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Article
A Stable and Social Europe: Fiscal Rules, a Stabilization Fund, Insolvency Rules, Gender Quota, Gender Pension Gaps, and Education. Reports

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New fiscal regulations for Europe

By Marcel Fratzscher, Alexander Kriwoluzky, and Claus Michelsen

ABSTRACT

• Current fiscal regulations worsened the economic situation in the euro area during the financial and sovereign debt crisis
• Regulations that allow more flexibility during downturns and have a countercyclical effect are needed
• Five suggestions for a new fiscal package: new spending rules, subordinated bonds to finance government spending, euro bonds, investment legislation, and new institutions

The overall economic development in the euro area has been disappointing in many respects since the beginning of the global financial crisis in 2008. The economy has been slowing down since the end of 2018, clearly illustrating its dependency on the global economy as well as its vulnerability in the face of uncertainties such as Brexit and an increasingly unpredictable US government.1

Member state governments have made fundamental mistakes in responding to the financial and economic crisis, often recognizing structural problems too late. The failure to coordinate macroeconomic policy instruments—monetary policy, fiscal policy, and structural policy—proved to be a fatal misstep. The governments often relied far too much on the European Central Bank, whose policies have lowered interest rates on public and private debt and boosted the economy.2

In other domestic policy areas, governments pursued negligent or even incorrect economic policies. Successful crisis management is possible, as the United States has demonstrated: between 2009 and 2011, the US government pursued a strongly expansive fiscal policy, with large fiscal deficits, while fundamentally reforming the banking system. At the same time, the Federal Reserve implemented an extremely expansionary monetary policy.

International consensus is that the fiscal policy in most European countries over the past ten years has been too restrictive and exacerbated the crisis. In particular, austerity policies have reduced the GDP of countries with high private debt levels.3 A significantly more expansionary fiscal policy with a strong focus on public investments and strengthening employment would have brought the euro area out of the crisis much faster and more sustainably. At the same time, implementing such an expansionary fiscal policy was not possible due to the existing Stability and Growth Pact rules and the European Fiscal Compact. Although governments were able to run fiscal deficits of more than three percent, they were only able to do so for a short time and to a limited extent. This situation is not appropriate for implementing structured measures aimed at boosting the economy with fiscal policy instruments, from which Italy in particular would benefit.4

European fiscal policy regulations must change. Concrete reforms should be implemented to address the lessons of the European financial crisis and to make the euro area crisis-proof:

First, the Stability and Growth Pact’s rules on new debt should be replaced by a nominal expenditure rule allowing national governments to increase government expenditure each year by no more than the nominal potential growth rate of their economy. This would mean, for example, that Germany would not be allowed to increase government spending by more than three percent annually.1

For countries with particularly high national debt, these growth rates should be lower to ensure that all countries will have a national debt below 60 percent of economic output in the long term (Figure). Advantageously, a nominal expenditure rule is significantly more countercyclical than the current rules. When the economy is strong, it restricts expenditure,

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For countries with particularly high national debt, these growth rates should be lower to ensure that all countries will have a national debt below 60 percent of economic output in the long term (Figure). Advantageously, a nominal expenditure rule is significantly more countercyclical than the current rules. When the economy is strong, it restricts expenditure,
as it must be geared toward potential growth rather than the current higher growth rate. During a downturn, there is more room for fiscal maneuver because decreased revenue does not have to lead to a reduction in expenditure.

National regulations that conflict with this spending rule, for example the “debt brake” (Schuldenbremse) in the German Basic Law, should be abolished. The debt brake reinforces the negative, procyclical behavior of German fiscal policy and leaves far too little scope for local authorities in particular to implement forward-thinking fiscal policies.

Second, governments should be obliged to finance expenditure beyond the permitted rates of increase through subordinated (“junior”) bonds. These bonds would have to be organized in such a way that in the event of a country’s insolvency, they would only be redeemed after the other senior bonds had first been redeemed. This could mean that these bonds would be automatically renewed or at least partially closed out. Thus, whether the market will add risk premiums to debt-financed overexpenditure depends on governmental credibility. If governments act irresponsibly, the financial markets will demand high-risk premiums and discipline them, a much more effective instrument than the rules laid out by the Stability and Growth Pact and pressure from fellow member states.

