined or not) are significantly less likely to move voluntarily to a non-pension job. In occupational pension jobs, portability losses continue being not significant in the decision to move. When pension endogeneity in the job choice is accounted for by the use of instrumental variables, the occupational pension participation dummies are no longer significant.

Mr Andrietti concluded that although previous studies considered a significant impact of occupational pension participation on job mobility, the results are very different when endogeneity of pension choice is considered. There are therefore certain doubts on the effectiveness of increase in pension portability on labour mobility. In fact, the loss of mobility of workers with occupational pension might be because of the better quality of jobs. In any case, it is important to consider the endogeneity in pension choice.

From a public policy point of view, it is necessary to point out that although there are serious doubts about the effectiveness of pension portability reforms in fostering labour mobility, the improvement of pension portability may be important for equity reasons, given that portability losses affect primarily low skilled workers and women (more mobile workers).

Commenting on this paper, **Stan Panis** recognised the importance of considering the endogeneity question. He also noted, however, that pension loss in the UK is in any case very low. Referring to the method used, he regretted the use of only one instrumental variable for four variables of different pension schemes participation status. He suggested grouping all occupational pensions to simplify the model.

## Session 2: Pension portability in Europe and the United States

**Stan Panis** (RAND Corporation, Santa Monica) presented his paper [Annuities and Retirement Satisfaction](#).

In contrast with other studies that focus on consumption or income after retirement, this paper studies satisfaction at retirement. It looks at the link between retirement satisfaction and the degree of annuitisation in the pension scheme. This is an important issue, given the trend during the last two decades from DB plans (which guarantee an annuity for life) to DC plans, which not always offer the option of an annuity for life. Even when they do, few people choose to take it (only 4% of DC plan holders convert their balance into an annuity, according to a study by Hurd, Lillard & Panis, 1998).

This study is based on panel data from the Health and Retirement Study (HRS), which covers households with persons 51 and older, and is linked to social security records. It began in 1992 and was conducted in 1995, 1998 and 2000. The 2000 sample included 20,000 persons, of which 51% were completely retired.

In his paper, Mr Panis first presents pre-retirement expectations and compares them with post-retirement satisfaction. In the HRS, workers are asked what they expect would happen to their living standards when they retire (improve, stay the same, decline somewhat or decline a lot). In their turn, retirees are asked whether their retirement has been better, about the same, or not as good as the years just before retirement. While 42.2% of workers expected their living standard to decline with retirement, 82% of retirees thought their years after retirement were better or at least as good as those before retirement. It thus appears that reality is often better than expected.

Retirees were also asked how satisfying their retirement was (very satisfying, moderately satisfying, and not at all satisfying). Though most individuals find retirement very satisfying, some are clearly more satisfied than others, with the most important factors being health and financial resources (as measured by household income or wealth). Older retirees are also more satisfied than the younger ones (what appears to be a generational issue) and married people more than those widowed, separated or divorced.

Regarding the main point of interest of the Panis-study, the link between annuitisation and satisfaction, the degree of annuitisation was measured using two rates: 1) social security reliance (fraction of expected total retirement resources from social security benefits), and 2) pension annuity ratio (fraction of expected total retirement resources from DB pensions and private annuities). The findings show that the more people rely on social security in retirement, the less satisfied they are with retirement, which was to be expected, as retirees that rely heavily on social security tend to be poorer. By contrast, the more people can count on lifelong guaranteed pensions, the more satisfied they are with their retirement. Furthermore, among persons without any DB pension, satisfaction tends to decline the longer they are retired, while for DB pensioners it remains approximately constant over the duration of retirement. This is probably because of increasing anxiety about outliving retirement savings of people without a DB pension plan.

To control for the possible income effect (people with DB plans having higher income), the level of satisfaction was also measured separately for retirees of different income levels. It resulted that at any income level, retirees with a DB pension are more likely to be satisfied than those without. Having a DB pension increases satisfaction by about as much as moving one income category up.

Mr Panis argued that these findings have important implications for future retirees. Over the last years, there has been a trend away from DB pensions, which guarantee a benefit for life, towards DC pensions, in which workers accumulate savings in an individual account. Much has been said about the investment risks of participants in DC plans, but much less about their longevity risks.

