Pension Reform in Europe

Politics, policies and outcomes

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1 Introduction

The political economy of pension reform

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The issues

In current accounts of pension policy, and of the welfare state more generally, there is something of an implicit consensus that emphasises path dependence and obstacles to reform. This book takes issue with such accounts. By focusing on the most recent reform experiences, it observes a trend towards some convergence between different paths and towards substantive change. It offers several approaches to explain this process.

The idea of a limited number of welfare regimes in terms of specific patterns of institutions, and of path dependence in terms of change processes that would deepen rather than flatten this specificity, has been a powerful corrective to the earlier assumption that the dynamics of capitalist modernisation would eventually make all countries converge on a single institutional model. But the new consensus has in its turn decreased our capacity to observe and make sense of what is going on today, by unduly limiting our attention for changes that do not fit the assumed paths, and our tools and concepts for giving them form.

The decades since the end of the Second World War have throughout been a period of major transformation in pension policy. Pension reform has become central to the European social policy agenda – first in terms of construction and expansion, then increasingly in terms of consolidation and retrenchment. The high levels of pension expenditures experienced in the past few years, and projected for the coming decades, have become a key concern for fiscal and labour market policy and economic growth.

Pension systems thus need to be viewed in a broader political economy framework. Their major purpose is to provide income security to retirees. In addition to such redistribution across the life course, they may also aim at redistribution across population groups, such as lifting the low-income elderly out of poverty. But beyond these goals, they are linked up with a range of other issues.

- They are typically the largest public transfer programmes, and thus the source of major fiscal pressures (and sometimes opportunities).
- They influence financial markets by creating or impeding the accumulation of funds and the rate of personal savings.

- They regulate labour markets by facilitating an ordered transition out of employment.
- They enable employers to manage their workforce by offering instruments for the shedding or replacement of workers.
- They contribute to the institutionalisation of the life course by creating a predictable sequence and timing between work and retirement.
- They provide workers with a legitimate claim to compensation for their 'lifelong' work, and thus with a stake in the moral economy of work societies.
- They produce new social and political cleavages by creating large groups of actual and potential beneficiaries.
- They structure the agenda of corporatist conflict and negotiation.
- They offer opportunities for administrative offices and jobs.
- They weigh in on election outcomes.

Through all these issues, they form a major part of the political economy of current societies.

In this introduction, we take up the issues first through an examination of the historical evolution of pension systems (and by that, of retirement as a universal new life stage), and second, through a discussion of the research literature. In the third section, we present an overview of the book's contributions, and finally come back to its overall results.

The evolution of pension systems

The origins of modern public pension policy can be traced back to the last few decades of the nineteenth century, when the first two pension schemes (which would become the two key models for pension policy-making) were set up: the (work-based earnings-related) German scheme in 1889, and the (universal flat-rate) Danish scheme in 1891. Following these examples, either universal or work-based pension systems were created over the first half of the twentieth century in all European countries. The early schemes followed different models or regime types, but they all tended to provide low benefits at rather high retirement ages. The idea of 'retirement' was just starting to be constructed and pensions were often conceived more as disability allowances than as retirement benefits as such (cf. Kohli 1987). Retirement age was around 70 years in most countries, and life expectancies were low, thus making the period of benefit receipt rather short. As a result, expenditures in pensions remained modest relative to current levels.

The big expansion of pension systems came after the Second World War. In countries where pensions were restricted to some specific occupational sectors, coverage was broadened to the entire working population. Countries with only basic income protection (flat-rate or means-tested benefits) also expanded coverage, sometimes eliminating the means-testing, sometimes including new earnings-related layers in the public scheme, or mandating occupational schemes.

Eligibility became more generous, normal retirement ages were reduced, and early retirement options were introduced in many countries (cf. Arza and Johnson 2005). In some cases, easier-to-meet eligibility rules were only applied to some occupational categories, reflecting the hazardous nature of some occupations, but also political power and influence. By and large, with the expansion of coverage and benefit generosity, pensions became a comprehensive system of income protection in old age. Their role for public policy broadened as they increasingly became a key instrument for industrial restructuring and for managing unemployment (Kohli *et al.* 1991).

Retirement as a universal new life stage thus became fully institutionalised in the second half of the twentieth century only. It was fuelled by the economic boom of the 1950s and 1960s when many countries started to provide pensions at a level of wage substitution – either through public pay-as-you-go systems or through broad occupational pensions – which allowed for a full exit from the labour force at a specific (and increasingly early) age. The long-term evolution of retirement has been striking, as can be demonstrated for Germany, which in 1889 introduced the first public pension system available for large parts of the population. Between 1881–1890 and 2002–2004, the proportion of men surviving to age 60 has increased from 33.5 to 87.8 per cent, and the average life expectancy at age 60 from 12.4 to 20.1 years. These added years are now increasingly spent in retirement: the labour force participation rate of men aged 60 or more has dropped from 67.9 per cent in 1895 to 14.4 per cent in 2004. In other words, retirement has become a life stage of its own, to be expected by the majority of the population, of considerable length and structurally set apart from gainful work (see Kohli 2000).

The long periods involved in the maturation of the new pension rules introduced after the Second World War meant that in many countries their full financial impact would not be observed immediately, but only some decades later, when the generations under these schemes started to retire. More importantly, the age structure was still that of a young and growing population, with a broad base of young and a narrow top of older ages. As a result, pension expenditures in the 1960s and 1970s were still rather low. In 1960, they amounted to 3.6 per cent of GDP in Sweden, 3.3 in Italy, 3.7 in the Netherlands, 2.6 in France, 5.9 in the Federal Republic of Germany, 1.2 in Spain and 3.1 in the UK. In 1980, they had more than doubled in most countries, reaching 9.6 per cent of GDP in Sweden, 6.9 in Italy, 11.4 in the Netherlands, 7.6 in France, 9.6 in the Federal Republic of Germany, 5.7 in Spain and 5.5 in the UK. Pension expenditures generally continued to rise over the 1980s to reach, by 1989, over 9 per cent of GDP in France, Germany and Greece, and over 11 per cent in Sweden, Italy and the Netherlands.[1] Further expenditure growth projected for the new century started to be seen as a risk for the sustainability of public finances and the competitiveness of national economies.

