Katalin Botos

Europe under double pressure

In the recent few years the per capita GDP level of the old continent has been lagging behind the GDP level of the USA by 25 per cent. Economic growth in the western half of Europe is significantly lower than in the United States and European growth rate stays far behind that of China. If we are looking for the possible causes it is clear to see that the high redistribution level of the European welfare states puts a heavy burden on the European business sector, a burden which harms its competitiveness. Attempts to introduce austerity measures understandably lead to political difficulties.

It is quite certain that in the long run the international environment will undergo changes. The United States has taken a budgetary debt path which is considered unsustainable even by Alan Greenspan, the former chairman of FED. The reason: the population ageing of the United States. Even in the United States the burden of social contributions – which is relatively low in international comparison – is likely to grow in the future. The budget deficit in the United States does not represent an operative problem today, because the huge currency reserves of China are invested in US government bonds which are able to finance the above deficit.

The widely admired growth rate of China will have its own limitations in the long run. First of all, China will have to spend enormous amounts to solve its environmental pollution problems. China will not be able to do without an institutional social security system as its market development is advancing. In addition, China is also witnessing a rapid ageing. This may necessitate the use of currency reserves for public consumption, a step which is likely to have consequences on the financing position of the United States.

Based on the above, we can state that a careful monitoring of the international financial system and the ageing trend in the developed and fast developing Asian countries will be of fundamental importance for the future of the world and the future of Europe.

COMPETITION AND COHESION

Today, Europe is the region with the world's third important economic weight. A group of European countries already have a common currency within the EU representing a strong economic unit. Sooner or later, the other member countries of the enlarged European Union will also have to join this group. This is the reason why in this comparative analysis the euro area is used as a basic unit.

The euro area's share in the world's GDP amounts to 15 per cent, while the United States has – for a long period of time – maintained its

20 per cent share. The two large economies of Asia, i.e. China and India, together with the countries closely linked to them already represent 27 per cent due to the rapid economic growth of the recent years.

Europe's region with a common currency has a 30 per cent share in international trade. The United States and the two Asian economic powers have a smaller share: 10 and 12 per cent, respectively. These figures indicate what an open economic region Europe is and why global phenomena are usually quickly reflected in the development of Europe's economic competitiveness.[1]

The statistical figures of the European Central Bank have been focusing on three global economic centres almost up to now and concentrated almost exclusively on Japan in Asia. Systematic data collection does not even cover Chinese figures – quite possibly because reliable and systematic data resources are not really available. The Central Bank's monitoring activity is concentrated on currencies in the international money markets, and in Asia it is the Japanese currency – the yen – that plays a significant role there.

According to statistics, euro area's population is higher than in the United States, and the population of the European Union, as a whole, exceeds that of the United States by 170 million people. Japan's population represents 40 per cent of the euro area's population. GDP per capita measured in PPP shows the following picture at the end of 2006: euro area – EUR 25.5 thousand, United States – EUR 35.4 thousand, Japan – EUR 26.3 thousand.[2]

The above figures demonstrate that the two countries with key currencies both exceed the performance of the euro area. The leading position of the United States is an obvious fact, no wonder European politicians are busy looking for the recipe how to catch up.

As we have seen above, it is no longer sufficient to pay attention to Japan only. China and India represent new challenges. Europe is under double pressure. Due to its weight and size, Europe has so far managed to keep pace with Japan, more or less. However, if the Asian economies with their large populations succeed in staying the dynamic path they have already taken, the above double pressure is expected to lead to serious problems.

European jobs are challenged by two things: high-tech, on the one hand, and the dumping of mass production, on the other hand, while unemployment and the labour activity level are already causing serious headaches in Europe.

