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The Political Economy of Pension Reform in Europe

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CHAPTER CONTENTS

INTRODUCTION

Since the end of World War II, 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 the even-higher ones projected for the coming decades, have now become a key issue of concern throughout Europe. At stake are the basic options not only for the welfare state but also for fiscal and labor market policy, and, more generally, for economic growth and social cohesion.

Thus, pension systems (both public and private) need to be viewed in a broader political economy framework (see Arza & Kohli, 2008b). Their major purpose is to provide income security to retirees. In addition to such redistribution (or individual income smoothing) over 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 income goals, pensions are linked up with a range of other issues:

- They are typically the largest public transfer programs, and thus the source of major fiscal pressures (and sometimes opportunities).
- They influence financial markets by favoring or impeding the accumulation of funds and of personal savings.
- They regulate labor markets by facilitating an ordered transition out of employment.

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- They enable employers to manage their work force by offering instruments for the shedding or replacement of workers.
- They contribute to the institutionalization 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 "life-long" work, and thus with a stake in the moral economy of work societies.
- They attach citizens to a public community of solidarity, and thus play a part in nation-building.
- 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, pension systems form a major part of the political economy of current societies. In this chapter we will not be able to touch on all issues, let alone cover them adequately, but will go into some of them as we discuss the institutional changes that have come to be known under the label of "pension reform."

THE DEVELOPMENT OF PENSIONS IN EUROPE

Origin and Expansion

The origin of public pension systems is conventionally credited to Germany's creation, in 1889, of an old-age insurance program under Bismarck. It was financed by social contributions and managed by public bodies with representatives of owners and workers, and provided modest earnings-related benefits for industrial workers and their surviving families. Many of the issues that have dominated later discussions could already be observed at this historical juncture (Kohli, 1987; Ritter, 1991): the pension system's contribution to the institutionalization of the life course and to workers' integration into the new moral economy of industrial society; its part in nation-building, especially critical in Germany with its late national unification; its impact on administrative and fiscal reform; and its relevance for office-seeking.

Two years later, in 1891, Denmark established the *Alderdomsunderstøttelsen*, a basic benefit for the elderly in need, which was financed by tax revenues and managed by the local government (Abrahamson & Wehner, 2003) – an early forerunner of the type that later came to be associated with the name of Beveridge. These first two pension schemes thus represented alternative institutional approaches to old-age income protection. They would soon be emulated by other countries, giving form to the pension regimes that have characterized European welfare states ever since.

Over the first decades of the twentieth century, most European countries set up old-age pension systems under different versions of these two broadly defined models. Anglo-Saxon and Scandinavian countries created basic pensions that were originally means-tested but later became universal. This group has been labeled "the Beveridgean family," in recognition of William Beveridge's role in shaping British welfare at the end of World War II (Myles & Quadagno, 1996). Continental and Southern European countries, instead, followed the German model, consisting of work-based earnings-related pensions, and formed the "Bismarckian family" of pension policy. Central and Eastern European countries were also influenced by the Bismarckian design, developing work-related pension schemes somewhat later than Western Europe.

These early schemes tended to provide low benefits at rather high retirement ages (age 70 in Bismarck's design) to limited parts of the population. Pensions were often conceived more as disability allowances than as benefits for retirement in the sense of a new life phase. High retirement ages and low life expectancies meant that the elderly received benefits for only a short period of time, if at all. As a result, pension expenditures remained relatively modest. In 1930, social expenditures (including pensions) were still below 5% of GDP in all European countries (Pierson, 2006).

After World War II, the welfare state, in what has been called its "golden age," fueled by unprecedented economic growth and an active organized labor movement, became the basis of the class compromise of advanced capitalist societies. Pension schemes across Europe were part of a broader welfare system to cover the main social risks, including work injury, sickness, and unemployment. Pension coverage was expanded to most workers and their families. Eligibility became more generous, normal retirement ages were reduced, and early retirement options were introduced in many countries. In Italy, for instance, the retirement age was reduced to 60 for men and 55 for women in 1939 (Brugiavini, 1997), and, in 1968, even earlier retirement was made available for both public and private sector workers. In some cases, easier-to-meet eligibility rules were only applied to particular occupational categories (such as mining), reflecting the hazardous nature of these occupations, but also their 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 was recognized and institutionalized as 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 (Kohli, 1987, 2000). From then on, popular expectations of states' duties for providing and peoples' rights for receiving adequate pensions would guide the political process of pension system transformation and the collective resistance against cutbacks.