Over the 1950s, 1960s and early 1970s, in an environment of sustained economic growth, the impact of pensions on public finances was less of an issue than it is today. Governments allocated a significant part of their budgets to

welfare expansion, in a context where public expenditure and aggregate demand were seen as key ingredients in the economic growth strategy. But things started to change after the mid-1970s. Growth rates fell, population ageing became more pronounced, and pension systems matured. Economic ideas started to shift away from Keynesianism, towards new supply-side policies which stressed productivity, international competitiveness and stringent public finances. The high wage contributions required to finance the growing level of pension expenditures (especially with pay-as-you-go financing) did not fit these ideas. The rising level of future pension commitments was also seen as a risk. Political attention thus started to shift to pension reform: in economic as well as in political terms the key puzzle was how to make existing pension schemes financially sustainable for the future while maintaining their effectiveness.

The rhetorics of 'reform' have also been important. Most of the policy steps that currently go under this label consist of 'retrenchment', in other words, of cuts in existing welfare state programmes. More neutral terms for what is going on would be 'change' or 'transformation'. The choice of terms is clearly not innocuous. As Vivian A. Schmidt has observed, 'no major and initially unpopular welfare-state reform could succeed in the medium term if it did not also succeed in changing the underlying definition of moral appropriateness' (Schmidt 2000: 231), and changing this definition requires convincing rhetoric and discourse. We speak of 'reform' here because it has become the general terminological currency. It also has some basic arguments going for it, in the sense that the existing pension schemes face increasingly stringent financial challenges, partly through the combined demography of low fertility and increasing life expectancy, and partly through the stronger exposure of national economies to global competition. But the translation of fiscal pressures into specific institutional changes owes much to the new mainstream of economic thinking and lobbying about the need for welfare state retrenchment and the merits of privatisation.[2] This should be kept in mind when speaking of 'reform'.

Solving the financial puzzle was certainly not easy in the new demographic context. The proportion of the total population over 65 years of age, which in 1950 was at only 9.1 per cent for the EU15 average, reached 14.3 per cent in 1990, and is projected to grow up to 20 per cent in 2020 and 27.6 per cent in 2050.[3] As to expenditure projections, estimations in the 1980s were that, in a no-change scenario, pension expenditures would soar to 20.8 per cent of GDP for the EU15 average in 2050.[4] Although some doubts have lately emerged on how precise these estimations were, it is agreed that a major growth of pension expenditures was to be expected. In any case, these projections granted pension reform a privileged place on the policy agenda. Governments throughout Europe started to discuss reforms which could go from small parametric adjustments all the way to major structural change.

Since the late 1980s, many reform plans have been approved and implemented. About 25 pension reforms affecting either specific groups of the population or the entire pension system were passed in EU countries over the period 1986–1990.[5] In the following five-year period (1991–1995), this number increased to 36, and in the past few years (from 1996 to 2002), to 55.[6] Although the number of reforms is not a comprehensive indicator of the magnitude of the changes taking place, it gives some illustrative idea of the importance of the pension issue on the policy agenda. The direction of reform has been, more often than not, towards a reduction of future expenditures, and increasingly so as time went on. While just over half the reforms introduced in the 1986–1990 period tended to reduce the generosity of the system, over three-quarters of the reforms passed between 1991 and 1995 moved in that direction. This was the period of 'cost-containment' during which indexation rules were modified, access to early retirement schemes was restricted, retirement ages were raised and a number of other specific parametric adjustments were introduced with the aim to restrict eligibility and reduce future benefit levels. In the most recent period (1996–2002) reforms have continued in this direction although in many cases they have also introduced a new feature: the creation of compulsory or voluntary private individual pension accounts (encouraged through tax incentives), with the aim to at least partly compensate for the projected fall in public benefits.

Beyond bare retrenchment, one of the key strategies of reform throughout Europe has been to operate via incentives: incentives to work, incentives to save, incentives to retire later. Labour market activation has become a key feature of European social policy. Early exit from the labour force, long encouraged by consensual strategies of all labour market actors, has come to be considered one of the central problems facing pension finances. While raising the retirement age limit beyond the traditional threshold of 65 remains highly contentious, raising the labour force participation below this threshold is now a broadly consensual goal, as stated, for example, in the Lisbon and Stockholm agenda of the EU which asks member states to reach a labour force participation rate of at least 50 per cent among the population aged 55–64 by the year 2010. Institutional incentives embedded in new eligibility rules and pension formulas are aimed at pushing the retirement decision up to later years. The critical issue that has generated conflict here is to what extent this is indeed a free decision by the worker, and to what extent it is enforced by, for instance, health reasons or labour market conditions. Defined-contribution arrangements, in which the level of benefits depends on contributions made, are often advertised partly because of their expected impact on labour market participation, even though the same goals could be reached through defined-benefit arrangements with actuarially fair discounts for early retirement. The decision to introduce tax incentives for private pension schemes (e.g. in Germany, UK, Italy) has also been a political one. Incentives can be appealing for all because, in principle, there is no forced change in behaviour: those who just wish to ignore them can do so. In practice, the introduction of incentives has often been combined with some forced change, for instance, when rejecting the 'incentive' to work longer under defined-contribution formulas means receiving a lower benefit. Moreover, as tax incentives have a public budget cost which is paid by the whole population, individuals in their role as tax payers cannot really opt out of them: they continue to pay for the incentives taken by others.