Nevertheless, the author underlined that he did not necessarily argue in favour of DB against DC plans, as the latter also have important advantages, for example in terms of portability. Yet he highlighted the importance of the lifelong income guarantee, which may be obtained by converting a DC plan into an annuity for life. He argued for policies encouraging annuitisation.

Commenting on this paper, **John Turner** said self-reported satisfaction could be misleading, as often there are differences between what people say and what they actually do. Indeed, people with annuities are more satisfied, but when they have the choice, they choose a lump sum. He also wondered whether the fact that people were more satisfied in retirement than in years before might not have been because of the general situation in the period when survey was conducted.

As it was also mentioned, annuities require solidarity between those who live less and those who live longer, but as **Leonardo Sforza** noted, occupational pensions are still not seen as part of social protection, but as company incentives. This point was also raised by the Chair, Elsa Fornero. The function of occupational pensions seems to be unclear. While **Ralf Jacob** (European Commission) in his presentation (see below) referred to them as part of social security, in many countries (such as Italy) they are still considered as part of a company's human resources policy, with no redistributive function.

**Leif Kvistgaard** (Danish Insurance Association) presented the paper by Anne Seiersen (Danish Insurance Association) on [Portability of Pension Rights – The Danish Experience](#).

The paper presented the fundamentals of the Danish three-pillar pension system. The first pillar consists of two main schemes. The first and most fundamental scheme is a flat-rate social pension, which in general is paid to all citizens. The benefit is financed out of general taxes and

the size of the benefit is thus independent of contributions. There is a supplement to the basic social pension, the size of which depends on any income, also pension income from an occupational pension. The public scheme also includes means-tested supplements for specific purposes such as housing, heating, medical expenses, glasses and so forth.

The other main scheme in the first pillar is the Danish Labour Market Supplementary Scheme (ATP), a DC plan that was originally an occupational pension scheme. It was established by law in 1964 in order to increase savings and compensation ratios for future retirees. The social partners were given the administrative competence for this scheme. Since almost all persons are covered by the scheme, ATP qualifies in the Danish pension system as a first pillar scheme. The original scheme has been complemented by a new scheme in 1998, the so-called 'Special Pension Saving', whose primary objective is to reduce consumption.

The second pillar consists of a variety of pension schemes, most of which are DC plans. In the majority of them, the projected benefit level is covered by a guarantee, issued by the pension institution, which in most cases is either an insurance company or an industry-wide pension fund. Only a minority of occupational schemes are managed by banks or by company pension funds. Around 80-90% of Danish workforce is covered by an occupational pension.

The third pillar consists of individual pension insurance and pension savings in life insurance companies and banks. No documentation exists regarding the extent to which the third pillar is used for retirement provision for persons not sufficiently or not at all covered in the second pillar and to what extent it is used as a supplement for those with preferences not met by the more standardised benefit packages in the occupational pension schemes.

The Danish labour market is highly unionised. The occupational pension schemes were largely established through collective bargaining, and therefore mirror the trade unions structure. Furthermore, the Danish labour market has high mobility, owing to the quite liberal rules for hiring and firing employees. Its rather flexible labour market requires a flexible pension system.

Following a 1987 law that obliged all pension institutions to make it possible for persons changing jobs to transfer pension rights (only annuities) between obligatory pension schemes, at only the cost of a transaction fee, the Danish Insurance Association and the Danish Association of Company Pension Funds approved an agreement that practically allows all employees changing jobs to transfer their pension rights to a new scheme at no cost. No individual risk assessment is done for the transfer. Transfer is, however, optional and a worker changing jobs could stay in the same pension plan if so he/she wishes.

According to Anne Seiersen, although some complex technical problems need to be solved, portability is possible as far as there is political will, as it has been the case in Denmark. Nevertheless, to make internationally applicable rules for pension portability will either be a task of great detail and great length or a task that cuts technical corners. In any circumstance, the rules are going to be applied to a lot of different pension systems and pension schemes. And unavoidably the rules will fit some schemes better than others. It is necessary to be aware of the corners that are cut and the consequences hereof. For the practical implication might be that the rules will not work in reality. And no increased mobility is experienced if the rules are too complex or too simple to solve the problems that are seen as the major obstacles by the potential mobile workers.