Institutional Differentiation

In the political economy of European welfare states, both the Bismarckian and Beveridgean types of pension systems were used for similar purposes, such as for the institutionalization of retirement and the management of the labor market. In many ways, however, their institutional patterns remained distinct, and there was further differentiation as the Scandinavian countries parted ways with the Anglo-Saxon ones. By 1990, pension systems seemed to be an easy fit for the three-fold typology of welfare regimes advanced by Esping-Andersen (1990): the "liberal" (Anglo-Saxon) regime with low public benefits to be topped up by occupational and private schemes; the "social-democratic" (Scandinavian) regime with high universal public benefits; and the "conservative" (Continental European) regime with public benefits aimed at preserving the status differentiation of the labor market.

In the Bismarckian family (most of Continental Europe), public pensions became more generous. Benefits were increased and often indexed to prices and/or wages, so that they offered a level of living more or less in tune with the growth of workers' incomes. This reduced the room for supplementary private schemes, so that the state remained the main provider. In Anglo-Saxon and Scandinavian countries, the expansion of pensions was first done through the transformation of previously means-tested schemes into universal flat-rate programs (Overbye, 1992). In Sweden, means-testing was removed in 1948 and the *folkpension* consolidated as a universal flat-rate benefit covering all the resident population (Olsson, 1987). Norway (1956), Finland (1957), and Denmark (1970) followed the same route. Britain also removed means-testing in 1946 in the wake of the influential Beveridge report (Beveridge, 1942), and the Basic State Pension (BSP) became a universal and flat-rate benefit for all. However, British benefits remained low in comparison to most other European countries. As benefits also depended on contribution records, many workers with incomplete working histories (who could not get a full BSP entitlement) still needed to resort to supplementary means-tested social assistance.

Another area of transformation in Scandinavian countries was the creation of new earnings-related layers set up to complement basic provision, giving these countries a partial resemblance to the Bismarckian family. For this reason, some authors have labeled them the "second generation" of social insurance systems (Hinrichs, 2001; Natali, 2008). In contrast, Anglo-Saxon countries started to diverge from the Scandinavian group in terms of the public–private mix of old-age protection, with a limited role for the state and a greater role for the market. The UK and Ireland – together with Denmark and the Netherlands – belong to what Myles and Pierson (2001) have called the "latecomer" countries, where public earnings-related pensions were introduced late or not at all. The State Earnings-Related Pension Scheme (SERPS), the first compulsory earnings-related pension in Britain, was only set up in 1975 and implemented in 1978. This late arrival made it politically weak: the SERPS was unable to resist cutbacks in the 1980s and was finally converted into the State Second Pension (S2P) in 2002.

Growing Spending

The long periods involved in the maturation of the new pension rules introduced after World War II 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 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 1950s and 1960s were still rather low (Arza & Kohli, 2008b). By 1980, however, they had grown to over 10% of GDP in Germany and Austria, and over 8% in Belgium, France, Italy, Luxembourg, and Sweden. By 2005, they had passed the 5% threshold in all countries but Ireland and Iceland, and in some cases, such as Italy, France, and Austria (all Bismarckian-type systems), they were already above 12% of GDP (OECD, 2010).

Under the favorable economic and demographic conditions of the 1950s and 1960s, pension expenditures were not yet seen as a problem for public finances. This started to change after the mid-1970s, when economic growth rates fell (sometimes into negative terrain), the demographic outlook clouded, and economic ideas shifted away from Keynesianism. For some time, the expansion of pension schemes still continued, and they were more broadly used for facilitating earlier exit from the labor force as a response to economic downturns and historical transitions such as those of Eastern Europe after 1990 (Kohli et al., 1991). But, over the 1990s, expenditure growth projections came to be generally regarded as a serious risk for the sustainability of public finances and the competitiveness of national economies. Pension reform, often meaning the reduction of benefits and public pension budgets but also the adaptation of existing schemes to changing socioeconomic and labor market contexts, acquired top priority on government agendas.