These reforms have entailed a new role for the market in the provision of pensions. Privately administered funded pensions, investing workers' contributions in the financial market, were not a European invention. Already in the 1980s, Chile had established the first large-scale private system of individual pension accounts. In 1994, the influential World Bank report *Averting the old age crisis* advocated the development of these schemes as one of the pillars in the 'three-pillar model' that has been largely applied in Latin America first, and Central and Eastern Europe later on (World Bank 1994). Although the World Bank prescriptions did not have a direct impact on Western European policy-making, the idea of pension funding and savings has gained greater attention by policy-makers as a new instrument to deal with the sustainability of public pension finances. In a step by step process, European countries have started to introduce voluntary or compulsory funded schemes, which are in most cases privately administered (the exemption being Sweden) but with various degrees of public regulation – an issue of sustained contention. This has occurred as much in countries with a long history of private provision (like the UK), as in those where a public single-pillar pay-as-you-go system was dominant (like in Italy and Germany). The idea of funding has not been restricted to private sector pensions. Some countries have introduced (or developed existing) 'buffer funds', i.e. a system of asset accumulation for public pensions aimed at guaranteeing financial sustainability over the demographic transition. As a result, total pension assets have been projected to increase markedly in many countries over the period from 2004–2050: from 135 to 243 per cent of GDP in the Netherlands, from 39 to 61 per cent in Sweden, and from 52 to 73 per cent in Finland.[7] Similar rises of pension assets have been projected for the Central and Eastern European countries where the shift to funded pensions was compulsory.

The research literature

Just as pension systems and pension reform have been central to policy agendas, they have been central to the welfare literature. Since Esping-Andersen's seminal *Three worlds of welfare capitalism* (Esping-Andersen 1990), the welfare regime concept has influenced most welfare research. 'Regime theory' has been oriented to evaluate how the diversity of institutional designs across countries was affected by different political orientations (and hence, ideas and power resources of different groups), and has produced different welfare outcomes – thus creating clusters of countries with similar institutional design, similar political orientations and similar outcomes. A substantial part of the research that followed was aimed either at empirically evaluating these welfare clusters (e.g. Goodin *et al.* 1999), at generating new clusters and typologies (Castles and Mitchell 1993; Ferrera 1996, 1998), or at revising the overall methodological approach (Kasza 2002). For pension systems themselves, recent reforms have put both 'regime theory' and the earlier Bismarckian-Beveridgean classifications under greater scrutiny, and new analyses have emerged to address the most recent reform pathways and the new 'pension regimes' (Myles and Quadagno 1996; Bonoli 2003; Natali 2004b, 2005; Ebbinghaus 2006; and Arza 2006). The reforms have changed what originally was defined as models and 'regimes'. As countries with different systems have adopted similar design features, the original classifications are no longer appropriate for comparison. Chapters 6 and 7 in this book are concerned with pension models and their outcomes. But rather than aiming at an overall classification of countries in clusters, they examine the specificities of system design, and use the results to comparatively evaluate reform pathways and impacts. This takes account of the increasing complexity of pension systems (and of the combination of 'layers' and 'pillars' within each system), and gives a new dynamic to the analysis (often too frozen in regime classifications).

The concept of policy models or regimes has also been connected to the literature of institutional change, widely developed in the past decade. Implicitly, 'regime theory' underpins a static conception of welfare (see Streeck and Thelen 2005 for a critical account). If clusters are determined historically as a result of the original political orientations and institutional choices of countries, it is unlikely that they could be rapidly modified, because they are not only sustained by the country-specific welfare principles, political ideas and national identities but have created their own conditions for continuity in the form of cleavages and constituencies. The idea of institutionally constrained and path-dependent welfare reform was put forward by Paul Pierson in his original study of pension reform in Britain and the US (Pierson 1994), and pursued further in the years that followed (Pierson 2000a, 2000b, 2000c, 2004). The key argument is that long-lived welfare structures are very difficult to modify because of the social expectations they generate. In the pension policy arena, this refers to the expectations of people, but also of specific groups which may have a strong commitment to certain policies (such as trade unions in 'Bismarckian' countries). Countries thus become 'locked in' in their once-established institutional arrangements, and change can be only incremental. The path-dependence literature responded to the empirical evaluation of welfare reform attempts, especially over the 1980s and early 1990s, when the argument was convincing because the empirical evidence for it was strong. But over the late 1990s and into the new century, many countries, including some Western European ones, managed to implement broader and sometimes structural reform processes. With this new wave of structural reform, the idea of path-dependence has come under scrutiny, and questions have arisen as to the conditions for overriding existing institutional (and hence political) constraints.

The idea of institutionally constrained change and of the conditions under which reform is possible has brought in a great deal of work on the political economy of pensions, that is, the negotiated influences and games underpinning pension reform 'success' (e.g. Natali 2004a on the role of trade unions, Schludi 2005 on the political and corporatist bargains, and Brooks 2005 on the role of local and international factors in pension privatisation). This political economy approach is at the basis of the four chapters that make up the first part of this book. Natali and Rhodes (Chapter 2) show how reform is not just an act of blame-avoidance, but often as well an act of credit-claiming whereby governments try to get support from improving the deficits of the system. In 'successful'

reforms, there is often a negotiated process which brings in social partners and opposition parties. Both Natali and Rhodes (Chapter 2) and Schludi (Chapter 3) deal with the specificities of these bargaining games and political exchanges, which are indeed the conditions under which reforms can be made feasible in a context of strong institutional constraints. Overbye (Chapter 4) directly challenges the idea of path dependence, and argues that the political psychology of pension reform is important – framing and packaging reforms so that they are perceived as pursuing valuable goals may be more important than institutional degrees of freedom in explaining which reform attempts are successful and which are not. Müller (Chapter 5) studies the political economy of structural reform in Central and Eastern European countries – the major path-breaking European reformers so far – and highlights the role played by the newly dominant epistemic community: the 'new pension orthodoxy'.

