The politics of pension reform in western Europe

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Two objectives and three pillars for pension policy

- Objectives
  - Poverty prevention (Beveridge)
  - Income maintenance (Bismarck)

- Pillars
  - 1st: cover basic needs through universal state provision
  - 2nd occupational provision providing earnings related benefits
  - 3rd individual private provision

Social insurance and multipillar systems

- Social insurance
- Germany
- France
- Italy
- Sweden

- Multipillar
- Australia
- Denmark
- Netherlands
- Switzerland
- UK
- (US, protomultipillar)

Public pension expenditure and pension fund assets in selected countries, 1998

	Expenditure on public pensions, % GDP	Financial assets of pension funds, % GDP
Social insurance countries		
France	10.36	na
Germany	10.29	3.3
Italy	10.99	3.2
Sweden	8.27	2.7
Average	*9.97*	*3.1*
Multipillar countries		
Denmark	7.73	21.5
Netherlands	6.75	85.6
Switzerland	6.71	74.9
United Kingdom	6.46	83.7
Average	*6.91*	*66.4*

Source: OECD SOCX (CD-ROM); OECD, *Institutional Investors Statistical Yearbook,* 2000, Table S.8.

The pension problem

- European countries have developed extremely successful et generous pension systems
- Citizen-voters are extremely attached to retirement, early and on good conditions
- Population ageing makes pensions schemes increasingly costly
- Cuts in the generosity of pensions will generate opposition and may result in electoral punishment

Retrenchment (Pierson 1994, 1998)

- In an ageing democracy, it is politically impossible to retrench pensions in a transparent way
- Retrenchment can occur, but through "policy by stealth"
- Four strategies :
  - Obfuscation
  - Division
  - Side payments
  - Delay

Pierson, P. (1994) *Dismantling the Welfare State? Reagan, Thatcher, and the Politics of Retrenchment,* Cambridge University Press.
Pierson, P. (1996) The New Politics of the Welfare State. *World Politics,* 48**,** 143-179.

What alternatives to "policy by stealth"?

- People are likely to accept cuts in pensions if:
  - They will not affect them
  - They are not visible
- But also if:
  - They are perceived as inevitable
  - They are spread in a fair way

Minimizing the number of affected people through long phasing in periods

- Sometimes reform are introduced through very long phasing in periods
- These can dramatically reduce the number of voters affected by a reform
- Delay can be seen as a divisive strategy

Year of reform, full implementation date and time lag in France, Germany and Italy

	Year of reform	Full implementation	Time lag
France	1993	2004	11
France	2003	2020	17
Germany	1989	2012	23
Germany	1999	2025 ca.	26 ca.
Germany	2006	2029	24
Italy	1992	2032	40
Italy	1995	2035	40

Bonoli, G. & Palier, B. (2007) When Past Reforms Open New Opportunities. *Social Policy and Administration,* 41.

Proportion of the voting age population affected by reform, depending on phasing in period, 2001

Length of phasing in/country	France	Germany	Italy
10 years	58%	74%	55%
20 years	40%	47%	38%
30 years	21%	27%	19%
40 years	4%	10%	3%

Bonoli, G. & Palier, B. (2007) When Past Reforms Open New Opportunities. *Social Policy and Administration,* 41.

Low visibility reform

- Modifying indexation mechanisms
  - Indexation of benefits
  - Indexation of reference salary
- Changing elements of the pension formula
- Changing the system completely, so that it is extremely difficult to compare pre- and post-reform conditions on an individual level

Reducing pension entitlements in a fair way

- Intergenerational equity
- Robert Musgrave: "the relative positions of the elderly and of the working population must not change as a result of population aging. Pension levels and contribution rates must be adjusted accordingly".
- Use of "sustainability" or "equilibrium" factors

Myles, J. & Pierson, P. (2001) The Comparative Political Economy of Pension Reform. IN Pierson, P. (Ed.) *The New Politics of the Welfare State.* Oxford, Oxford University Press.

Intragenerational equity

- Italy: reductions in some “peaks of generosity”, privileges
- More redistribution (minimum pension guarantees)
- Advantages for workers with physically demanding jobs (*travaux pénibles*, *lavori usuranti*)

Cuts are perceived as inevitable

- Contested demographic and pension scheme budget projections
- Matter of defining (future) reality
- Automatic government mechanisms may help

Automatic government mechanisms in pension reform

- Indexation
- Conditional indexation (Netherlands, Switzerland)
- Demographic factors (e.g. in NDC systems)
- Adjustment /sustainability factors