CURRENT CHALLENGES

There is broad agreement on the list of challenges that pension schemes now face, but disagreement on how these challenges should be interpreted, what impetus for reform they should provide, and, most of all, what the reforms should be (see the next section). First on the list is population aging. The increase in life expectancy (at birth as well as at later ages) has been massive, and has usually been underestimated by official population projections (Oeppen & Vaupel, 2002). This has been one of the great achievements of modern societies, but it comes at a price: of working longer, increasing pension contributions, or decreasing benefits. Barring the advent of a major natural disaster or man-made destruction (which is not something that does, nor should, inform welfare policies), life expectancy growth is likely to continue, and may even accelerate through biomedical advances (see Chapter 4). On the other side, the drop to low and very-low fertility as part of what is usually conceptualized as the Second Demographic Transition has meant that younger cohorts of workers are getting smaller. There are (tentative) arguments about a possible fertility increase in the most advanced societies (Myrskylä et al., 2009), but a return to above-reproduction fertility and thus to natural population growth seems unlikely. Some quantitative easing of population aging can come (and has come) from immigration, but for most European countries the numbers that would be required for keeping the ratio of workers to pensioners constant are clearly above what is politically feasible (United Nations Population Division, 2000).

In terms of pension costs and benefits, it is obviously not crude demography that matters but indeed the ratio of workers (as contributors or tax-payers) to pensioners. Demographic dependency ratios may thus be misleading; what counts is to what extent the "demographic potential" is really at work and how much it produces. Changes in employment rates, productivity per worker, and age of transition from work to retirement will thus modulate the effect of the underlying demographic structure.

The second key challenge is economic transnationalization (and similar macro-economic changes). This has meant, among other things, an increase in the mobility of capital and thus the bargaining power of employers, a shift from banks to financial markets as main providers of credit, and a shift from "stakeholder" to shareholder control with claims for more immediate profits. In such an open economy, the political ability of states to levy the taxes and contributions required for social security is eroding (Scharpf & Schmidt, 2000).

It should be noted that the willingness of citizens to pay taxes still varies widely among nation-states. This may have to do with cultural preferences for redistribution and economic equality. Tax and contribution levels that are accepted, e.g. in Sweden, would be deemed unacceptable in Anglo-Saxon countries and would be subverted in Mediterranean countries. The Anglo-Saxon countries follow the opposite route: They offer generous tax breaks to the finance industry and to employers as an incentive to provide private old-age pensions and health insurance, resulting in a "divided welfare state" that absorbs almost as much public revenue as the welfare arrangements of Germany and France but with less-efficient and less-egalitarian outcomes (see Blackburn, 2008; Hacker, 2002). As a result, welfare state benefit levels also vary. Welfare institutions may be conceived as filters that modify the impact of transnationalization in nation-specific or regime-specific ways (Blossfeld et al., 2006).

At the level of production, the shift has been described as one from a "Fordist" mode, characterized by standardized mass production with high-level wage bargaining and seniority, to a "Post-Fordist" mode, with flexible production and individualized work contracts. The Post-Fordist mode implies a rise of discontinuous careers with more flexibility and insecurity, and, more generally, a destandardization of life course patterns. Karl Ulrich Mayer speaks of the transition from a Fordist to a Post-Fordist life course regime that also extends into the domain of the family (Mayer, 2001). The male breadwinner model gives way to female career employment, and family models shift towards delayed and partial marriage, high divorce rates, low fertility, and, consequently, pluralized family forms. There are obviously other causal factors beyond transnationalization at play here, but the changes seem to coalesce into a consistent pattern.

For the welfare state, this implies a shift from the "old" risks of the Fordist to the "new" risks of the Post-Fordist society. Other observers see a shift from the traditional "passive" welfare state, with its emphasis on social protection from market risks, to a new productivist "workfare" state that activates its citizens by providing them with the skills and motivation for employment; in other words, by increasing their marketability (Jessop, 2002; Vis, 2007). In a broader conceptualization linking social and economic policy, this has been termed the model of the "competition state" (Vukov, 2010), emphasizing "that states are no longer concerned with maximizing citizens' welfare through redistribution, but rather with actively promoting the competitiveness of their territory," through economic policies that attract capital and facilitate enterprise and innovation, and through social policies that foster re-commodification by assuring labor market flexibility and a high supply of a skilled and motivated work force.