The activity rate shows the following distribution: euro area – 69.9 per cent, United States – 75.4 and Japan – 72.2 per cent. In Europe the employment of the working-age population is lower than in its global competitors. If we take the aggregate proportion of the young and the elderly compared to the working-age population, we can see that there is a surprising similarity in the three regions, the figure is 49.4 per cent in all three centres! However, if we look at the figures in details, the proportion of young people in the United States is higher which is a favourable fact considering the future. There are fewer children in Europe and Japan than in the United States, consequently, the maintenance of the elderly is a heavy burden on the active population in the first two. The working-age population is confronted with the serious burden of running an economy which must be capable of providing for the children, for themselves and also for those beyond their active age. It is important for everyone to see clearly: regardless of the type of social security system in place, the well-being of the elderly primarily depends on the work done by the active workforce. Even in the capital-funded social security schemes the active working population must be able to produce the goods that guarantee the consumption of pensioners, goods that cannot be provided for without a proper replacement of the labour force from both quantitative and qualitative points of view. This is a fundamental assumption even if the capital-funded social security schemes can and will strongly contribute to technical development and to the improvement of productivity. Each and every social security scheme becomes mature after a while, and at that point the capital-funded systems are transformed into pay-as-you-go systems.

In Europe care for the elderly is organised within an advanced social system by means of a mandatory social security scheme. In the United States pension insurance carries certain public responsibilities as the system of pension insurance is complemented with corporate pension fund schemes. In the United States there is no comprehensive public health-care in place and the other social benefits are also modest since the United States is fundamentally based on an economy designed for self-care. As a consequence, the social security contribution paid to the state budget is much lower compared to GDP than in Europe. This lower level of mandatory contribution enables the American economy to be more competitive, because there is no significant difference in the wages which are calculated together with the corporate pension fund contributions. Social security contributions paid to the central budget are also lower in Japan, and we can safely state even in the absence of relevant Chinese data that the competitiveness of the Chinese economy is also boosted by such incidental wage costs. And let us not forget that in these emerging economies wage costs represent only a fraction of those in the West. The assessment of the above facts must inevitably include another important factor, i.e. family relations play a very different role in the Asian civilisation than in the individualistic western civilisation. In Asia there is no need for social security costs, because families there provide for the elderly relatives and the family income is used to raise and care for the children. To put it bluntly: in Asia a modest living standard and work without financial reward are accepted, consequently, such activities are not reflected in the expenditure side of the economy. *International trade rules do not prohibit* the improvement of competitiveness *by accepting personal sacrifices.* In reality, it means producing at a cheaper cost. The Western world must face the fact that economic competition is also the competition of civilisations and social systems.

Even the dynamically developing Chinese economy is faced with a problem is this area. The recent economic system in China is a mixed one: the traditions of the past are replaced in an ambiguous way by a capitalist production method in which profit-oriented enterprises do not undertake the responsibility of life-long care for employees, a responsibility which was taken for granted within the former socialist state-owned enterprises, as these traditional socialist state-owned enterprises also fulfilled social functions. Capital investors are evidently using different principles to run their enterprises. Right now, there is no clear vision as how the economic system will be developing in the future in China. The first health insurance schemes designed for the elderly were organised in the mid-90s, however, pension insurance is yet to be set up. As a result – in view of the fast ageing tendencies in China – this is likely to represent a serious burden for the working-age population of China at the end of the first third of the 21st century. The open question is whether Chinese society will be capable of accepting this burden purely based on the Confucian tradition. Sooner or later, China will have to set up a public pension system, a measure which is going to aggravate the public burdens of enterprises. However, this challenge is not yet present in the fierce competition of today.

Europe's competitiveness is under double pressure and is facing a significant challenge.

How the goals of the Lisbon Strategy aimed at creating a society and economy that is both competitive and socially cohesive is yet to be seen.

DEMOGRAPHY AND COMPETITIVENESS

In order to study the phenomenon of ageing, based on the OECD report, we analysed the development of ageing in nine developed countries – Canada, Finland, Germany, Italy, Japan, Holland, Sweden, Great-Britain and the United States.[3]

Life expectancy at birth in these countries is high for both men and women: in the year 2000 it was 75.2 and 81.2, respectively (unweighted average). According to the forecasts, these numbers are expected to further increase by 2030 (78.5 and 84.1 years). The proportion of the age group of 65 plus represented 15.4 per cent in the year 2000 and is expected to rise to 25 per cent in 2030. The proportion of the 65 plus group compared to the working-age population will be up from 23 per cent in 2000 to 42 per cent. The expected statistical figure is especially unfavourable in Italy where the above indicator will rise to 50 per cent in 2030 – indeed, lots of cohorts of the Italian bambinos will not be born! This indicator is very high in Japan to: it is 46 per cent. In this country the rate of the elderly is growing fast, and the percentage of the 80 plus in the total population is going to increase from 3.7 per cent in 2000 to 10.2 per cent. The expected percentage in 2030 will be over 8 per cent in Sweden and Italy, too!