Radical reform has meant, in most countries, a greater role for the private sector, and in some of them (especially in Central and Eastern Europe), a shift from unfunded (pay-as-you-go) to funded schemes. Structural change implies that the entire institutional design is being modified, but its impacts on specific outcomes are less clear. How design and outcomes are connected has probably been the most widely debated issue in academic and policy-making circles in the past decades, starting with the first advocates of pension funding and privatisation (e.g. Feldstein 1995, 1996, 1997; Feldstein and Liebman 2000, 2001; James 1996, 1997) who framed much of the debate that followed. Another set of studies has been more critical on the merits of these proposals, highlighting the 'myths' and 'truths' of pension funding and privatisation (e.g. Orszag and Stiglitz 2001; Barr 2002; Eatwell 2004; Cesaratto 2005). The recent reform processes have generated new concerns as to the distribution of risks (e.g. Schmähl 2003). Historical analyses have critically evaluated the origins and development of private pension provisions by focusing on their connections with the financial sector and on the emergence of new powerful actors in this field (Blackburn 2002 and Chapter 8 in this book). The debate has expanded with the development of new pension models going beyond the funded vs. pay-as-you-go dichotomy (such as notional defined-contribution schemes, see Cichon 1999; Disney 1999 and Holzmann and Palmer 2006), and the integration of reform experiences into a more 'balanced' World Bank approach (e.g. Holzmann and Hinz 2005; Gill *et al.* 2003). The aim has always been to answer the key policy question of which system design better serves a set of policy objectives, but while the most important objectives over the 1990s were financial sustainability, aggregate savings and private provision, poverty prevention and benefit adequacy have slowly gained greater attention. The chapters in this book show that the analysis of outcomes needs to go beyond the comparison of one broadly defined model over the other (pay-as-you-go vs. funding, private vs. public, flat vs. earnings-related), to better understand the effect of each layer of a complex system on the outcomes for different groups of the population in a particular context. Thus, Frericks and Maier (Chapter 9) evaluate the gender impact of the specific elements of welfare regimes and their interaction with the particular position of women in the labour market; and Arza (Chapter 6) shows the distributional principles, and likely distributional effects, of the new combinations of layers and pillars in current pension systems. This calls for a shift of attention, from the big comparisons between regimes and models, to detailed empirical assessments of the effects of each single element of a model, of its operation in the overall system, and in the social, economic and demographic context of each country.

As change has accelerated in welfare provision, the role of welfare ideas and attitudes towards the welfare state has also become a key issue for political and sociological welfare research. Interest for it has been motivated by the implications that ideas and attitudes can have for both the politics of pension reform (what principles, models, and institutional designs do individuals prefer and support? How important is this support for the successful implementation of reforms?), as well as for 'regime theory' (do attitudes cluster along the same lines as institutional systems? Have clusters of attitudes changed?). Recent work has assessed the change in welfare principles and ideas in the context of major reforms (e.g. Cox 1998; Plant 2003; Taylor-Gooby 2005). The extent to which attitudes differ across welfare regimes is relevant for understanding the social basis of welfare clusters, and thus the logic of welfare regimes as socially entrenched modes of welfare production. The increasing availability of population survey data has made it easier to answer some of the longstanding questions on whether attitudes towards welfare and welfare reform differ across countries, over time and/or between generations (see, for example Svallfors 1997; Svallfors and Taylor-Gooby 1999; Boeri *et al.* 2002; Gelissen 2000). The discourse of 'generational equity' has gained ground in the period of welfare retrenchment, and provided legitimacy for it (Bengtson and Achenbaum 1993; Thomson 1989; Williamson *et al.* 1999). 'Generational equity' refers to the claim that some generations have benefited more than others from the welfare state as a result of institutional and demographic change. According to a simple model of correspondence between material position and attitudes, an unequal distribution of resources and costs across generations should be reflected in different degrees of welfare support: among the young and the old. Kohli (Chapter 10 in this book) shows, however, that there is not much evidence for the existence of a generational cleavage and conflict in attitudes. The connection between welfare receipt and attitudes is more complex than often assumed.

The contributions

In the pension policy literature two approaches have been central. On the one hand, the political science literature has been mostly concerned with explaining institutional change through the interactions between existing institutions, policy-makers and relevant social actors. On the other hand, the sociological literature has examined the institutional structure of welfare states in terms of models for welfare provision (most often deriving from Esping-Andersen's characterisation of welfare 'regimes'), including the goals and ideas of policy-makers, governments and

society at large, and the outcomes of policy on specific population groups and cleavages (such as by gender, income or occupation). The two parts of the book are directed to the study of each of these two areas of welfare analysis.

The first part deals with the politics of pension reform. Responding to widespread concerns over the resilience of pension structures and the political costs involved in major reforms, the first four chapters of the book are all centred on a common theme: the political forces that make pension reform viable in different national and institutional contexts and the nature of political bargains, actors and cleavages surrounding policy change. In the light of recent reform processes, the contributors question the conception of pension systems as 'immovable objects', aiming to understand how institutional and political constraints can be and have been overcome.