Third, the EU should allow the private sector to create synthetic euro bonds in order to increase the supply of safe bonds. This would allow private investors to bundle the government bonds of the euro countries, securitize them, and deposit them as collateral with the ECB. This would both increase the supply of safe bonds and create an anchor of stability, giving all euro area countries a little more time to respond to a crisis. The concern that Germany would have to assume more risks as a result is unjustified; increased stability in the euro area would also benefit Germany.

Fourth, investment legislation stating that governments must not make fiscal adjustments solely at the expense of public investment in education, infrastructure, and innovation should accompany the new debt rules. During the crisis, many governments reduced public investment, thus slowing their own economic growth, including employment and tax revenues, on a sustained basis. In many German municipalities, too, public investment was reduced far too much.

Fifth, European and national institutions must be strengthened to urge governments to take the right action in fiscal policy and create transparency. All member states should be obliged to introduce autonomous and competent national fiscal councils. While many countries already have such fiscal councils, they are usually not independent and have limited resources and opportunities to carry out independent analyses and make recommendations. In addition, the European Fiscal Council should be strengthened and report directly to a European financial commissioner, who should have more autonomy and power than previously.

In addition to modernizing fiscal rules, an important part of European reform, a stabilization fund could help the euro area respond better and faster to future crises and keep costs to the economy and society low.⁶

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Just under half of the euro area countries meet the 60 percent debt limit.

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**Keywords:** Fiscal rules, public debt, countercyclical policy
A stable and social Europe

A stabilization fund for a more crisis-proof euro area

By Marius Clemens

ABSTRACT

• No country in Europe is safe from a recession
• A stabilization fund which member states pay into while the economy is strong and from which they receive grants during downturns can improve welfare in individual euro area countries
• The fund should be structured in such a way that permanent transfers are not possible and high-risk countries pay relatively higher contributions, similar to insurance

The 19 countries in the euro area differ significantly in their economic structures. Economic shocks, such as a demand slump, affect them differently as well, and they are not always able to mitigate these shocks. Monetary policy could play a stabilizing role, but these 19 countries share a common policy instrument. Therefore, the common central bank can only respond to an individual country’s recession to a limited extent. National fiscal policy can also act as a safeguard, but only if it has a countercyclical effect, i.e., if the government increases spending comparatively during an economic downturn. In a recession, however, national tax revenues fall while social transfers rises. The euro area countries are not able to incur additional expenditure to stabilize the economy without breaching the euro area deficit and debt criteria.1 Thus, urgently needed government investments are reduced or completely postponed, further exacerbating the recession. This has been the experience of some European countries in recent years.2

To solve this problem, this contribution proposes a stabilization fund that should ensure that the consumption level in the euro area countries remains stable even during a recession. The fund allows individual countries to hedge against specific shocks and the euro area to become more crisis-proof by sharing risk within the monetary community.3

Member states pay a contribution to the stabilization fund, which in turn pays grants to individual countries in times of crises to provide financial relief (Figure). The aim of the stabilization fund is not to create a permanent and unilateral transfer mechanism, but rather to provide a safeguard in the event of a recession.

The contribution amount is based on economic developments and is paid to hedge against future crises. During an economic downturn (defined using hard indicators), a part of the collective fund’s assets is paid out to the affected governments. The funds must be earmarked, for example

2 Philipp Engler and Mathias Klein, “Austerity Measures Amplified Crisis in Spain, Portugal, and Italy,” DIW Economic Bulletin no. 8 (2017) (available online; accessed April 8, 2019. This applies to all other online sources in this report unless stated otherwise).
to be used for training measures for the unemployed or for urgently needed investments. The proposal thus differs in two respects from the European unemployment insurance model currently under discussion.4

Importantly, the proposed stabilization fund springs into action relatively automatically, enabling national fiscal policy to be expansionary in the event of a recession. In order for the fund to fulfill its role and to prevent euro area governments from avoiding their responsibility of conducting a sound economic policy (moral hazard risk), the parameters of the fund must adhere to certain rules.

First, permanent, unilateral transfer payments should be prevented. Accordingly, funds will only be paid out if certain thresholds are exceeded, such as if a country’s unemployment rate is well above the long-term trend and rising sharply. Countries with increasing, structurally high unemployment rates will not receive payouts, and thus will be incentivized to fix the structural problems on the labor market.