Furthermore, what are considered as reasonable costs or shortcuts in some pension systems and schemes may be considered as being of great importance in other schemes. To what extent is it reasonable to require the national pension systems to adapt in one way or the other to the preconditions of well-functioning portability rules when in the foreseeable future the vast majority of employers will probably stay in the national pension systems? How do we make sure that scheme members who are unlikely to consider international mobility do not in one way or the other bear the costs of the few mobile members? Or, on the other hand, is it important



enough that at least some employees are mobile in order to make it acceptable that the pension-scheme members in general must bear the potential costs or other disadvantages?

**David Pratt** (Albany Law School, New York) then presented his view on the portability problem in the US, addressed in his paper [Pension Portability in the United States](#).

Portability is one of several problems of the American private pension system, whose result is that not enough Americans receive a private pension, and for many, the amount received is inadequate. Regarding DC, there is almost total transferability of assets between plans (following a federal legislation from 2001). The main remaining problems are therefore that many individuals are not covered by DC plans and that many savings initially foreseen for retirement are withdrawn and spent before.

DB plans have more portability problems, but the extent of these has been reduced because of the decline in the number of DB plans and the conversion of many of them into account-based DB plans (which allow accrued benefits to be paid in a lump sum).

In the US, there is no obligation for employers to offer a supplementary plan and many private employers do not offer any plan to their employees (mainly smaller businesses). In 1999, 56% of full-time employees were covered by retirement plans, but only 21% of part-time employees. Some 81% of workers in establishments with 2,500 or more employees were covered, but only 30% of those with fewer than 50.<sup>13</sup> In 1998, 66 million US workers aged 25-64 did not have a retirement account of any kind. Moreover, even those covered have often accumulated benefits for a very low value. Employees in companies without plans, according to a 2000 Small Employers' Retirement Survey, tend to be younger, have lower earnings, less education and remain with the company for less time.

According to Mr Pratt, employers should be persuaded to offer plans through both educational outreach and economic incentives. Educational programmes and economic incentives should also be introduced to increase awareness among employees of non-sponsoring employers, so that they put pressure on their employers to make a plan available. Employees who are offered a pension plan, however, do not always contribute (from 1987 to 2000, the percentage of employees declining coverage increased from 12% to 15%). The high and increasing costs of health insurance seem a likely cause of decline in take up of retirement plans.

Another problem with employers' plans is that many workers may not be eligible or never acquire vested rights due to waiting or vesting periods. Indeed, while the median job tenure in 2000 was 3.7 years, three out of the four allowed vesting-schedules require a longer vesting period. For vesting purposes, a year of service is generally defined as a 12-month period in which the employee is credited with at least 1,000 paid hours, what makes that part-time or seasonal employees may never have vested rights. (Nearly one-third of the workforce is in 'non-standard' jobs: part-time, temporary, contract worker or self-employed). Moreover, participation in an employer plan may be limited by the employer to certain categories of employees. According to Mr Pratt, employer provided benefits should be fully vested in a maximum of two years. He also recommends obligatory coverage by employers sponsoring a plan to all employees who are 21 years old and have a short period of service, as well as a reduction in the number of hours' service required for eligibility and vesting from 1,000 to no more than 250.

The pension system allows for pre-retirement distribution of savings. Many of these distributions are spent, wholly or partly, rather than kept in a retirement plan. According to a 2000 study, 68% of 401k plan participants who change jobs between ages 20 and 59, cash instead of rolling over their account balance.

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<sup>13</sup> US Department of Labor, Bureau of Labor Statistics, Employee Benefits in Private Industry, 1999 (December 19, 2000).

Tax incentives have proved to be an insufficient deterrent and the only effective solution would probably be to limit the possibility of making pre-retirement distributions.

The portability losses principally affect shorter-service workers covered under DB plans. Approximately 59% of covered workers experience some portability loss, with an average pension loss equal to 25% of the single career benefit. Three possible options to improve portability in DB plans are: 1) to require employers to index benefits or assets for inflation, 2) to promote multi-employer plans, which would permit portability among member employers, and 3) to allow the transfer of pension assets between plans or a credit for service.