The European and the American economies will not be able to finance this high proportion of elderly population without fundamental reforms. Social security expenses already represent a serious problem for the United States as the baby-boom generation is now reaching retirement age. Former FED chairman *Alain Greenspan* made a statement shortly before his retirement saying that the US budget deficit had already taken the American economy on an unsustainable path.[4]

One of the most important factors in this path is the sharp rise of social security expenses. In Europe the redistribution rate has significantly increased in the past few decades, the ratio of taxes and contributions to GDP has also grown. The largest growth has been recorded in social security contributions. Now that the above-mentioned challenges already have an increasing impact on Europe's competitiveness, measures must inevitably be taken to curb the growth of social security contributions, while at the same time budget deficit continues to pose a serious problem in a number of European countries.

The European Central Bank whose mission is to guard the value of the Euro keeps emphasising that the large social systems badly need structural reforms and this is particularly valid for the pension system.

Structural reform does not necessarily mean the need to switch over to a capital-funded system despite the European trends that indicate this course of action. The reason behind this trend may be found in certain illusions about the capital-funded system both in public opinion and even among experts. It is widely believed that the capital-funded system contributes to the sustainability of the pension system. There is only a limited truth behind this belief. It seems that in specific cases where the previous pay-as-you-go system is transformed into a capital-funded one, the latter one seldom proves to be more effective if all conditions remain unchanged, and this is so especially because the costs of transformation must also be added to the operational costs. So what are the causes of the costs of transformation? The causes are very much the same everywhere, the ones we also experienced in Hungary when the system was transformed in 1998. The missing amount of money will have to be provided by the budget for the pension benefits of pensioners who stay in the old system and receive their retirement income accordingly. If the income rate which was guaranteed earlier does not change, then the reform is purely of financial technical nature. Genuine reform measures mean the following: longer working years to be eligible for pension, lower rate of guaranteed retirement income relative to the wage level of the active workforce, stringent limitation of early retirement. In theory, a balance may also be reached by increasing pension contributions, but this alternative is not feasible, because it would undermine international competitiveness. Today we are witnessing some sort of a rearrangement among the possible channels of state taxes and contributions. Within the various forms of state revenues, corporate taxes and contributions represent a decreasing proportion, while tax levied on consumption is on the rise. The first one has a favourable impact on enterprises and capital investment, whereas the second one has a negative effect on the population in general. It shows quite clearly that the final burden is always on the citizen. Measures in Hungary aimed at reducing pension contributions within the pension reform are clearly attributable to the pressure of international competition and to the expectations of entrepreneurs, foreign capital investors. However, these are no factors to prove that the new system would be more effective. Hungarian analyses have shown that based on the data of the recent few years, the pension benefit of those who joined the mandatory capital-funded pension scheme will be lower than the benefit they would receive calculated under the present pay-as-you-go scheme. Yields in the various funds have also fared unfavourably. This is partly explained by the cost of setting up the new system and partly by the relatively high operational cost and the low yield of investments. This latter one has recently shown a modest improvement. Unfortunately, this is not an improvement to celebrate! The improvement is due to the rising income on government bonds driven by the large budget deficit. These funds can practically invest their money exclusively into risk-free securities, i.e. government bonds. In other words, behind the comfortable income generated in the pension funds lies a worrisome macroeconomic phenomenon whose burden has to be borne by taxpaying citizens. The transformation into a system of pension funds creates an additional budget deficit, because the missing revenues have to be compensated in the social security system, but no problem this will be passed on to the new pension fund. (In other words, it solves the very problem it causes.) The budget deficit grows simply because the debt that has been implicit in the past becomes explicit debt for the budget. In the case of retirees who *will in the future* join the new system budgetary liability is incurred not only when pension benefits become due, such liabilities arise already *now* when pension payments have to be made by the pensioners of today. This is a reverse process compared to the economies in which these liabilities are carried forward into the future and are capable of increasing their spending at the expense of their future income. We, in Hungary, intended to narrow the present spending by transforming an implicit debt into an explicit one. It did not work and only led to a further aggravation of the state budget deficit.