Second, it is advisable to bind the contribution amount to various characteristics, similar to the insurance principle. As the country with the highest number of individuals subject to compulsory insurance, Germany would probably have to pay the largest contribution in absolute terms. However, the amount per capita is likely to be lower than in many other countries because, as with insurance, countries that had a higher risk of crisis in recent years should also pay a higher per capita premium. This should also motivate structural reform efforts.

Third, it makes sense not to tie the funds to a single purpose, as that would remove the flexibility needed to react appropriately to the specific causes of crises. The government of the recipient country in consultation with the fund would need to decide how to respond to the crisis.

According to these principles, a stabilization fund reduces economic fluctuations and is a mechanism for making the entire currency area more crisis-proof in the future.

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4 Cf. Martin Greive and Jan Hildebrand, “Das sind die Details zu Scholz’ Plänen für eine europäische Arbeitslosenversicherung,” Handelsblatt Online, October 16, 2018 (in German; available online). In this model, countries receive loans instead of grants and the funds may only be used to help the unemployed.

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JEL: E32, E63, F45

Keywords: Monetary union, stabilization funds, fiscal policy
A STABLE AND SOCIAL EUROPE

More efficient insolvency regulations could increase financial markets’ resilience

By Franziska Bremus and Tatsiana Kliatskova

ABSTRACT

- Integrated capital markets could smooth a large share of country-specific consumption and income fluctuations
- Equity capital play an important role in the process
- Insolvency regulations are a key factor for stronger equity market integration
- Uniform European insolvency regulations are desirable; more efficient regulations on the national level would be an important interim step

If production falls in a certain European country—as the result of a drop in demand, for example—income and consumption will fall as well because the country cannot absorb the entire shock alone. If the effect of the shock is distributed among several countries, the impact on any one country is not as great. The example of the U.S. shows that integrated capital markets make an important contribution to cushioning production fluctuations. While regional shocks are smoothed out by around 60 percent in the U.S. (mainly in credit and capital markets), in the EU the average is only 20 to 40 percent.

An important reason for the lack of risk sharing in Europe is that European capital markets are still rather small in comparison to GDP and nationally fragmented. Investors hold a disproportionately large number of bonds from domestic issuers. Consequently, the “home bias” in many European countries is high, and national shocks can only be cushioned through international portfolio diversification to a limited extent. To create more stable financial market structures in Europe, and thereby support income and consumption smoothing, the European Capital Markets Union aims at gradually removing barriers to integration.

International equity capital investment is particularly effective at smoothing out country-specific fluctuations since it tends to be longer term than investment in debt and income fluctuations are directly absorbed between investors and capital-acquiring countries by adjusting dividend payments, for example. On the contrary, the integration of bond and credit markets can actually reinforce fluctuations. For this

reason, the integration of equity capital markets in particular should be advanced.

Alongside differences in regulations for financial services as well as tax and contract law, heterogeneous and inefficient insolvency regulations have proven to be a significant obstacle to integrating European capital markets. Varying insolvency regulations make it more difficult to assess the risk of a capital investment in a foreign country, rendering such investments less attractive. Low efficiency is reflected in low repayment rates in the case of bankruptcy and/or long repayment periods, making investment riskier.

Although the insolvency regulations in many EU states have been reformed and improved in recent years, the OECD indicators show considerable heterogeneity within the EU (Figure). While the insolvency regulations in the United Kingdom have been relatively efficient since 2010, Hungary and Estonia are the two lowest-ranking states.

An empirical analysis for the 2010 to 2016 period confirms that inefficient insolvency regulations are a significant obstacle to the integration of the stock and bond markets. In other words, countries with more efficient insolvency regulations receive higher levels of cross-border investment. Preventive measures are especially important for foreign investment. Foreign investors invest more in equity capital in countries with pre-insolvency regimes, i.e. measures that take effect before bankruptcy, early warning mechanisms for entrepreneurs, or special insolvency regulations for small and medium-sized enterprises.

Even though it will be difficult to harmonize insolvency regulations within the EU due to country-specific legal systems, quality improvements on the national level, particularly in the area of preventive measures, would be a promising step to foster the integration of the capital markets. In addition, more transparency regarding country-specific regulations should be created by making comparable information centrally available—on the hierarchy of claims in bankruptcy cases, for example. This would not only advance integration and market-based risk sharing, but also remove some bad loans from bank balance sheet and thereby pave the way for completing the Banking Union.