The Bush administration has issued some proposals to increase individual savings, which according to experts would not increase total savings, but rather cause a shift from employer-sponsored retirement plans towards individual savings. Maybe the best solution would be to strengthen social security.

**Yves Stevens** (Institute of Social Law, Law Faculty, University of Leuven, Belgium), who contributed the paper, [The improvement of the legal framework concerning pension portability: Is open coordination an option?](#), first mentioned the increasing importance of pension funds in the EU, with the total volume of contributions having increased by 62% over the period 1997-2000.

Addressing pension portability in the context of labour mobility and the fundamental EU principle of free movement of persons, he reviewed the main EU texts on this area, and particularly the first Commission's evaluation report of the national strategies on pensions (first evaluation report from December 2002). He noted the difficulty of a common EU approach, given the great variety of national pension systems. He questioned about the adequacy of the open method of coordination to go about improving portability of supplementary schemes. The EU Treaty recognised the EU competence in social security as a requirement for the free movement of workers, but until which extent does the EU have jurisdiction to legislate on supplementary schemes? He argued that if, as stated by other participants, the issue of portability of supplementary pensions is a question of equity, discussions should perhaps be put in the context of the social Europe.

**Vincenzo Andrietti** presented a second paper, [Evaluating Pension Portability Reforms. The Tax Reform Act of 1986 as a Natural Experiment](#).

In the US, workers participating to employer provided pension plans and especially those in DB plans, show a much lower turnover. The literature has still not provided a clear explanation for the link between participation to an occupational DB plan and job mobility. Pension portability reforms have been carried out in order to improve mobility of labour force (which would more rapidly adjust to shifts in demand) as well as for equity concerns (minimise retirement income losses suffered by highly mobile workers).

In this paper, the author assessed the impact of a pension portability reform on job mobility behaviour. The reform considered is the US Tax Reform Act of 1986, which reduced the maximum applicable vesting period from ten to five years in case of 'cliff' vesting and from 15 to seven years in case of 'graded' vesting. The observed group were workers participating in DB plans. Most DB plans were subject to ten years 'cliff' vesting before the reform and passed to 5 years vesting after the 1986 reform.

The impact of the reform is evaluated using a 'difference in difference' estimator, this is, comparing the average effect in terms of job mobility of the reform in the treated group with the effect in a control group of similar characteristics but not affected by the reform. The treated group are workers participating in a DB plan. The DB plan participation should be random and not related to the outcome in terms of job mobility; otherwise, differences between both groups might just reflect non comparability between groups rather than the effect of the reform. Several control groups are used, so that if results are similar, we can be confident of being evaluating the



result of the reform and not other differences between the treatment and the control group. The data used come from the rotating panel Survey of Income and Program Participation (SIPP), from years 1984, 1986, 1990, 1992 and 1996, which were used to construct three different samples with pre-reform and post-reform data. Pre-reform and post-reform surveys were differently combined to form three different samples.

The main finding from this study is that the reform had a statistically not significant effect on voluntary job mobility rate of the treated groups, for both men and women. This finding is robust to the use of different control groups and pre/post reform samples. The results suggest that, while the reform reduced the pension loss of workers participating in DB plans, it was ineffective in its purpose of fostering the voluntary job mobility rate of workers tied to jobs by an employer provided plan with a long vesting. The results of this study support the reduction of vesting periods in order to ensure a higher retirement pension for workers with fragmented careers, but weaken the employers' argument to continue using the vesting period as an efficiency improving tool (to economise on hiring and training costs). Nevertheless, given that shorter vesting periods also require higher funding costs by employers, a welfare analysis to evaluate workers' gains and employers' costs implied by a vesting reform should be carried out.

### Session 3: Removing obstacles to portability and liberalising pension provisions

**Ralf Jacob**, (European Commission, DG Employment and Social Affairs) presented the EU framework and the Commission's scope for action in the promotion of occupational pension portability (for a more in-depth discussion, see Mr Jacob's paper [Portability of Supplementary Pensions in the EU](#)).<sup>14</sup>

Ralf Jacob first and most importantly most stated the reasons why portability of occupational pension rights is a matter of concern to the EU.