David Natali and Martin Rhodes (Chapter 2) concentrate on the reform processes in veto-heavy pay-as-you-go systems. The authors analyse recent efforts in four Bismarckian welfare states – France, Germany, Italy and Spain – and demonstrate the centrality of negotiated bargains and trade-offs to neutralise opposition. When population ageing and increasing budgetary strains push pension system reform to the top of the political agenda, governments do in fact have at their disposition a number of tools to engage into what the authors call a 'political exchange' with the social partners in order to facilitate the passage of reform. This exchange involves trade-offs between 'policy goals', 'vote goals' and 'office goals' as key factors to get social partners' support. The outcome of this negotiated reform process is thus often not just bare retrenchment but a combination of measures aiming at financial sustainability with other measures oriented to meet some of the social partners' demands. Through an analysis of the bargaining processes in France, Germany, Italy and Spain, the authors show how this exchange has actually taken place in recent reforms. 'Policy goals' such as increasing financial sustainability, for instance, have been in the interest of both governments and trade unions, and have been partly addressed following union's demands via the financial separation of national solidarity from social insurance. 'Office goals' also appear as highly relevant in Natali and Rhodes's analysis, in particular, the consolidation of trade unions' managerial role in old and new pension schemes (as for instance in the new fully funded private funds in Germany and Italy). Similarly, long transition periods in all countries have contributed to meet 'vote goals' for the government by reducing the visibility of cutbacks and thus the negative electoral payoff. These negotiated trade-offs become crucial to neutralise opposition and facilitate the passage of reforms. In this process, the government may also be able to respond effectively to the claims of different actors for improvements in the distributive qualities of the pension system, the level of coverage and protection against risks. Thus, the authors stress a key element of reform which is not always taken into consideration in recent welfare analyses: pension reform need not be a game of 'blame avoidance' only but can also be used as a 'credit claiming' tool when some of the demands of influential social actors are introduced in the reform package, and some longstanding problems are dealt with in the process.

Martin Schludi (Chapter 3) takes a different approach to the conditions under which pension reform is made feasible. While Natali and Rhodes look at how governments can package reforms so as to get support and even claim political credit, Schludi focuses on the initial (political) conditions under which an agreement between the government, the opposition parties and the social partners is possible. He argues that the political feasibility of pension reforms critically depends on the government's ability to orchestrate a reform consensus either with the parliamentary opposition or with trade unions, and identifies the conditions under which such a 'pension pact' is likely to emerge. In the partisan arena, the feasibility of reform depends, as Schludi shows, on both 'policy distance' between opposition parties and the government (i.e. how large is the difference in their policy ideas and objectives) and 'positional conflict' (i.e. how big are the electoral incentives for parties outside the government to use opposition to reform as an electoral tool). In the corporatist arena, trade unions tend to prefer negotiated reform, which allows them to realise some of their claims in the reform process, and so does the government, which can increase the odds for reforms being approved and implemented by taking trade unions on board. The 'agreement point' (that is, the reform outcome from the negotiation in the corporatist arena) will depend on the specific position of trade unions and its distance from the status quo. As unilateral reforms are the exception, and successful reforms are usually concerted ones, this chapter, by analysing the conditions under which concertation can take place, helps us understand why some reforms are politically feasible in some countries and not in others, and within the same country in different periods of time.

The puzzle of how path-breaking reforms can actually occur is addressed from a different perspective again by Einar Overbye (Chapter 4). For him, it is neither bargaining games nor concertation processes that matter most but rather the political psychology of pension reform. Overbye argues that even path-breaking reforms are possible when they are framed in such a way as to gain support from the 'sensible' and 'socially caring' citizen. Successful reforms are those which manage to present themselves as directed towards social aims to which citizens find it difficult to oppose. The feasibility of reform is thus not only the outcome of political bargaining among social groups defending their well-defined interests. It is also the result of the way in which opinion leaders manage to present the reform as a 'socially desirable' good. This discursive framing introduces an element of unpredictability to the political scene, and makes it more difficult to assess in advance whether a specific pension reform will be politically viable. In addition to framing, Overbye highlights a number of institutional and contextual features which can increase the feasibility of path-breaking reform, including:

1 the breadth of coverage and the efficiency of administration;
2 the existence of a crisis;
3 the expected macroeconomic stability and interest rate levels.

Overbye argues that in Latin American countries, for instance, limited coverage and an inefficient administration have eased the way for path-breaking reforms, because reforms could be presented as a major improvement over existing systems. Administrative deficiencies in previous arrangements also tend to help radical reform, because mismanagement seems easier to deal with in defined-contribution systems, where a clear link exists between what individuals pay and receive. For the same reason, countries going through economic or fiscal crises, particularly those directly affecting pension system finances, find it easier to move out of the path, because existing systems have lost the support of their constituencies. As to macroeconomic variables, national interest rates and stable future prospects facilitate reform towards funded defined-contribution schemes because they can advertise the greater gains obtainable from private investment. Against conventional wisdom, Overbye also suggests that path-breaking reforms may, under some circumstances, be easier to pass than path-dependent ones, because in the former the definition of the winners and losers is less clear. Changing 'everything at once' may reduce the visibility of reform effects, making it easier to frame such change as socially desirable (a winner-without-loser type of outcome) than would be possible with typical path-dependent parametric reforms. While 'breaking the path' of pension policy has always been seen as a difficult avenue to take, Overbye thus argues that the opposite may be the case.