Excluding Poland, the efficiency of insolvency rules has improved or remained the same in all countries. It remains, however, very consistent across the board.

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JEL: E02, F21, G15
Keywords: Capital market integration, legal harmonization, institutional differences

Gender equality is one of the EU’s core values, an important political objective, and, according to the European Commission, an important driver for economic growth. The main priorities in the EU’s Strategic Engagement for Gender Equality 2016–2019 include promoting economic independence for women and men, equal pay for equal work, and gender equality in key decision-making processes.

However, gender equality has not been reached in these three areas in any EU member state. For example, the average gender pay gap in the EU is 16 percent, and the proportion of women in the highest decision-making bodies of the largest publicly traded companies was only 26 percent in 2018.

In order to promote gender equality in these bodies, the EU Commission proposed legislation in 2012 aimed at introducing a binding gender quota of 40 percent for supervisory boards of the largest publicly traded companies. The European Parliament adopted the bill by a large majority in November 2013, but it was rejected by the European Council.

In addition to the EU-wide discussion, many EU member states have been discussing introducing domestic gender quotas for decision-making bodies in the private sector. Starting in 2007, eight EU states have followed the example of a non-EU state, Norway, and introduced binding gender quotas. The first EU state to introduce a mandatory quota was Spain in 2007, followed by Belgium, France, Italy, and the Netherlands in 2011. In 2015, Germany introduced a binding gender quota of 30 percent for supervisory boards of publicly traded companies which also have employee representation on their supervisory boards. Austria and Portugal followed suit in 2017. All other EU states either have non-binding recommendations for gender quotas in their respective

2 Cf. information on the gender pay gap on the website of the European Commission.
4 Cf. the website of the European Parliament. Along with the United Kingdom, Bulgaria, the Czech Republic, Denmark, Hungary, Lithuania, Malta, the Netherlands, Sweden, and Slovenia, the German government in particular has campaigned against a binding EU-wide gender quota.
5 In 2003, Norway became the first country in the world to introduce a binding gender quota of 40 percent for the supervisory boards of state-owned and publicly traded companies.
corporate governance codes (11 countries) or no binding regulations or recommendations at all (nine countries).  

The binding quotas in force differ in terms of the percentage, the amount of time allowed to reach the quota, which types of companies the quota applies to, and, especially, in terms of the sanctions applied if the quota is not reached. For example, Spain and the Netherlands do not apply sanctions. Countries such as France and Italy, on the other hand, have relatively harsh sanctions, including fines of up to one million euros. Germany and Austria chose a more moderate policy of “empty chairs.”

A comparison of EU member states shows that countries with binding quotas have seen a significant increase in the proportion of women in the highest decision-making bodies of the largest publicly traded companies in recent years. This increase was significantly larger than in the countries without a mandatory quota, where there was little improvement over the same period. Countries which now have mandatory gender quotas had a lower proportion of women in decision-making bodies on average in the mid-2000s than the countries without a quota (eight vs. 12 percent in 2005). In 2017, the proportion of women was 28 percent in countries with a quota, nine percentage points higher than in countries without a quota (Figure). In other words, since the mid-2000s, the proportion of women in the relevant decision-making bodies has risen by 20 percentage points in countries with mandatory quotas, while in other countries it has only risen by seven percentage points.

This descriptive evidence suggests that mandatory quotas are an effective means of increasing the proportion of women on the top bodies in the private sector. As the EU stands for equality and wishes to be an international role model for gender equality, introducing a binding EU-wide quota would be the first step toward sustainably increasing the proportion of women on decision-making bodies.

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6 An extensive overview can be found in Holst and Wrohlich, "Increasing Number of Women on Supervisory Boards of Major Companies."