As the main arguments he mentioned that:

- Statutory pension schemes (first pillar) often are not sufficient to guarantee adequate income after retirement.
- Occupational pensions are increasingly promoted by public policies as important element of social protection
  - by making membership mandatory;
  - by creating a favourable conditions for collective bargaining;
  - by obliging employers to offer private pension; and
  - by offering fiscal incentives.
- Free movement of persons is one of the fundamental goals of the EU – and must not be penalised through reduced pension entitlements.

To illustrate the political commitment he drew attention to important recent Commission documents:

- *Social Policy Agenda 2000–2005* (June 2000) – promote mobility, notably by removing obstacles in the field of social security and in particular supplementary pensions.
- *Action Plan for Skills and Mobility* (February 2002) – make progress in relation to the portability of supplementary pension rights of migrant workers.

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<sup>14</sup> Mr Jacob actually gave his contribution after the first session on day one, but it is inserted here as belonging by its nature to session 3.

- *Common objectives for pension systems* presented to the Laeken European Council (December 2001) – ensure that labour market mobility and non-standard employment does not penalise pension entitlements.

As principal obstacles to portability, Ralf Jacob mentioned, in particular:

- acquisition of rights – waiting periods, vesting periods, minimum ages;
- preservation of rights – protection against inflation;
- transferability – possibility to transfer a capital equivalent to acquired pension rights into a new scheme;
- taxation – risk of double taxation as a result of cross-border mobility.

Although portability problems exist also at national level, additional limits in fact arise in cross-border mobility: job change might require a change to a different scheme where a national job change would have been possible without, transfers might be impossible or more complicated, and different tax systems may clash.

According to Mr Jacob, policy should therefore aim at:

- facilitating cross-border membership to avoid change to another pension scheme;
- facilitating acquisition of rights: shorter waiting and vesting periods, lower minimum ages;
- protecting dormant pension rights of early leavers;
- facilitating transfer of acquired pension rights; and
- avoiding unfair tax treatment.

At the EU level these goals could be pursued in a number of ways and using several available instruments:

- the *Treaty* – to fight tax discrimination interfering with freedom to provide services and free movement;
- the *Pension Fund Directive* – common prudential standards allowing mutual recognition and cross-border membership;
- the *Portability Directive* of 1998 (98/49) – equal treatment for migrant workers with regard to preservation, payment of benefits and information; cross-border membership;
- *Regulation 1408/71* – aggregation of periods and cross-border payment of benefits (mainly covers statutory schemes);
- *EU-level collective bargaining* – consultation of social partners; and
- *'open method of coordination'* – attempting to influence national policymakers.

According to Article 138 of the EU Treaty, the Commission should consult social partners on any envisaged proposal in the field of social policy. In May 2002, in an initial stage of consultation in the issue, several questions on possible action at EU level were sent to social partners. Social partners, in their responses, have recognised the need for EU action, although the preferred instruments differ between employers and trade unions. Although employers prefer softer legislation (exchange of information in good practices, recommendations, code of conduct, guidelines, one organisation also proposed a directive on transferability), trade unions call for a directive, in case agreement between social partners could not be achieved. At this point in the developments, it was difficult to foresee exactly what would be the choice of action. If a draft directive were to be submitted, the time frame for adoption would be two to three years and the implementation might be gradual during a certain number of years.

In the immediate future the main task would be the second stage of consultation with social partners (consultation on a Commission proposal). This legislative procedure could however always be suspended if social partners reach an agreement among them.

In 2001, CEPS launched a **Task Force of CEPS** members and experts to discuss the issue of **cross-border portability of pension rights**. This Task Force met in four occasions, which resulted in the publication of a report with its main conclusions and recommendations. The report, *Cross-Border Portability of Pension Rights, An Important Condition for an Integrated Market for Pension Provision*, Jørgen Mortensen (to download this report, see CEPS [Book Store](#)) was presented in the workshop by its rapporteur, **Jørgen Mortensen** (CEPS, Senior Research Fellow). It presents a general overview of the different issues related to pension portability, which are usually dealt with by different Directorate-Generals in the Commission (employment, taxation and single market).