Pensions have a peculiar place in this concept as they are the one policy area where a productivist emphasis seems inappropriate and income protection remains paramount. Even here, however, activation is now being promoted, in terms of remaining in the work force as long as possible, of remaining productive in other fields such as volunteering or family care, and of becoming an independent entrepreneur, if not of one's work career, at least of one's investments.

The pension literature has so far not given much attention to these issues. It has until recently stressed continuity, by predicting that pensions would remain stable (or expand further) through the sheer weight of their existence and the political clout of the class of beneficiaries that they created, and that the changes that would occur would remain path-dependent; that is, restricted by the specific principles and policies institutionalized in each welfare regime. As we shall now see, these predictions have been overturned by the dynamics of pension reform.

THE DYNAMICS OF PENSION REFORM

Contrary to most theoretical expectations, reform has been deep and widespread. "Cost-containment" started in the UK in the early 1980s and rapidly expanded across Europe. Most countries changed indexation rules from wages to prices, reduced early retirement options, increased normal retirement ages, and extended the period of reference for the calculation of benefits under earnings-related systems. In virtually all cases, personal pensions were created, either by privatizing parts of the existing system, by setting new mandatory layers, or by establishing incentives (such as tax deductions) for voluntary individual savings. Most countries reformed pensions incrementally, in a step-by-step process that introduced significant innovation but maintained the main architecture of existing systems. Such parametric adjustments allowed governments to contain the projected growth in public pension expenditures for the future. In a number of cases, however, reform was more structural, reshaping the original structure of pension policy, like in Central and Eastern European countries. An illustrative overview of the changes is given in Table 18.1.

Reversing the Early Exit Trend

Early exit from the labor force, long encouraged by consensual strategies of employers and unions with the explicit or implicit collusion of the state (Kohli et al., 1991), has come to be considered one of the central problems facing pension finances. In Germany, it has been calculated to account for almost 25% of the old-age pension budget (Börsch-Supan, 2006). Early exit is also at odds with the emphasis on activation that has become a key feature of European social policy. While raising the retirement age limit beyond the traditional threshold of 65 remains highly contentious, raising the labor force participation below this threshold is now a broadly consensual goal, as stated, for example, in the Lisbon (1999) and Stockholm (2000) agendas of the EU.

The EU has no mandate for pension reform (or any other social policy), but has ventured into this area indirectly through addressing the competitiveness of European economies. Increasing the employment rate of older workers became a centerpiece in the employment strategy agreed upon by the Lisbon summit, to be implemented through the "Open Method of Coordination," a soft policy instrument based on common goal-setting and regular progress reports. The goal set in 2000 for the year 2010, to be achieved by all member states, was an employment rate of at least 50% among the population aged 55–64. To some observers this seemed an overly ambitious goal at the time, given that several countries showed a rate of less than 30% (while Denmark was slightly, and Sweden – in line with countries such as the US, Japan, and Switzerland – already largely above this mark). But, as Table 18.2 shows, by 2008 another six out of the fifteen EU member states of 1997 had reached the goal, some among them (such as the Netherlands, Finland, and Germany) with very substantial increases that amounted to a policy reversal.

On the other hand, half of the population aged 55–64 in employment seems like a modest goal, with a long way still to go towards activation. The critical issue that has generated conflict here is to what extent employment at this age is a free decision by the worker, and to what extent it is constrained by labor market conditions or health reasons. To the extent that elderly workers have become unfit for work or unable to find employment, a rising retirement age in pension schemes backed up by actuarially fair deductions for earlier exit will entail for them a drop in pension income beyond their own choice (also see Chapter 14).

Expanding Private Pension Provision

One other key area of reform has been the reconfiguration of the public–private mix in pension provision. Privatization was either direct or indirect and incremental through "layering" or "conversion" (Natali, 2008; Streeck & Thelen, 2005). The market portion of the pension mix expanded both in countries where it

Table 18.1 Typical reform trajectories in Europe (c. 1990–2010).

