

Pension Reform: Why and How?

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Introduction

This paper attempts to respond to two main questions concerning present problems with the pension systems in Europe: on the one hand, what are the causes of such problems, and on the other hand what is being done and, respectively, what else can be done further to find resolution to that predicament. In order to provide any form of answers, we must first define the questions both in terms of the pressures to which pension systems are subjected, and in terms of the ways in which the various welfare regimes are generally influenced by these pressures.

Subsequently, we can move on to talk about the actual and possible responses to these present and future threats. While it would be beyond the scope of this paper to offer a comprehensive list of the measures that have been or that could imaginably be undertaken to counter the said strains, we do attempt to capture the fundamental aspects of the problems encountered and the broad directions from where solutions are expected to come. Some actual examples of existing and possible measures are also presented, in connection to the generic, conceptual solutions discussed.

European Pensions: the Why's and How's of Reform

The following discussion begins by defining the reasons behind the current crisis, in relation to the welfare state in general but focusing more on particular aspects that pertain to the pension system. Having thus seen why there is a problem, we move on to discuss a series of existing and potential lines of action to alleviate it.

Inevitability of pension reform

In this section we will see how, for a number of reasons, pension reform has become an inevitable part of current discussions on social policy topics. The reasons are grouped around three categories of factors related to: globalization, the maturation of the welfare state, and demographics, all interacting with each other. We look at them as representing two basic types of pressures: external to the nation-state, and internal. It is possible, based on the existing literature, to conclude that, while each of three factors is significant in its own way, internal pressures are more poignant than external ones—meaning that globalization takes second place behind the demographic issue and the problem of maturing welfare states.

External pressures

As a phenomenon which affects all countries and all people, *globalization* has an effect on European countries' welfare systems by undermining those governments' overall autonomy. A particular case of 'artificial' globalization, if one can use such a term, is the creation of the European Union which clearly has powerful effects on states' autonomy to create and implement their own social policy (though these effects are, as yet, mostly indirect). The shift of manufacturing to territories where labour is less expensive is partially due to the high cost of social provision (including

pensions) in developed countries. Since this leads to further pressures on the welfare state due to rising unemployment, the general scenario is one of a vicious circle at the interaction of global pressures to cut manufacturing costs and local pressures to provide social security. The possible answer to this, i.e. service employment, is not a viable long-term option since services are not growth-generating to an extent so as to provide for the expanding needs of the welfare state in general.

Another possible external type of pressure, caused by the political factors working to harmonize social policy across the European Union, is not a cause in and of itself: it should rather be regarded as a consequence of internal pressures' being recognized at the European level. Following this recognition, European actors should and do feel obliged to take action and to bring resolution to the problems resulting from the interaction between an increasingly inter-dependent union and the internal pressures inherent to the existing national pension arrangements.

Internal pressures

External pressures might not represent an unbearable burden—but the situation becomes more difficult to handle if we take into account the intrinsic problems of the social security systems of mature welfare states themselves. There are two dimensions to this internally-generated problem: one, the very *maturation* of the systems themselves, and two, the *demographic* question. In brief, we are in fact looking at an interaction here: government commitments made over the past half-century have all come to maturity. That means governments must continue to deliver on promises that have become institutionalized; of interest to us is the high level of security in old age expected by voters everywhere in the developed democracies. However, these voters are very numerous, and the baby-boom generation is only now beginning to retire. By combining this phenomenon with falling fertility rates and the restructuring of households (mainly through the changing role of women, but also as an overall process of individualization), we build a more complete picture of the demographic factors at work.

Hence, less and less workers will have to provide, in the coming years, for a growing number of retirees. These workers' productivity is hampered by the shift of developed economies away from manufacturing which has higher growth potential. Other pressures within the welfare state also mount, such as the cost of health care (expectedly also caused, in part, by the growth in the proportion of older individuals).

Reform is needed but not always welcome

The need for reform of the welfare state in general and of pension systems in particular is accepted by academics and politicians alike. Even opponents of reform often agree that some changes are obviously necessary: the levels of fiscal stress caused by developed welfare states are becoming ever-harder to bear.