It is not easy to conduct a debate in Hungary whether it is necessary or justified to reduce pension contributions. True, after the regime change, Hungarian social security contributions had a percentage rate higher than in the Western countries. Now that it has been reduced to a competitive level we should be reminded of the fact that these contributions are paid of lower wages than in the Western economies. Whose life is it anyway? At what a low level should the consumption of pensioners be set, especially compared to the welfare societies west of the river Lajta? The cloven hoof is showing: first of all, the lower contribution rate is serving the greater profit opportunities of foreign capital rather than the alleged goal to legalise activities in the black economy. Compared to zero contribution rate (in the black economy), the present 16 per cent is high… The claim that a lower contribution rate generates a higher level of employment is unfounded. In Hungary, this claim is usually explained with the growing employment figures under the Orbán-government. The *post hoc* does not necessarily mean *propter hoc.* Growing employment under the Orbán-government was attributable to the housing subsidy scheme rather than to reduced contributions. In actual practice, employment figures were on the rise exclusively in the construction sector, nowhere else.[5] Although the reduction in contributions was certainly a welcome measure for enterprises, it was primarily linked to better sales opportunities facilitated by the expansion of the subsidy scheme. There is no such thing as a free lunch: the price to be paid for reduced contributions was growing subsidies. The growth of profits generated by the construction sector was far from being sufficient to finance the increasing expenses of subsidies.

We can look at the other side of the same coin and say that we have no choice if we want to attract capital and compete for it with our Eastern neighbours. It is an empirical evidence that foreign direct investment (FDI) has been very intensive among the developed countries, and in relation to them, Hungary's position has been quite positive in the past two decades. There are some indications, however, that in the most recent stages of globalisation capital movement has become sensitive to wages. Research findings also prove that the tax rate has not been the primary factor of capital market reactions.

If we look at the interrelationship of demographic trends and social security schemes, one of the inevitable questions is this: do pension systems become unsustainable because of an ageing population or are we facing an even bigger problem, namely, economic growth is insufficient, the expanding economy does not create a higher level of employment, and this is the real crux of the problem.

To further enhance the country's ability to attract capital investments is certainly not a solution from this angle. It is a well-known fact that foreign-owned enterprises that represent 50 per cent of the companies in Hungary, only employ approximately 20 per cent of the workforce. Foreign capital is known to be operating with high productivity. Statistical data, however, also show that wage increases are not proportionate to the high level of productivity, and as a result, wage-based contributions paid to the social security fund continue to be modest.

If we consider that Europe's activity rate is lower than that of its competitors and the Hungarian rate is even lower, then – I believe – it is justified to raise the following question: would not it be better to aspire for a higher level of employment, and thus by accelerating economic growth "outpace" the demographic problem?

The answer is short: *no*. The problem cannot be "outpaced" by growth. What is possible and is a must is to alleviate the problem. Indeed, Europeans have become somewhat lazy and it poses a serious problem, because due to a well-developed social safety net and possibly also due to the limited job opportunities, pensioners are supported by an ever falling number of active workers. In the year 2000, a pensioner was supported by two active workers in Germany, in Italy the ratio was only 1.4, while in the United States it was 3.3. Interestingly, in both Japan and Canada one inactive person is supported by 3 active workers. In the group of developed countries the (unweighted) average is about 2.4. The possible future scenarios signal a significant deterioration in every country. The worst scenario predicts a rate of 0.8 in Italy, and the average value is predicted to be 1.4 active workers for each pensioner.

Based on data in 1998, men aged 65 were expected to live another 16 years on average (in round figures), while the same figure was 20 years for women, in other words, pension benefits were to be paid for 16 and 20 years, respectively, on average. This is only true on condition that all people concerned indeed retire at the age of 65, however, this was far from being the case. In almost every country with an advanced social security system employees seem to take the various opportunities of early retirement. This is not surprising, because in most countries the method of calculating pension benefits does not encourage people to do so. The expected pension assets, i.e. the discounted value of pension contributions minus the cost of their acquisition, will become less favourable for the pensioner if he chooses to stay in employment. This method of calculation reflects the concept that with a shortage of job vacancies young people should be guaranteed job opportunities, a concept that has its own merits. Additional remedies here may be found in actuarial solutions. The fundamental problem, however, is the shortage of jobs.