Katharina Müller (Chapter 5) takes up the political economy of pension reform in Central and Eastern Europe. She evaluates the nature of reform in transition economies, characterised by a shared context of structural change and pension financial imbalance inherited from the past. With a detailed cross-country analysis, Müller shows that in spite of this common legacy, the reform choices made in post-socialist pensions reflect considerable diversity. They include parametric changes, adoption of the new 'notional defined-contribution' system in some countries, and a shift towards funded private pension schemes in most cases. The different versions of the 'three-pillar approach' adopted across Central and Eastern Europe all share the introduction of full or partial privatisation in previously fully public schemes. Since the early 1990s, pension policy ideas started to change and a newly dominant epistemic community consolidated what has been called the 'new pension orthodoxy'. The analysis of the political context and dynamics enabling this paradigm shift provides insights into political processes that are not necessarily shared with Western Europe. International financial institutions, particularly the World Bank, have been key actors in the transmission of new ideas in old age policy. They influenced reform not only via the use of loan conditionalities, but also by offering expert-knowledge transfer and potentially attractive incentives to governments pursuing pension privatisation. Müller also highlights the policy learning and cross-border transfer of ideas occurring between Central and Eastern European countries and from Latin America. At the local level, market-oriented economists were often key agenda-setters who succeeded in communicating the reform advantages in a coherent and appealing way. Among the political actors, ministers of finance were critical

players. Ministers of labour or welfare tended to have more reservations about the three-pillar model but were less influential, which reflects the new paradigm of pension policy as an economic restructuring tool. Trade unions and governments on the left were not as clearly against pension privatisation as in many Western European countries. Some trade unions supported privatisation while left parties in some countries were also willing to support reform in order to demonstrate to the international community their commitment to market-oriented policy. The reform process became part of a 'signalling' strategy to gain the credibility of international organisations and risk-assessing firms. A final strategy was reform 'packaging'. Consistent with the argument by Natali and Rhodes, Müller shows that the reforms could be used to distribute benefits to relevant actors so as to gain their support (e.g. trade unions being allowed to run their own pension funds), while at the same time using exclusionary compensations to divide the opposition and reduce the visibility of benefit cutbacks with new advantages (such as the introduction of ownership rights for individual accounts).

The second part of the book concentrates on the nature and outcomes of pension reform experiences in Europe. In the search for a solution to the financial challenge posed by growing pension budgets, both the scope and the mechanisms for public intervention have been revised, often changing the public-private mix in pension provision as well. The chapters in this section address the nature of change in terms of models, principles, ideas and discourses, as well as in terms of their effects on poverty, income distribution and gender inequality.

Camila Arza (Chapter 6) evaluates the distributional principles of pension policy, and shows how recent reforms have modified the stratification goals that have long characterised countries and pension schemes in well-defined clusters. The chapter analyses four countries belonging to different 'worlds of welfare' as well as to different pension system models (Bismarckian/Beveridgean), which have gone through major reforms in the past two decades (Italy, Sweden, Poland and the UK). Countries which originally embraced different welfare goals and ideas have shifted towards similar distributional principles. It is thus not just pension institutions that exhibit path-breaking, but also (to a greater or lesser extent) the principles that underpin them. A shared feature across countries has been the individualisation of pension rights and benefits. This means that benefits now depend more closely on individual characteristics, in particular, individual labour market histories and income levels. While this has reduced the inequalities deriving from special regimes and sectoral privileges, it has also reduced risk-pooling in old age: most of the risks of old age financing have been transferred to the individual. Institutionally, this was done either by increasing the share of private defined-contribution schemes in pension policy, or by redesigned public provision under actuarial principles (via NDC models). The separation of poverty prevention and income replacement in two layers has also redefined the role of the state, which maintains a major role in poverty prevention (with non-contributory, means-tested benefits expanding in all countries)

but leaves more room to the private sector in income replacement. Where the state remains important in income replacement, as in Sweden and Italy, a model of distribution which mimics the distributional logic of private pensions tends to be adopted – providing individualised entitlements dependent on individual work histories, choices and risks.

Martin Rein and Karen Anderson (Chapter 7) take the reform trajectories in three smaller countries (Sweden, the Netherlands and Denmark) as test cases for some of the key ideas underpinning most recent welfare research. First, the authors discuss the assumption of path dependence: that when setting up pension schemes, countries had to choose between the two conflicting principles of either solidarity or equivalence, and that once this has been decided, countries would continue on the same path in the future as a result of the institutional constrains for radical change. In practice, in all three countries these principles have been combined in different and original ways over time, and there has been no clear lock-in effect into one or another institutional structure. With 50 years of experience, the solidarity system in these three countries has evolved towards its own negation, that is, towards privatisation, means-testing and earnings-related equivalence policies. This reframing was not the result of a single deliberate choice made at a single point in time. Rather, the new public-private mix has resulted over time from many choices and non-choices. The authors also challenge the idea of a straightforward connection between system design or 'welfare regime' and policy outcomes. Through an historical analysis of the formation and change of pension policy in the three countries, they show how similar origins and different evolutions (in terms of institutional design) have produced similar outcomes in terms of the levels of poverty and inequality, as well as in terms of the public budget allocated to pensions. This implies that what actually matters is not the basic system approach but how the specificities of the programs are designed and implemented. A well designed public-private mix may manage to produce equally egalitarian results as a public-dominated solidarity approach.

Robin Blackburn (Chapter 8) is more sceptical about the potential benefits of private pension schemes. He studies the past and present of commercial pension provision in the US and the UK, two countries with among the longest (and most significant) private pension histories in the world. Through a detailed analysis of the performance of these systems, Blackburn provides a learning experience for other countries reforming their pension arrangement in the Anglo-Saxon direction. In both the US and the UK, pension benefits for future generations will be substantially below what would be needed to maintain pensioners' relative income. This is partly due to the crumbling defined-benefit schemes, but also due to weak security markets and the high costs of private personal pensions. The author shows that employers now tend to prefer defined-contribution plans because they allow them to eliminate future risks. The fight for the maintenance of past pension promises under defined-benefit schemes puts trade unions in a difficult situation because of the impact it could have on jobs. The 'jobs vs. pension' dilemma highlights a key problem of commercial

pensions: the concentration of risk that emerges when provision depends on a single employer. The 'failure of the divided welfare state' is thus related to the limitations of private defined-benefit and defined-contribution schemes to provide secure, adequate and sustainable income protection for the entire old-age population. This failure shows up not only in aggregate measures of performance but in distributional outcomes as well: in both the US and the UK, a significant share of old-age households is expected to be below the poverty line, and yet another large share will receive benefits of less than half their previous income. Inequality is also related to the distribution of tax relief for private pensions, most of which goes to the tenth decile of the income distribution – the only one which is able to accumulate reasonable levels of pension wealth for retirement. Overall, the author has a clear message: 'the Anglo-Saxon model is not worthy of emulation'. If pension coverage is to be effective, it needs to move away from the commercial and individualised form.