There are two reasons why reform is a difficult subject to approach in all of the various welfare regimes. Primarily, there is an electoral disincentive to reform. A very large proportion of the population has vested interests in the pension system. Changes to anything from the level of benefits to retirement age are not going to be welcomed by most of the population, since life and career plans are made according to them; promises of anything better than the current situation are met with scepticism, particularly when the existing state of affairs does not seem, on most individual

levels, so dire. Public perception, therefore, plays an important role and votes are cast according to that perception. Very real, financial interests must not be understated, however: the older generation has more votes, is better represented and has more to gain in the short-term from maintaining the status quo.

Secondly, the existing structures are very ‘sticky.’ Institutions, once created, do have an oft-talked about tendency to live and grow for their own sake. Clearly, welfare state and pensions-related institutions serve good purposes, but their evolution is path-dependent and subject to what is called now “institutional maladjustment”—they pursue, unchanged, policies which made sense at one time, but which now require significant adjustment: the most frequent example is retirement age itself, which instead of shifting upwards as it was supposed to do after its initial introduction (when people’s life expectancy was very near the still-current 65-year-old retirement threshold—except in France), became an institution unto itself. All this structural rigidity now means further counteraction to the very real need for reform.

No matter: changes are occurring in various forms both in Europe and beyond. Let us now look at how these changes are taking shape and what are the principal considerations with regards to the transformations required.

How to carry out pension reform

In this section we will approach, first, the broad directions where pension system recalibration can come from (again, as part of the wider recalibration process of the whole welfare state). We will subsequently look at a series of practical questions and answers that are being asked in relation to recalibration, all the while referring to relevant examples. Some out-of-textbook questions are also raised.

Directions of reform

The process of pension reform is linked to all other areas of the welfare system. We will discuss pension recalibration by pointing out its strongest links with other parts of the system. This is done as part of an analysis based on the four different perspectives of pension reform which go in parallel with the overall process of welfare reform: we label them functional, distributive, normative and political-institutional recalibration.

Functional recalibration in the case of pensions means primarily cost containment. A fairly clear example of this can be found in France (even if, arguably, the transformation has been insufficient): along with basic benefit reductions for people retiring without having contributed for a full pension, longer contribution periods have been introduced for public employees (who make up a large part of the French pension bill). Further, an incentive to work longer has also been introduced, effectively amounting to containing present and future retirement costs for those who take up this pension supplement (by working longer they contribute more, only to later receive more pension—but expectedly for a shorter time than they would have otherwise). In acting this way, the French reformers have provided fresh definitions for the social risks associated with old age and thus recalibrated the balance between various functions of the pension system. Thus, for example, clear differentiation is made in terms of retirement age between those who started working at a young age and other members of the workforce—a phenomenon that was ignored by previous arrangements (since initially the system was designed for the mass of workers who did, indeed, generally start working at a young age).

Hence, we have seen that cost containment implies doing two things: one, cutting back on expenses and two, encouraging people to work longer, thus increasing their contributions to the system, and lowering the pension bill after they retire. Clearly, however, this takes place both within the philosophical framework of the welfare state and in a context of fiery opposition to the process of recalibration exhibited by various stakeholders.

Consequently, the second principle that is at work alongside functional recalibration is one of *distributive* recalibration. This pertains primarily to redefining the system in terms of ‘justice’: public protection must be rebalanced across various social clienteles. Just equilibrium in terms of the protection offered is sought for the whole population: for insiders and outsiders of the system (i.e. for contributors and non-contributors), across various occupational groups (particularly relevant in the conservatist-corporatist type of regimes), within and between generations and among men and women.

To illustrate this clearly, we choose to exemplify by looking at Southern regime type countries: in Italy, along with very significant reductions in overall pension expenditure (i.e. cost containment measures), inequality of coverage was also addressed as part of the reform. Minimum coverage was improved, even as protection was reduced for the most looked-after social groups of state employees and a ‘core’ cluster of private-sector employees. In Greece, the extraordinarily sheltered position of some pensioners is in stark contrast with the complete lack of protection offered to most others. To correct this and other distortions that had been accumulating in the system over the years, a social dialogue was initiated which led to a series of small, incremental changes (‘mini-reforms’) culminating in the pension reform of 2002.