REFORM TYPE	TYPICAL REFORM TRAJECTORIES
Parametric reform	• Raising retirement ages (most countries, recently Czech Republic, Denmark, Germany, Greece, Hungary, Italy, Switzerland) • Increasing contribution years for entitlement (most countries, recently Czech Republic, France for public sector) • Eliminating or restricting early retirement options (most countries, recently Belgium, Denmark, Greece, Ireland for civil servants, Poland, France for public sector) • Introducing incentives for later retirement (Italy, France, UK, among others) • Changing indexation rules from wages to prices (most countries, recently Hungary, France for public sector) • Extending the working period for the calculation of benefits to the entire working life (most countries, recently Finland) • Adjusting benefits to changes in life expectancy (Germany, Finland, Portugal) • Adjusting eligibility conditions to changes in life expectancy (France, Denmark) Reducing transformation coefficients in NDC pensions, leading to pension cuts (Italy)
Structural reform	• Reconfiguration of the public PAYG pension scheme into a NDC system (Italy, Sweden, Latvia, Poland) • Shifting towards a mixed system with mandatory private individual accounts (Bulgaria, Croatia, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic)
Improving minimum protection, adequacy, and coverage	• Improving or extending coverage in the basic poverty-prevention pillar (Finland, Sweden, Italy, UK) • Increasing minimum benefits (Belgium, France, Spain) • Lowering earnings thresholds to cover low-income and part-time workers (Switzerland)
Multi-pillarization through "layering" and "conversion"	• Converting companies' severance pay into pension plans (Italy) • Adding new mandatory layers for individual savings (Denmark, Sweden, UK automatic enrolment to national pension savings scheme) • Encouraging voluntary individual pension savings and/or occupational pensions with tax incentives (France, Germany, Hungary, Poland, Portugal, among others) • Introducing minimum employer contributions to occupational pensions (Norway) Converting DB occupational pensions into DC (Sweden, UK, among others)

Source: Authors' elaboration based on OECD (2009) and national legislation.

had been virtually absent (most Bismarckian regimes) and in countries where it had already played a significant role (the Netherlands and Anglo-Saxon, and Scandinavian countries).

The most radical shift occurred in some Central-Eastern European and ex-Soviet Union countries, where public pension schemes were partly privatized following the "mixed" model already implemented in a number of Latin American countries (Müller, 2004). This model is the combination of a public "pay as you go" (PAYG) pillar that is sometimes means-tested and a second pillar of mandatory individual accounts, of varying size and importance. Contributions to the private pillar ranged from 10% in Latvia to 9% in Poland and Slovakia, 8% in Hungary, and between 2% and 5% in Bulgaria, Croatia, Estonia, and Lithuania, indicating that its size has indeed varied greatly across countries.

A growing role for private pensions can also be found in Western Europe, both in the mandatory and voluntary systems. In the Italian case, traditionally characterized as a public pension monopoly, economic incentives were introduced to enhance the development of a private pension layer that could partly compensate for the projected fall in public pension benefits. Projections suggest that public benefits at retirement for dependent workers will fall from 79% of previous wages in 2004 to 64% in 2050, while the self-employed are expected to suffer still greater losses (European Commission, 2006). In 1992, the "Amato reform" (named after the then Prime Minister Giuliano Amato) created occupational ("closed") and personal ("open") pension funds financed through voluntary tax-deductible contributions (Ferrera & Jessoula, 2007), and in 2005 the contribution previously oriented to finance a severance pay started to be automatically directed to a supplementary pension pillar. Between 2006 and 2008, affiliation increased by 67%, reaching over two million workers in

Table 18.2 Employment rates of older workers (ages 55–64), 1997–2008 (percentages).

COUNTRY	1997	2001	2008
EU15	36.4	38.8	47.4
Denmark	51.7	58.0	57.0
Finland	35.6	45.7	56.5
Sweden	62.6	66.7	70.1
Ireland	40.4	46.8	53.6
United Kingdom	48.3	52.2	58.0
Austria	28.3	28.9	41.0
Belgium	22.1	25.1	34.5
Germany	38.1	37.9	53.8
France	29.0	31.9	38.2
Luxembourg	23.9	25.6	34.1
The Netherlands	32.0	39.6	53.0
Greece	41.0	38.2	42.8
Italy	27.9	28.0	34.4
Portugal	48.5	50.2	50.8
Spain	34.1	39.2	45.6

Source: European Commission (2010).

occupational pension funds, and by 81% in personal funds, reaching about 800 000 workers. By the end of 2008, private pension funds had accumulated assets of over 61 billion euros, or 3.9% of GDP (COVIP, 2009).