7 Cf. for example the website of the European Commission.

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**JEL:** D22, J16, J78, M14, M51

**Keywords:** Board diversity, gender equality, gender quota
Gender pension gaps—a problem in many European countries

By Anna Hammerschmid and Carla Rowold

ABSTRACT

• The living situation of the elderly population in Europe is gaining importance due to demographic change
• In many European countries, women receive substantially lower pensions than men; gender pension gaps among pensioners can be up to 69 percent
• When taking elderly people without a pension into account, the gender pension gap increases substantially in many countries
• Gaps could be reduced by changing pension entitlement conditions and strengthening the reconciliability of work and family life

In many European countries, women receive less pension income than men. As more and more individuals in Europe will be reaching the retirement age in the coming decades, this gender inequality is of particular relevance. Women are more likely to be affected by social exclusion and poverty in old age,1 which poses enormous problems for the member states’ social systems. This article compares and discusses the gender pension gaps in several European countries.

The analysis uses two different definitions for calculating the gender pension gap. The first definition solely includes individuals of retirement age who are receiving a pension income, thus reflecting the pension gap among pensioners. The second definition encompasses all individuals of retirement age, including those not receiving a pension income. Those without a pension income are considered to have a pension of zero; including them depicts financial inequality in old age more comprehensively.

Using the first definition, the average pension gap2 is clearly pronounced in all countries with the exception of Estonia, although the gap is smaller in Scandinavian and Eastern European countries. The gap is largest in Luxembourg, Portugal, Germany, and the Netherlands (Figure).3

When using the second definition, women in almost half of the 18 EU-countries under study receive less than 50 percent of men’s annual pension income on average. The ranking of countries also changes noticeably using this definition: the


2 The calculations are based on SHARE data. For details on the methodology and data, see Peter Haan, Anna Hammerschmid, and Carla Rössler, “Gender Gaps in Pensions and Health: Germany, France, and Denmark,” DIW Economic Bulletin no. 43 (2017) (available online), as well as The SHARE Project. Except for a few changes, the Economic Bulletin article calculated pension inequality in three countries using the first definition. Slight deviations in the results are, among other, due to the fact that the sample was limited to a maximum age of 85 and due to adjusting the handling of non-response for the relevant pension variables. In addition, in the present version, respondents with income from employment or unemployment benefits are only excluded if it was not from a side job.

3 Such patterns (partly, with the exception of Sweden and Portugal) are found in other studies as well. Cf. Francesca Bettis, Platon Titonas, and Gianni Bettis, The gender gap in pensions in the EU: Study commissioned by the European Commission (2013) (available online); Platon Titonas et al., Men, women and pensions. Study commissioned by the European Commission (2013) (available online); Eta Burkevica et al., Gender Gap in pensions in the EU. Research note to the Latvian Presidency. European Institute for Gender Equality (2013) (available online); Manuela Samčūtė Ėliškienė et al., The gender pension gap: Differences between mothers and women without children. Study for the FEMM Committee, Policy Department C: Citizen’s Rights and Constitutional Affairs (Brussels, 2016), Social Protection Committee & European Commission, “The 2018 Pension Adequacy Report.”
largest pension gaps are to be found in Luxembourg, Spain, and Portugal. The increase in the gender pension gaps when using the second definition is particularly striking in Greece (from 22 percent according to the first definition to 51 percent according to the second), Spain (from 32 to 74 percent), Italy (from 32 to 50 percent), and Belgium (from 34 to 57 percent). One explanation for this increase could be, at least in the three Southern European countries, the relatively high minimum contribution years (15 to 20 years). Combined with a low female labor market participation, this could lead to many women having no pension entitlements.

The gender pension gap also rises substantially in Slovenia, Austria, Ireland, and Portugal when using the second definition. With the exception of Ireland, these countries also have comparatively high minimum contribution years (minimum of 15 years).

The difference between women’s and men’s pension incomes in Luxembourg, Germany, and the Netherlands is especially stark, regardless of which definition is used. Although these countries have lower thresholds for pension entitlement (zero to ten years of contribution), there seem to be other important mechanisms leading to considerable gender pension inequality. Possible factors include varying degrees of gender inequalities in the labor market.

Gender-specific pension inequality is thus a serious European problem. In some countries, especially in Southern Europe, the gender pension gap could possibly be reduced by easing the conditions for receiving pension income. In addition, women’s career profiles need to be strengthened in all countries so that more and higher pension entitlements can be accumulated during working life. In particular, measures strengthening the reconciliation of work and family life for both men and women could contribute to this goal. Moreover, the general question of whether care and family work, which is mainly performed by women, is sufficiently rewarded in the current pension systems also needs to be addressed. Societal mentalities and practices must change for women to be included fairly in the different country-specific pension systems.