It is the matter of this social dialogue that we will address now, as well as the question of public awareness of both the problems of modern welfare states in general (and pension systems in particular), and of the solutions that are being introduced. *Normative* recalibration means exactly that: the change of perceptions concerning the social protection system, based on discourse using new symbols and symbolic initiatives (including discourse and value-related arguments). Their aim is to broaden the public understanding of the new functional and distributive dilemmas that result from the three factors mentioned earlier (in the section “Inevitability of pension reform”—demographics and maturing of the welfare state, globalization), based on scientific argument rather than other premises, and ultimately to smooth the way for reform by reshaping stakeholders’ preferences. By involving stakeholders (down to the individual level) in the process of norm-setting in this way, a commitment is made to their being informed as part of the process.

Interesting contrasts can be pointed out in this regard among countries belonging to different regime types: Italy—a good example of multi-dimensional recalibration from the southern regime—has seen the emergence of rich new discourse and debate over issues such as ‘intergenerational justice’ and ‘gender equality.’ On the opposite end of the scale from the normative standpoint, reform (particularly in the field of pensions) has been undertaken at a ‘stealth’ level in the UK (a line of action easier to pursue under the majoritarian Westminster model of government). To be fair, British reform in other sectors has included a hefty normative dimension (e.g. when dealing

with poverty and social exclusion issues). Also, in the case of pensions, the British system—based to a much lesser extent on public provision—need not, perhaps, be subjected to such public debate. Continental countries stand in a different place altogether: in their case, normative recalibration is difficult precisely because the dialogue and discourse bring forth extraordinary differences of interests and opinions, entrenched in a high level of institutional ‘stickiness’ and, perhaps most importantly, a coalition-based decision-making system with many different stakeholders.

It is, however, just this variety of actors involved in the decision-making process that hints to the *political-institutional* dimension of recalibration: reform is not only a question of moulding stakeholders’ preferences and interests as the normative element indicates, but also of shifting the presence and role of the various political and institutional actors involved in the process of change. Here Europe’s example is relevant as a whole, in that two things are taking place at the same time:

- On the one hand, the EU has the role of a slowly-emerging supra-national social policy authority, while
- On the other hand, at national level there is pressure to decentralize administrative power to the lowest levels (the subsidiarity principle).

EU-level efforts to reach a ‘European social policy’ in the future are motivated by the needs of citizens for coherent social protection wherever they may happen to move, live or work in the Union. The Open Method of Coordination (OMC) embodies that effort toward harmonization, also illustrating brilliantly the how process of functional, distributive and normative recalibration has a strong political-institutional component: within this European process, the involvement of political and other institutions (stakeholders) ensures the progress that has (arguably) been registered in the area of reform itself, as well as in the area of political cohesion regarding important aspects of policy. In the field of pensions, the OMC has not yet had the time to prove itself, as its application in this area is a relatively recent undertaking. The main themes set for the exercise coincide rather neatly with the overall directions for reform discussed here, as is shown in Table 1.

Dimensions of reform	OMC themes
Functional: <ul style="list-style-type: none"> • Social risks • Re-balancing social protection • Cost containment 	Financial sustainability: <ul style="list-style-type: none"> • Raising employment levels • Extending working lives • Public finances sustainability • Adequacy of private provision
Distributive: <ul style="list-style-type: none"> • Insiders/outsideers • Intergenerational justice • Intragenerational equity • Gender equality 	Adequacy: <ul style="list-style-type: none"> • Preventing social exclusion • Enabling maintenance of living standards • Promoting solidarity
Normative: <ul style="list-style-type: none"> • Symbolic initiatives (norms, values, discourse) • Anchoring debate to science • Re-shaping stakeholder preferences 	Modernisation: <ul style="list-style-type: none"> • Adaptation to flexible careers • Increasing equality among sexes • Demonstrating ability to meet challenges (political consensus, monitoring)

Table 1 Correspondence between dimensions of reform discussed here and the Open Method of Coordination's themes and objectives

The correspondence is obviously not perfect in the three cases above, with various OMC objectives being categorized under different schemes than our approach based on dimensions of reform. Certainly, however, when summing up reform dimension components and OMC themed objectives (respectively), the correspondence becomes much clearer.