The expansion of private pensions has reached other countries in the Bismarckian family as well. In Germany, the "Riester reform" (named after the then Minister of Labor and Social Affairs) in 2002 boosted the development of private pensions, with the number of Riester contracts reaching over 11 million by March 2008 (Germany, 2008). Still, much of the small print of the Riester reform remained contentious, with the banks and insurers lobbying for fewer constraints in the regulation of the Riester funds in order to increase returns and thus attract more participants. In France, another typically single-pillar public system, voluntary salary-saving schemes with tax incentives were first established in 1997. The Raffarin government later created and developed new savings plans with wide-ranging impacts (Mandin & Palier, 2005). By December 2009, a funded occupational pension scheme financed through voluntary contributions by workers and employers (PERCO) had accumulated assets for 3 billion euro. Private pension development was also significant in Belgium, where about 45% of the employed population was covered in 2005 (European Commission, 2006).

In Sweden and Denmark, new mandatory funded layers were created on top of the existing public pension schemes as well as on top of the occupational schemes emerging from collective bargaining agreements. In the Anglo-Saxon countries, where the state has traditionally had a more limited role for social security, private pensions have always been important. In Ireland no public earnings-related pension exists, and in the United Kingdom the public earnings-related pension scheme (SERPS), finally implemented in 1978, had been designed in such a way as to avoid "crowding out" existing private provision. Changes after the 1980s further limited the state's role in income replacement and reinforced the development of the private pension market and the multi-pillar structure of British pension policy.

Towards Multi-Pillar Systems

Expanding private provision has reoriented pension arrangements in the direction of the multi-pillar model (Bonoli, 2003). This pension architecture is characterized by a number of pillars and layers that complement each other to meet different objectives in social security (from poverty prevention to income smoothing, insurance, and savings). Each pillar can be organized under a different mechanism of financing, administration, and benefit calculation. In general, the state keeps the functions of poverty-prevention and interpersonal redistribution, while income-smoothing over the life course is partly left to the private sector under mandatory or voluntary schemes with benefits linked to past earnings or contributions. Significant design variation exists among countries. In some cases, collective agreements promote non-statutory occupational pensions with wide coverage. Additional savings are often promoted through tax-deductible voluntary contributions to individual pension accounts in a third pillar.

In previously single-pillar schemes, like most Continental European ones, the development of occupational and private pensions has added new pillars. This has changed the structure of provision to a more complex interaction between state, occupational, and private pensions, similar to the one already found in some "latecomer" countries, most notably the United Kingdom, where repeated reforms modifying and adding new layers and pillars have constructed what is probably the most complex pension system in Europe.

From Defined Benefits to Defined Contributions

This reconfiguration has also usually included a shift from DB to DC systems, which have been promoted through the spread of notional defined contribution (NDC) schemes at the national level in countries such as Italy, Sweden, Latvia, and Poland (Holzmann & Palmer, 2006), as well as through the expansion of occupational pensions (typically DC) (Schulz & Borowski, 2006). NDC schemes are actuarially fair systems that do not accumulate funds (thus avoiding transition costs and risks of mismanagement and investment) but give only "notional" credits instead, as in Bismarckian PAYG schemes. To the extent that the latter offer benefits that are fully linked to the individual's contribution history and age of retirement and moreover comprise a link to the changing demographic conditions (as is the case for the German system after the reform of 2004), they in effect mimic an NDC system (Börsch-Supan, 2006). Some see NDC systems as representing the current wave of reforms. Moreover, they may turn out to be the point of convergence of the still-diverse systems of today.

In occupational pensions as well, DC systems have tended to replace existing DB arrangements (as has been the case in the US). In the UK, employers were allowed to convert their DB plans into DC in 1986, and many did in the years that followed. In the mid 1990s, over 60% of "contracted out" workers had joined a private DC pension. In Sweden, almost simultaneously to the reforms in the statutory pension system, non-statutory occupational pensions were also modified following nationwide agreements between employers and trade unions. In 1998, the pension scheme for blue-collar workers started to move from DB to DC models (Palmer & Wadensjö, 2004), the scheme for local government personnel followed in 2000, and that for state workers in 2002. Although some schemes kept DB entitlements, the change has been significant.