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4 Similar developments found in Tinios et al., Men, women and pensions.


6 Cf. OECD, Employment rate 2018 (available online; accessed March 12, 2019).


8 The findings for Luxembourg, Germany, and the Netherlands, Austria, and Ireland are qualitatively confirmed by previous studies; the results for Slovenia and Portugal differ substantially. Cf. Bettio, Tinios and Betti, The gender gap in pensions in the EU, Tinios et al., Men, women and pensions.


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JEL: J14, J16, J26

Keywords: Gender Pension Gap, Europe, SHARE
### Education platform for more cooperation among schools

By Felix Weinhardt

**ABSTRACT**

- Knowledge and education are essential prerequisites for the future well-being of Europe
- In the areas of training and continuing education, EU education policy is one of the major success stories of the European Union. There is a lot of potential to be tapped when it comes to school education
- Recommended: more school partnerships and a European education platform for connecting decision makers and schools
- The EU should provide funding for independent external evaluations of school-related measures

Without knowledge, a knowledge-based society cannot flourish. In the context of global competition, EU member states are facing similar challenges. Increasingly global economic integration, the demographic shift, new challenges, and the shorter half-life of existing knowledge—i.e., digitalization—are issues confronting all EU states. Educational policy can supply some answers to the issues that crop up.

The EU has already made much progress in the areas of training and continuing education. Setting up a “European Education Area” is one of the EU Commission’s declared goals. Erasmus, the well-known university exchange program, has been expanded to Erasmus+, including other programs. Digital Opportunity Traineeship is an internship program embedded in Erasmus+. It places computer sciences students in companies in the private economy in other EU states. The Bologna Process harmonized university degrees, the European qualification framework created comparability among different academic degrees or skills. In this context, the Common European Framework of Reference for Languages with reference levels for language proficiency is a widely recognized solution. The Youth Guarantee for it is part is a commitment by all EU member states to ensure that all young people under the age of 25 receive a good quality offer of employment, continued education, apprenticeship, or internship within four months of leaving formal education (Figure).

As part of the planned European Education Area, the area of school education appears to be marginal. Schools can apply for school partnerships and realize joint advanced education projects as part of the Erasmus+ program. Compared to the Bologna Process, for example, which had an influence on the structure of university degree programs throughout Europe, sights have been set lower for schools.

The EU member states should create solutions to common challenges in the school area, thus benefiting from the diverse experience of all the states. How should schools react to digitalization? Which training measures for teachers have proven expedient? There are plenty of mutual issues, but citizens often perceive them as national or (as in Germany) regional issues. It will be necessary to create awareness and interconnect actors in order to exchange experiences without jeopardizing the educational sovereignty of the member
states. In this way, it will be possible to avoid redundantly acquiring knowledge on a decentralized basis.

The European education platform proposed here would permit decision makers in the educational field to compare externally evaluated programs and receive support in implementing them. In addition to the effects and costs of a measure—using digital technology in the classroom, for example—the quality of the empirical evidence with regard to its effect must be assessed.

A key criterion for the process is independent external evaluation. This would ideally occur in the form of field experiments in which measures would be carried out at randomly selected schools. In this way, subsequent differences in learning could be causally attributed to the measure. In some places in Germany this is already happening. In England, the Education Endowment Foundation’s Teaching and Learning Toolkit has had positive feedback. It compares over 120 externally evaluated interventions with regard to their costs and benefits, interconnects interested schools, and provides support for implementation.¹

A platform like this, which sets up a European network of decision makers and supports schools as they master common challenges, would be a good European education initiative. In particular, the EU should provide funding for independent external evaluations of programs. Such a platform would not only leverage synergies, but also further embed education policy in the consciousness of EU citizens and lay an “early” foundation for the long-term economic viability of the EU.

¹ See the Education Endowment Foundation website.

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JEL: I21, I28

Keywords: Education, program evaluation

Figure
Youth who are neither employed nor in training or continuing education
In percent of the population in the same age group (15–24 year olds)

Source: Eurostat.

The EU’s goal is for all young people under the age of 25 to either be employed, in continuing education, or completing an apprenticeship or internship.