The fourth dimension of reform, on a political-institutional level, is reflected in the OMC's themes and objectives rather by definition than otherwise: the transformation of political and institutional actors and their role is inherent to the OMC's very existence, and thus need not be explicitly added as a theme or objective of the method itself.

Types of questions for reform

Reform occurring across the four dimensions outlined above carries with it a series of questions that have been asked in relation to pension systems for a long time. We will list these questions as 'types' of questions that can be asked, but as we will further argue, they represent rather pointers for analysis than the subjects of firm choices made in the practice of pension recalibration.

The basic questions asked of pension systems are whether they should be:

- Public or private,
- Pay-as-you-go or funded,
- Defined benefit or defined contribution,
- Mandatory or voluntary.

In any case, no changes are occurring solely along these lines in the real world, however. Recalibration results in the blurring of these apparently-strong dualities. Concurrences are sought between these choices, so that end results often exhibit novel combinations of choices and approaches: the case of the UK is perhaps most interesting, in its broad and innovative shift of policies for the whole social protection system. Even though pensions are not central to British recalibration, the mix-and-match approach to new policy-setting can be seen for example in the creation in 1999 of a new minimum income guarantee for pensioners, higher than basic pension and not means-tested, indexed to earnings, as an alternative to basic private provision. Broadly speaking (though perhaps not most relevantly in the British case), such sophistication comes from a combination of two reasons: on the one hand, the problems are obviously complex and often require complex solutions; however, it is not a habit for political and institutional agents to provide sophisticated solutions, even when they are needed. In the case of pension recalibration, however, there is very strong resistance and scrutiny of the process—leading to policies that are farther-reaching and meet the needs and demands of more stakeholders than would otherwise be the case.

Broadly speaking, the answers provided by the reformers across Europe place pension provision on the following tracks:

- The first pillar is usually (but not necessarily) a pay-as-you-go system with defined benefits, and it is mandatory;
- The second pillar is funded, and often occupational-based;
- The third pillar is always funded, and never mandatory.

The level of refinement of the solutions implemented as opposed to the simple duality of the basic choices outlined proves a clear bias towards a scientifically-inclined approach to pension reform, rather than the use of traditional partisan rhetoric. Moreover, the fact that divergent interests can and have been brought to *some* level of compromise (despite the relatively unimpressive results achieved in some countries) reflects the virtue of the normative dimension of reform.

Conclusion and further questions

At the end of our analysis, we can conclude based on the discussion of the main elements of pension reform that in order to survive and prosper into the future, representatives of the various regime types have had to borrow from others' practices and to innovate. Indeed, as Europe's success stories show, each regime has the potential of being successful—but usually by borrowing from others and always by innovating in its social policy.

A further issue remains untouched by our analysis, though it is highly relevant nonetheless: the interaction between pension systems reform and other areas of reform. Health care springs to mind first of all, but also other domains such as labour regulation (safety and well-being at work, for instance). One example of such interaction is the yet-unanswered question of whether increased well-being at work does or does not increase worker satisfaction and whether that, in turn might not represent one solution to the problem of early retirement through policies aimed at improving well-being.

It is also possible that new insights into managing reform can be offered by disciplines such as social marketing, in the area of normative recalibration: since progress is generally made in this field only through broad consensus, it would be wise to know how to use techniques offered by marketing science to effectively influence the perception and behaviour of stakeholders according to the objectives of reform.

These and other dimensions of research can and should be addressed and decisions to pursue them or not should be made, even as we face increasing challenges to the welfare system in general and to pensions in particular.