Under both private and occupational DC and national NDC systems, the value of pensions depends on the amount of contributions paid as well as on life expectancy. A stronger link between contributions and benefits makes individual work histories matter more for future benefit levels (Arza, 2008). Periods outside the labor market, in unemployment or atypical work with no protection, will reduce benefits unless the scheme includes a special credit for them (as is the case, e.g., for childcare in Germany). Recent projections suggest that, by 2046, female workers who dedicate three years to childcare will have their net replacement rates cut by four percentage points in Latvia, Hungary, and the Netherlands, while workers who spend three years in unemployment will suffer cuts of six points in Slovakia and Finland, five points in Italy, and four points in Germany, Latvia, and Poland (European Commission, 2009). All these countries have recently adopted or reinforced DC systems either in public or private pension layers, or in both.

DC systems resemble savings schemes in that benefits closely reflect the distribution of income and work patterns prevailing over the course of one's working life. In a Post-Fordist world with more flexible labor markets, atypical employment, and non-traditional family structures, pension schemes that tighten the link between working lives and benefit levels can generate new gaps in old-age income protection.

Different Regimes, Similar Reform Trajectories?

The idea of "welfare regime" stresses that the various dimensions of welfare arrangements occur as packages where the parts depend on and complement each other, and that cross-country differences in these packages align themselves into a limited number of types or "families of nations" (Castles, 1993; Esping-Andersen, 1990; Ferrera, 1996). Regimes reflect the allocation of welfare roles among the state, the family, and the market, and the underlying principles that have guided policy choices. Once established, welfare regimes are thought to restrict the range of further choices in path-dependent ways. A similar idea has been offered by the Varieties of Capitalism approach, which focuses on the different ways in which capitalist economies are coordinated

(Hall & Soskice, 2001), and has been fruitfully applied to the articulation between pensions and the labor market (Ebbinghaus, 2006).

The wide-ranging reforms of the past two decades have put this idea to the test. If similar socioeconomic and demographic challenges are affecting European countries, do the pre-existing institutional structures specific to each regime orient pension reforms in diverging directions, thus deepening regime differentiation? Whether and how institutional structures influence the feasibility of alternative reform options has become a key concern in the analysis of the political economy of reform (for example, Myles & Pierson, 2001; Natali, 2008). Or, in contrast, do reform processes follow similar trajectories and thus wipe out the differences across regimes? Such convergence could take several forms: regimes may adopt some features of each other, they may all move towards one of the regimes (the most likely candidate being the Anglo-Saxon one, with its minimal public pillar and high share of funded private pensions), or they may follow the same new trajectory (such as towards NDC schemes).

The question can be framed in terms of the relative importance of the "push" of common reform objectives and the "pull" from institutions. In recent practice, there has been a bit of both: reforms have substantially modified the welfare architecture of previous systems but differences among states persist. Similar instruments and strategies were adopted in the service of similar goals across countries but policy-making encountered less resistance if it built on existing systems rather than radically transforming them. A common trajectory towards a multi-pillar architecture and an expansion of private DC pensions can be observed. There are no "pure" cases anymore; all of them have become hybrids. However, shared challenges and similar reform strategies have interacted with institutional structures and political processes, which vary across countries. As a result, there are still significant differences that tend to follow the conventional regime boundaries. To what extent this will remain so will depend on the sheer weight of the common challenges as well as on mutual policy learning and the evolution of a common policy framework in the EU.

THE POLITICS OF PENSION REFORM

Pensions as "Immovable Objects"

As mentioned above, the successful expansion of welfare states has created conditions that militate for their own continuity. Existing institutions are resistant to change, both in terms of general inertia and of the specific welfare regimes (path dependency). In the literature of the 1990s, European pension systems were widely thought of as "immovable objects" (Pierson, 1998), as part of the "frozen landscapes" of welfare regimes (Esping-Andersen, 1996). This way of thinking had good reasons going for it. Welfare states had created their own constituencies; they had turned the citizenry or large parts of it into their "stakeholders," who would oppose dismantling or changing them. These interest-group networks produced lock-in effects that reinforced the status quo.