Patricia Frericks and Robert Maier (Chapter 9) analyse the gender impact of pension reform. For them, reform has had mixed effects on gender equality, with on the one hand a better recognition of housework and child-caring in a system that, on the other hand, continues to be 'gendered', thus reproducing existing gender inequalities in the labour market. Welfare state arrangements define and implement social norms in an ongoing process of formulating what is normal. An example is the rules for pension benefit calculation, which presuppose a standardised biography still based on the male breadwinner model. The achievement of full pension entitlements depends on compliance with these norms, in particular with lifelong working careers. But real lives do not necessarily comply with this standardised ideal, and women are especially likely to have life courses which depart from it. The authors concentrate on four elements which affect future pension entitlements and are particularly gendered: labour market participation, caring, learning and the linkage between public and private pension schemes. Labour market participation is gendered for many reasons: lifelong working is less likely for women simply because of child birth and child rearing; women are more likely to work part-time and to have lower wages than men. Gender-neutral calculation norms actually contribute to reproducing the gender gap precisely because labour markets are gendered: if entitlements are strongly attached to work, and pension rules are the same for men and women, labour market differences will be immediately reflected in benefit levels. There are now counteracting elements within pension schemes aimed at reducing the gender gap in pension entitlements based on a gender-positive rather than gender-neutral perspective. These arrangements include care credits, parental leave and life course schemes, but their development is uneven across countries. The authors show that the reduction of gender inequalities in pension policy is not a straightforward task. Structural factors (such as labour market inequalities) as well as design features (the breadwinner model being used to define the pension norm) need to be addressed if pension policy is to be de-gendered; gender-neutral norms are not sufficient.

Martin Kohli (Chapter 10) discusses pension policy as a societal effort to

achieve generational equity. In the history of the welfare state, the key 'social question' to be solved was the pacification of class conflict. Now its place seems to have been taken over by generational conflict. The new inter-generational cleavages still need to be balanced, however, with the old intra-generational ones. This requires an examination of the concepts of age group and generation or cohort. In terms of justice theory, ageing and age group membership do not present problems; it is the discontinuity among generations which raises equity concerns. The author shows how the ideas about generational equity have been organised in public discourse, how they manifest themselves in the attitudes of the population towards the welfare state and pension reform, and how the contradictions between public discourse and popular attitudes may be explained. The discourse of generational equity – as it has developed since the mid-1980s – claims that the elderly receive an unfair amount of public resources, and that this comes at the expense of the younger population. In terms of the distribution of resources, the empirical record does not confirm this claim: while the elderly in most countries have improved their economic wellbeing over the past decades, it still remains below that of the active population. As to popular attitudes, the distributional conflict among generations is much less pronounced than is presumed (or advertised) by the proponents of generational equity. Support for public pensions is still high. There is some differentiation along the age dimension, but much less than one would expect from a purely interest-based model of political preference. The prediction (or fear) that the political agenda will increasingly be dominated by narrowly conceived old-age interests is thus not warranted. On the other hand, there is some evidence for the continued relevance of the old cleavages of class. The main explanation for this contradiction between discourse and attitudes that the author proposes lies in the generational interdependence frame. Recent research on transfers among adult family generations shows that there is a substantial downward flow of financial resources from the older to the younger generations, both as *inter vivos* transfers and as bequests. These family transfers partly depend on the availability of public pensions. Another explanatory factor is the institutional pattern of age politics.

Conclusion

Our book thus tackles some of the key issues of recent welfare reform with new perspectives and on the basis of new empirical evidence. It reviews the concept of welfare regimes, and evaluates how and in what directions the recent pension reforms have changed the clusters as they were originally defined. These broad models can no longer be taken as appropriate indicators of outcomes. Part of the problem is the application of the overall regime typology to specific welfare domains such as pensions, where clusters may need to be cut differently (e.g. based on the Bismarck-Beveridge differentiation). The other part is that even these narrower models focused on pensions are less and less close to the reality unfolding across the successive waves of reform. A more capillary small-scale analysis is necessary to show that pension systems across countries have become both more similar (by reducing benefits, tightening eligibility conditions and increasing the role of the private sector) and more different (by increasing the number of specific rules of benefit allocation and the number of pillars and layers in each system). There is convergence with respect to the original regime classifications, and divergence with respect to the new differentiations. Pension systems are moving farther and farther away from the ideal types embodied in regime classifications; most countries now have to be classified as hybrids.

This links up with the issue of institutional stability and change, which has been dominated by the ideas of path dependence and locked-in constraints to reform. The book demonstrates that these dominant ideas need revision. It highlights the political, social and economic conditions under which reforms can be feasible, the actors involved, and the policy instruments and mechanisms by which reforms are negotiated among them.

The idea of path dependence may have been applied too rigorously right from its inception. Past experience shows that pension policy – as welfare policy more generally – has usually been rather pragmatic and resourceful, incorporating features from competing basic designs if they promise to solve some of the problems at hand. Conceptual exchange among countries through mutual observation and learning has always occurred on a regular basis, and is likely to have increased through Europeanisation and the spread of benchmarking and best practice procedures. This policy pragmatism has been a key element of the adaptability and economic sustainability of the welfare state so far (Lindert 2004).