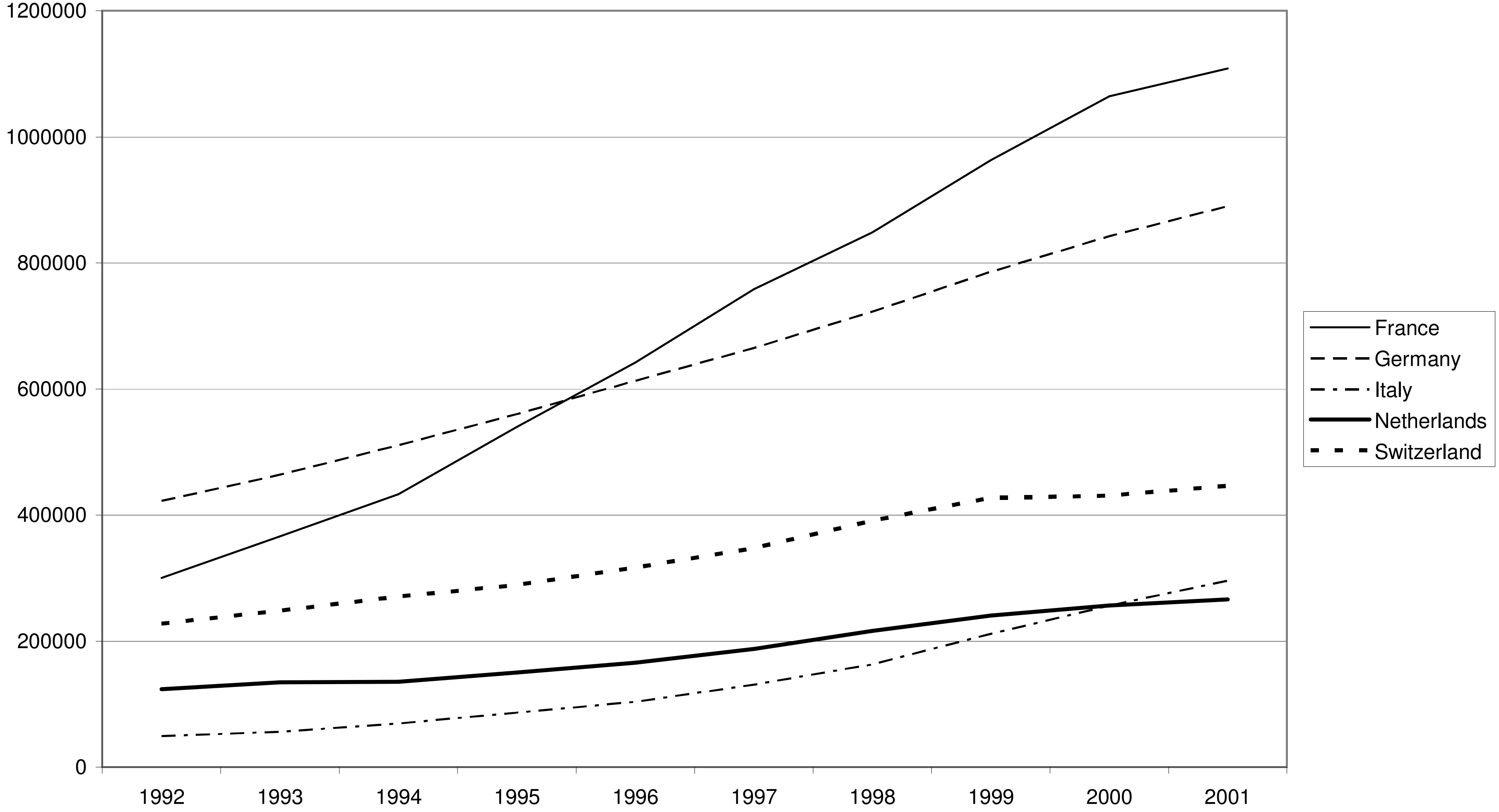
Weaver, K. (1986) *Automatic government. The politics of indexation,* Washington, D.C., Brookings.

Pension optimists among working age individuals (percentage answering the items underlined)

Year (survey)	Question	France	Germany (west)	Italy
1992 (EB37.1)	Do you think that the pensions you will receive when you retire will be… Completely adequate/Just about adequate/Somewhat inadequate/Very inadequate	44.5	70.6	52.7
1999 (EB 51.1)	In the future there will be more elderly than there are now. Do you think that people will get less pension for their contributions? Yes/No/Don't know	11.5	24.4	24.9
2001 (EB 56.1)	Do you think that the state pension you will receive when you retire will allow you to get by…With great difficulty/with difficulty/easily/very easily	24.4	23.3	13.8

Source: Eurobarometer surveys

Financial liabilities of life insurance companies, in million EUR (assets for D and CH)



What will continental European pension systems in 2030-2040 look like?

- Germany: replacement rate of social insurance pensions = 46%
- Italy: replacement rate for new pensioners = 49%
- At the same time, funded provision is expected to expand substantially
- Convergence towards a multipillar model?
- What about inequality?