When individuals are interviewed, they usually say they are ready to work after reaching retirement age. But statistical figures show that in practice only a few people do so. The desire to stay in employment and work after retirement age certainly depends on one's state of health and also partly on the availability of flexible part-time jobs which pensioners would prefer. It seems that employers do not bother to offer such arrangements. Despite the fact that such flexible job opportunities would be important for other disadvantaged groups, such as people with disabilities, mothers and long-distance commuters. Economic policy makers have the task to find incentives to encourage employers for such arrangements.

In the above subject area we are witnessing very strong trends. According to a survey conducted in the United States 20 years ago, 50 per cent of pensioners indicated that they would be prepared to take up a part-time job, today 70 per cent would welcome such opportunities. If there were such opportunities. Surveys also show that most of those answering the questionnaire complain about the scarcity of part-time job opportunities.

The generosity of the social systems is also the reason why in the poverty-stricken strata of society a lot of people do not care for saving for their retirement years. In social groups living under the poverty threshold in which social services are automatically in force saving is clearly non-existent. Early retirement schemes are also more frequently used than it would be justified by health reasons.

The *Hungarian experience* is also a good example to illustrate the above. After the regime change, Hungarian society's reaction to the worsening job market was to choose early retirement and disability pension in large numbers. (There is no reason to necessarily associate this trend with corruption. For the majority of those pensioned off with a disability seemed quite fair since most of them had overstrained themselves with working in two or three shifts, and it did not take too much effort to detect permanent health impairment.)

Even a moderate increase of the retirement age may improve the balance to a considerable extent. This measure, however, would go against certain above-mentioned social policy objectives, such as the facilitation of the employment of young people. One of the crucial questions is whether employees are able to cope with the up-to-date requirements of the modern labour market when they reach old age. Computer literacy is not easy to acquire for the elderly, whereas young people automatically grow up with it without even recognising its difficulties. It is understandable if the increase of retirement age is coupled with measures aimed at restricting the conditions for early retirement. Such measures may contribute to the sustainability of the pension system but fail to automatically solve social problems. Here is a Hungarian example to illustrate it: based on a political initiative, legislators have made it possible for anyone to retire after 40 years of employment regardless of their age.

We can certainly conclude that the system in place must be reviewed and new incentives will have to be incorporated in them to encourage people to consider working longer. Japan is planning to introduce a system in which from 2025 only those above the age of 65 will be eligible for pension benefits. Practically in every country working after retirement age is awarded with a bonus. In Britain the system distinguishes between those who retire on their own initiative and those who are forced to retire. In Sweden a pension benefit may be 60 per cent higher if the beneficiary retires at the age of 70.

It seems that the social security systems offer no remedy for one fundamental injustice, i.e. the costs of raising children are not taken into account.[6] The liberal social concept believes that raising children is a private matter. I am afraid this is an assumption which needs revising from the perspective of social security reform.

In modern states with the rule of law individuals can decide how to live their life, but it is also quite clear that for the smooth running of the economy human resources are just as important as capital. Despite the fact that human resources can be literally purchased in the labour market, they cannot be effectively created without raising children in loving families and without acquiring the necessary skills. In addition to costs associated with raising children, the expenses of educating them demand considerable sacrifices for the families and parents involved. It is evident for everyone with a basic knowledge of statistics that the per capita income is significantly higher in families with no or few children than in large families. It cannot be simply shrugged off and it is not fair to say that mothers and fathers with six children can get six times more satisfaction and joy than those without children. There is no denying life is unjust: there are many young women who would love to have a well-balanced family with children, but cannot find an acceptable partner and acceptable conditions. This is one of the injustices of human life which we must accept with humble sole. But why aggravate it artificially?! What society can do in order to facilitate the free development of the individual must be done. To have children depends on a free decision. But if we commit the injustice of putting heavy burden on families with children, while at the same time also expecting them to accept the very same financial sacrifices as people without children do for providing for their retirement years, then the principle of social justice is violated. It was along the same lines that *József Botos* proposed that differentiated benefits should be granted at retirement age to those who accepted the sacrifices of raising children and who educated a new generation of qualified labour force. Botos is not alone with this concept: the same idea was reflected in an article recently published by *J. R. Morse,* a senior fellow of the American Acton Institute.[7]

One may argue that this solution must presume a closed system, because this is the only way to interpret the linkage of labour and capital in the average of a longer period. Considering the conditions of a modern global world, we can see that human capital can also be imported just as well as financial capital is attracted into domestic economies in the form of direct investment. So some claim that there is no reason to encourage the birth of children, migration is a potential alternative.