The lack of pension portability is a serious problem for individuals moving from one country to another, a source of additional costs for firms, an obstacle to the free movement of workers in the single market, an obstacle to the free provision of services within the single market and a source of labour market rigidities.

Pension portability should however not be considered as a target in its own right, but as a means to achieve a more efficient allocation of resources through increased mobility of the labour force and an integrated market for pension provision. Enhancement of the freedom of movement of labour and free provision of services will indeed not be costless for society. The costs of an enhancement of pension portability may be a lowering of the incentives of firms to invest in occupational training and other aspects of human capital formation.

Some general portability issues are the problems related to vesting of pension rights and backloading of pension benefits. To these should be added the particularly cross-border problems: conflicts of tax systems, cross-border transfer of the capitalised value of pension rights and cross-border membership of pension schemes.

The report reviews the main legal issues and EU jurisprudence (namely the Bachmann and Danner cases) and the most recent initiatives in favour of integration of the pension market (including the proposal for a pan-European pension fund, by the European Federation for Retirement provision, which will be presented later on).

Its main recommendations were:

- improvement of the scope for transferring the capitalised value of pension rights;
- coordination and increasing transparency in actuarial calculation of the pension liability (claim);
- mutual recognition of prudential surveillance of pension funds;
- elimination of national restrictions on the cross-border membership of pension schemes;
- elimination of restrictions on deductibility of premiums to pension schemes in other EU member states;
- a general shift to EET principle of taxation of pension provision; and
- generally more flexibility and individual choice.

The report also suggested that member states should (in open coordination) agree on guidelines for 'best practice' with respect to: 1) vesting of pension rights; 2) degree of backloading; 3) procedures for adjusting vested pension claims for general inflation; 4) clarification of the approach to adjusting open-ended pension schemes for changes in life expectancy (as already introduced at least in one member state); and 5) increase in the transparency of the actuarial standards for calculating the liability of pension schemes vis-à-vis their members.

Commenting on this report, **Elsa Fornero** found trade-offs between some of the proposals, which in her opinion should be explicitly mentioned. She also found it weak to ask for

portability as a way to enhance labour mobility, when there is not strong evidence about the influence of portability losses in mobility. Pension portability might be important for highly skilled workers, but perhaps few individuals would profit from it. One should question whether the benefits compensate for the costs of promoting portability (for example, a replacement of DB plans for DC plans would improve pension portability, from which mobile workers could benefit, but it would also increase the investment risk of many workers who will never move).

Ms Fornero nevertheless welcomed the call for greater individual choice, mainly in some countries such as Italy, which allocates 30% of taxes to social security, but one should also consider that greater choice could increase costs (as has been the case in Latin America and the UK).

**Linda Luckhaus** (School of Law, University of Warwick) warned about the dangers of certain reforms leading to greater individual choice. Some lessons could be learned from the two successive reforms in the UK. Whether the first reform (1978) allowed employees to opt out from the mandatory State Earnings-Related Scheme (SERPS) into defined benefit occupational pension scheme, the second reform (1986) extended the contracting-out option to defined contribution (DC) occupational plans as well as to private schemes. This led to the extension of many poor selling practices, against which the uninformed consumer was not able to defend himself/herself.

**Chris Verhaegen** (EFRP, European Federation for Retirement Provision) presented the EFRP's proposal for the creation of European Institutions for Occupational Retirement Provision (EIORP). For a fuller discussion, see Mr Verhaegen's paper [A European Institution for Occupational Retirement Provision \(EIORP\)](#).

This pan-European IORP would be established and regulated in one member state, but allowed to establish separate sections that are tax approved in other member states and comply with their local social and labour laws. Such an institution would allow a single plan for all EU employees, which could stay with the same scheme when moving to another member state, but would also allow member states to collect appropriate taxes.

Regarding regulation, solvency rules and prudential supervision, the rules of the home country would be applied. As regards taxation, contributions and benefits should be granted equal treatment in the different member states as those to local pension plans. The main difficulty would be to determine what proportion of assets belongs to which national section and are therefore subject to the taxation policy of each member state. EFRP proposes that the assets are split between countries based on liabilities for each section at last valuation. EET regime in all member states would be needed.