Another aspect of conceptual rigidity – and even reification – has been the assumption that institutional design features fully determine policies in line with the original design intentions. Against this (implicit or explicit) assumption, it can be shown that policies have turned existing institutional frameworks to new goals and uses, much more so than taking the institutions at face value would lead us to believe. As welfare systems mature, the problems to be solved change, not least through their own making. A case in point was the broad trend towards early exit from the labour force, shared by most Western countries in the 1980s and early 1990s (Kohli *et al.* 1991; Ebbinghaus 2006). This trend was brought about by policies using different institutional repertoires and turning them to a common goal through creative redeployment – a form of institutional 'bricolage' that often subverted the original goals that these institutions had been set up to achieve, for example, by using unemployment and disability insurance to achieve early exit from employment much before the pension system 'as such' could kick in.

The connection between institutional design and outcomes is highly complex on yet another level: that of the differential impact of various instruments on various social groups. Some reforms are likely to increase the future wellbeing of some groups but risk to decrease that of others. Impacts need to be systematically differentiated by gender and cohort, and to be projected against the likely evolution of life course patterns of employment and family structure.

A final contribution of the book is its concern with the issue of legitimacy,

fairness and justice, and with public discourse on this issue as part of the politics of pension reform. The book engages the 'generational equity' debate, and shows that there is not nearly as clear-cut a generational divide in people's attitudes and support for the welfare state as is generally assumed. It also challenges the assumption, basic to most political thinking on the welfare state, that the latter has created its own constituency and empowered it so that it now foils any attempt at reform. This assumption is based on too narrow a model of interest-based political preference and behaviour. Here is another instance of our overall message: that many of the received ideas need to be replaced by a richer and better grounded account of how institutions cluster, change, and influence outcomes.

Notes

1 Figures are based on ILO (various years), and exclude public-sector schemes.
2 This is not to say that other, more structural explanations for this translation should be ruled out. The literature on welfare state expansion provides good evidence for such explanations. Fred C. Pampel (1994) has shown that from 1959 to 1986, the effects of population ageing on public spending in OECD countries varied according to whether a country had class-based corporatism and strong leftist parties. Population ageing resulted in higher spending on pensions and the aged relative to spending on families and children only in countries (such as the US) without these features. Self-interested mobilisation by age is thus more likely in countries which do not have class-based institutions that emphasise *intra*-generational over *inter*-generational cleavages and conflicts (see Chapter 10 in this volume).
3 Figures taken from United Nations World Population Prospects database at esa.un.org/unpp/.
4 OECD (1988).
5 Excludes Luxembourg.
6 Data from Fondazione Rodolfo Debenedetti 'Social Reforms Database' (last updated in 2003).
7 Data taken from European Commission and Economic Policy Committee (2006).

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Preface

Over the past decades, pension systems have come to the fore of policy-oriented academic research. The strains on public finances produced by population ageing coupled with an eroding tax base have boosted a debate that has increasingly moved to the fundamental issues of the roles of the state and the market in welfare provision, and of public and private responsibilities. Pensions have long been a key element in national welfare systems, but their implications for these basic welfare issues have made them acquire much wider significance. The overwhelming interest in academic and policy circles on the future of pension policy has also resulted from the characteristics of pension systems themselves. Pension policies have consequences much beyond simply providing income security in retirement. They touch upon questions such as the scope for public action, its effects on economic growth and social wellbeing, and its distributional outcomes in terms of 'who gains' and 'who loses' from public policy. They are, moreover, one of the central arena where corporatist games between the state, business and labour organisations are being played. And unlike other group-specific or targeted policies, they have (or will have) direct implications for the entire population – as contributors earlier and as beneficiaries later.

This book has been conceived to provide answers to some of the fundamental questions that have arisen from recent pension reform attempts: how do welfare institutions change and what is the role of bargaining games and negotiated trade-offs in initiating and implementing these changes? Who are the actors involved and how do they interact? What are the 'new ideas' on old-age security and how have they affected policy design and outcomes? What are the distributional consequences of pension reform? What have been the successes or failures of alternative reform designs? Do recent reform processes reflect the existence of an intergenerational conflict or a fading support for the welfare state? Our conviction that these questions require an interdisciplinary and comparative answer has stimulated our search for interaction between scholars from different backgrounds. The interdisciplinary and comparative approach also allows us to fill a gap in the research literature, which has been mostly oriented to describing institutional design changes in individual countries. Our goal is more ambitious: to discern what is behind and what is ahead of these institutional

changes: in other words, how reforms were produced in the policy process and what their likely outcomes will be.

This productive exchange was initiated in the Workshop on Pension Reform in Europe, held at the European University Institute (Fiesole/Florence) on 13–14 May 2005, and jointly organised by Camila Arza, Martin Kohli and Martin Rhodes. The format of the workshop asked for comparative presentations, to be centred not on single country cases but on systematic issues of politics and policies. We aimed to bring together some of the most important academic experts working on the origins, trends and outcomes of recent pension reform in Europe, and almost all of them followed our call. In the light of the discussions at the workshop, they have in the meantime thoroughly revised their chapters, and made them speak more to each other.

Many people have contributed to make this book possible. We are indebted to the Robert Schuman Centre for Advanced Studies and the Social and Political Sciences Department of the European University Institute for generous financial support for the organisation of our first meeting. We are especially grateful to Martin Rhodes, who has first been an active co-organiser and participant of the workshop, and then has provided accurate and intelligent advice for the preparation of the structure and content of the book. Our thanks go also to Helen Wallace (until recently the Director of the Robert Schuman Center) for her support, and to the students and researchers who have participated in our discussions, thus helping all the contributors to develop and sharpen their arguments. We trust that this book will also help them and all others who endeavour to understand the social and political origins and implications of welfare reform in Europe.

C.A. and M.K.