This solution means shifting the burden of raising children to others, an idea whose analysis would go beyond the scope of this study. But it is justified to raise the question whether in our global world it really does not matter who is standing behind the work bench, the counter, the architect's drawing board or in front of the computer monitor? Are we ready and capable of accepting an immigrant labour force from every corner of the world to integrate them? Does it really matter how our local communities develop? Is Europe as a whole going to become a multi-cultural continent, is multi-culturalism becoming characteristic of the world as a whole? Is it going to be a driving force behind efficient production, is it going to benefit economic growth and development?

And even if all these questions are answered in a positive way we are yet to face another interesting problem which financial experts have been confronted with only recently.

THE IMPACT OF DEMOGRAPHIC CHANGES ON FINANCIAL MARKETS[8]

A pension system based on self-care and capital-funded schemes is interpreted as a system in which citizens in their active working age accumulate assets as long as the income of their work makes it possible. Reaching the age when they can no longer work they sell these assets to the next generation whose members are looking for possible investments for the very same purpose. In other words, this is the way each consecutive generation is trying to secure their future, the years spent in retirement. The accumulated investments are thus transformed into revenues by the elderly and by doing so they guarantee that the level of their consumption remains unchanged.

Indeed, according to a summary study published by the OECD, in the nine countries surveyed the income available for the elderly population does not fall under the level of their active years. This is accomplished by using a number of methods. Their income derives from state pension schemes, from contributory private and corporate pension funds complemented by possible part-time jobs taken up after retirement. On top of the above, there are also additional social benefits and revenues of their accumulated assets sold. There is also another important component: the organisation of their life-style. It means that in some countries pensioners regularly live with the younger generations or actually, especially because by living in the same household general overhead costs are lower and a number of services which single pensioners would have to pay separately can also be saved, such as care for the elderly, cleaning and cooking, consequently, the income of the elderly with such a life-style enables them to continue their earlier consumer habits and to finance cultural and leisure-time activities including travels. The price to be paid for this live-style: the different generations must accommodate to each other. This is the model followed by Italy and Japan in the group of countries surveyed. In Italy there are examples even for a reverse situation: the different generations live together because young people are unemployed and they all rely on the guaranteed income of the elderly…

Let us see now the conditions of what we refer to as the forth pillar, i.e. the concept of turning investments into income for your years of retirement.

An eminent American academic, *Jeremy Siegel,* raises the following question: “Sell! Sell to whom?” Fine, when we reach retirement age we sell our investments. But looking at demographic trends we can see that the next generations will be smaller in number, consequently, there will be an oversupply of assets. Asset prices may melt down compared to expectations and the actual amount of savings will be lower than presumed! ("A smaller nest egg than anticipated".) This is not an unfounded concern, but the future trend does not necessarily lead to the substantial decline of asset prices, because people do not usually offer all their assets for sale. Often investments are bequested to their children or alternatively – as it is customary in the United States – such bequest goes to charity funds. Understandably, the decision is the function of how far and to what extent the income of the pensioner is dependant on his investments. In countries where this is the principle form of income for senior citizens both share prices and real estate prices behave in a "textbook" manner when large groups of the population reach retirement age at the same time (e.g. the baby-boom generation).

There is another factor that may derail the price development in this model: international capital movement.

In countries where there is no acute ageing problem and there is no sufficient supply of assets to satisfy growing demand for savings, those seeking potential investments will use the chances offered by international capital movement. Consequently, international capital movement may contribute to the levelling of asset prices.

Earlier in this paper reference was made to an important phenomenon in the global economy, i.e. a young migrant labour force is moving towards the developed countries to make up for the demographic changes there. As we can see now, inadequate demand for assets is particularly attributable to this trend, in other words, capital "is also migrating" after young migrant workers… This is how citizens of countries with high productivity rate can conquer the world.