The EFRP is trying to explore the proposed approach by undertaking a voluntary pilot scheme including UK, Netherlands and Ireland, three countries with well-developed occupational pension schemes and similar prudential supervision systems.

The draft directive on the activities and supervision of institutions for occupational retirement provision represents an immediate step forward, introducing mutual recognition of supervisory authorities in different member states and facilitating cross-border membership and management of occupational pensions.

**Nickolai Slavchev** (Allianz Bulgaria Pension Company) presented the regulatory framework under which the supplementary pension provision developed in Bulgaria, focusing particularly on its degree of internalisation.

Since 1994, privately managed pension funds have been establishing in Bulgaria as a voluntary supplementing vehicle of retirement saving. These funds started developing independently from the process of pension reform, which only started its partial privatisation, through transfer of compulsory contributions into privately managed occupational pension funds, in 1999. This fact,

together with the important exchange and consultation with international experts, allowed the development of a relatively international system of supplementary pension provision.

At national scale, the pension portability problem was easily dealt with in Bulgaria, as all pensions are fully funded DC schemes and vesting is immediate.

For the management of pension funds, the Bulgarian legislation established the principle of the ‘prudent man’, as in countries with the most developed supplementary retirement provision. Pension companies invest little abroad, which according to the author is because of restrictions on asset management such as limits to the share of foreign assets in the pension fund portfolio, minimum limits for the share of national assets and currency matching requirements. (Both voluntary and compulsory pension funds follow a similar regime on the limits for investment in assets abroad.) As a further obstacle to internationalisation, the Bulgarian tax system does not provide tax incentives for contributions paid to a pension fund in another country.

Adopting the Community legislation would progressively entail a certain liberalisation of the asset management and may also result in elimination of the preferential tax treatment of in-country membership of pension funds.

Whereas the liberalisation of pension fund asset management could be viewed by the Bulgarian authorities as a ‘drain’ on the national capital market, pension companies licensed in Bulgaria might overcome this by concluding agreements with foreign companies in the form of ‘international retirement provision franchising’.

### III. Round Table: Setting the European research agenda on pension portability

The workshop ended with a round of proposals for future research in pension portability in Europe. The topics suggested were:

- a study of DC plans as a solution to portability of pensions (John Turner).
- a comparative study on rules in vesting periods. According to Mr Turner, every country should have a law with maximum vesting periods, as a matter of worker rights. Elsa Fornero also considered important to compare other vesting requirements.
- proposals for plans that could be used by multinationals. Regarding occupational pensions, it is important to consider the employer’s view, otherwise they may not have incentives to provide them (John Turner).
- the effect of pension loss on labour mobility, where further empirical evidence is needed (Vincenzo Andrietti).
- European research on pensions, where more data is needed (Vincenzo Andrietti). In the US, there are four panel surveys with data on pensions (which include the Panel Survey on Income Dynamics, the Health and Retirement Survey and the Survey of Income and Program Participation). In Europe the only panel data that exist come from the European Community Household Panel (which in its initial waves included a few questions on occupational pensions that were removed afterwards), the British Household Panel Survey for the UK (with no question on type of pension) and the German Socio-Economic Panel. These data should be improved and linked to administrative data (to measure their reliability). Stan Panis mentioned also the existence of a Dutch panel survey – the Center Savings Survey – and two new panel surveys in the pipeline, ELSA (English Longitudinal Survey on Ageing) and SHARE (Survey of Health, Ageing and Retirement in Europe).
- the extent to which people move after retirement, where more data is needed (Stan Panis).
- a study of the costs for a member state of allowing deductibility of contributions in pension funds in other member states (David Pratt).

- a study of the costs for companies from the imposition of common actuarial standards and obligations to allow and accept transfers of pensions (Lorena Ionita, UNICE).
- research in general needs to be focused not on labour mobility but on keeping the standard of living after retirement, according to Mr Panis.

Elsa Fornero concluded the workshop mentioning that perhaps the main issue was not so much portability of occupational pensions, as the important challenge that ageing presents for first-pillar pensions. She also noted the cost of third-pillar pensions and the problem of abusive practices in the private pensions market.

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