If we investigate what role pension funds play in shaping investment tendencies, then we must also look at the relationship between demographic trends and monetary policies, because if the population is ageing, the risk management policies of funds will also have to change. As large groups of retirees approach retirement age when pension benefits have to be paid in large amounts, pension funds become increasingly cautious in their investment policies. Even if the regulations were to allow funds to choose high-risk investments with relatively larger yields pension funds in such situations tend to restrain their risk-taking. Such cautious policies are likely to lead to the asset price "meltdown" referred to above, or at least make it more likely to happen. Pension funds basically use two schemes: a scheme based on a guaranteed level of pension benefits and a scheme based on fixed contributions. It is the first type of scheme in which funds may find it more and more difficult to fulfil their promises because in the case of asset price meltdown additional contributions become necessary. This is why the second type of scheme, which is based on fixed contributions, is becoming more widespread, as a result of which, pension funds are paying more attention to risk management today. This is the priority concern now as opposed to earlier pension fund policies which primarily focused on protecting the interests and rights of members. Financial derivatives may offer a solution to a number of problems, such as "spreading" the interest or the inflation risk. The pension fund sector, however, faces a truly difficult problem with *longevity risk.* Fund managers find it impossible to define and cover the costs associated with longer life, especially because they cannot find partners in the financial markets to accept such risks. Although there are some market players, such as the pharmaceutical industry, which actually make profits out of greater longevity. These market players, however, are relatively small compared to the enormous risks involved, so a market solution is yet to be seen here.

There are certain solutions available for the individuals to save. There are tailor-made solutions offered by the annuity sector, such as the financial institution of reversed mortgage.

A significant proportion of private savings are "frozen" in real estate assets. With a view to our fragmented societies in which parents cannot expect to live with their children, they cannot expect to be supported by the next generation in return for the invested assets that they will inherit, some sort of an institutional solution will have to be found. One possible solution is offered by financial institutions which own substantial portfolio of savings, they offer an annuity for the elderly in return for the acquisition of the right to their real estate without an obligation for the owners to sell them. Based on the life expectancy, the annuity is fairly easy to calculate and thus can be offered for the elderly. In Hungary, one example for the above solution is the so-called Hild-annuity scheme. It is evident for everyone that banks and financial institutions wish to benefit from such schemes, in other words, this is not a non-profit activity. There is always a price to pay for individual treatment! However strange it may sound studies conducted even in the most developed countries show that the financial literacy of the citizens and households is not particularly high, there is still a wide scope for further financial awareness and further room to improve the culture of financial knowledge.

Despite all these potential opportunities and solutions, Europe will have to face its own selfishness in the context of international competition and demographic problems. Possibly if we want to maintain our concept of an open world economy, we may have to draw some lessons from the experience of Asian civilisations which organise their life based on community and civil values rather than exclusively on individualism. Although it is very doubtful, we cannot exclude the possibility that Europe is capable of reforming itself in such a profound manner.

Notes

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2 ECB Statistics, Pocket book, 2006 October

3 Ageing and Income, OECD, 2004. In the forthcoming, the figures relating to the above nine countries are taken from the cited publication.

4 Ron Paul: How Government Debt Grows http://lewrockwell.printthis.clickability.com/pt/cpt?action=cpt&title=How+Governm, United Stetes public debt http://www.ansewers.com/topic/united-states-public-debt

5 The author's calculations based on the Hungarian Statistics Pocket Book

6 József Botos: The development and economic questions of the Hungarian social security system (A magyar társadalombiztosítás kialakulása és gazdasági kérdései), Osiris Publishing House (Osiris Kiadó), Budapest, 199, p 120)

7 Jennifer Roback Morse, PhD, Senior Fellow in Economics: A Catholic Alternative to Europe's Social Model http://www.acton.org/ppolicy/comment/article.php?article=307

8 José Manuel González-Páramo: The ageing problem: its impact on financial markets and possible policy responses, Speech on 'Funding social security systems – international experiences' Würzburg, 1 December 2006. http://www.ecb.int/press/key/date/2006/html/sp061201_1.en.html

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