The empirical evidence on welfare state attitudes and preferences supports this view (Kohli, 2006). Many surveys have shown and still show that pensions are hugely popular – in fact the most popular part of the welfare state. This may reflect a perception that there is no moral hazard involved. Pensions and the life in retirement that they make possible are considered a well-deserved right; the elderly have been seen as unquestionably "worthy" benefit recipients. A large majority of respondents across all age groups and countries usually opt for maintaining or expanding pension benefits, even if the latter option is framed in such a way that respondents are made aware of the need to raise taxes or contributions for it. Raising the retirement age is almost unanimously opposed. In other words, European countries have developed a very successful and popular social security system to which citizens have become attached. Some generations saw these welfare rights expand over the course of their lives and participated in the political processes promoting this transformation. Social security has thus influenced the economic choices of workers and their families and their expectations on benefit rights from the state, the employers, and the market.

The early literature on the expansion of old-age security offered the demographic growth of the elderly population as a key explanation for this expansion: growing elderly populations create both a need for welfare spending and a political constituency to fight for it (Wilensky, 1975). This "gray power" thesis is still widely advocated today. In a formal model for Germany, Sinn and Uebelmesser (2002) have projected the median age of voters and the "indifference age" as the age of the cohort that is affected neither positively nor negatively by a pension reform. The assumption is that reform will be feasible if, and only if, the median voter favors it. The authors conclude that, until 2016, a reform can be democratically enforced because a majority of the voters will still be below the indifference age. Year 2016 is "Germany's last chance"; after that year, it will be a gerontocracy.

The reality of the two past decades has largely falsified the gray power thesis, however. Pension reforms involving cutbacks have broadly occurred, in spite of the growing number of elderly voters. The gray power thesis is also not a satisfactory explanation of the variation among welfare states with respect to their age orientation (Lynch, 2006). The failure of the gray power thesis is partly due to its erroneously mechanical model of voting preferences. Elderly voters do not only vote in their own narrow self-interest (Goerres, 2009). They are also interested in the well-being of their descendants and are net contributors in the intergenerational exchange with them (Kohli, 1999).

But while the gray power thesis is not borne out by the evidence, the broader popular dislike of all forms of pension retrenchment is amply documented. The argument that pensions are difficult, if not impossible, to scale back politically remains reasonable. How, therefore, have the large-scale pension reforms of the past decades been achieved? On this question there is a range of possible explanations, put forward to explain policy change in other domains as well (Streeck & Thelen, 2005). Many explanations focus on the dynamics of political institutions (Immergut & Anderson, 2007). There are also attempts at identifying the social-structural changes that underpin the making of new political coalitions in a post-industrial or post-Fordist context (Häusermann, 2009). Other explanations emphasize the political strategies and the ideas that facilitate retrenchment.

Political Strategies to Pass Unpopular Reforms

The shift from welfare state expansion to retrenchment has been coupled with a shift from the politics of "credit claiming" to those of "blame avoidance" (Pierson, 1994, 2001). It is hard to convince the voters that a government should get credit for cutting back welfare schemes. (The Schroeder government in Germany tried it but failed resoundingly because it was unable to frame the cutbacks as inevitable.) Attempts are made instead to avoid the blame, share it with the opposition, or redirect it altogether (the EU is often a handy scapegoat for this). In the politics of blame avoidance that characterize unpopular reforms, governments adopt strategies to minimize political costs and electoral punishment. People are more likely to accept pension cuts if they are not really visible or if they do not affect them directly. The first of these options leads to "obfuscation" strategies (Pierson, 1994) consisting of making reform outcomes too difficult to understand for a non-expert. Such strategies are typical of structural reforms, helped by the fact that even experts may lose sight of the key factors, as evidenced by the wide currency of myths in the evaluation and comparison of pension policy options (Barr, 2002). One way to obfuscate is to change the entire system at once so that it becomes difficult to compare pre- and post-reform conditions and identify winners and losers. Thus, paradoxically, path-breaking reforms may meet with less political resistance than incremental (parametric) reforms, whose outcomes can more easily be calculated (Overbye, 2008).

The second option is to use long phasing-in periods for reforms to be implemented. This can reduce the opposition of workers close to retirement who are typically more concerned with pension issues and therefore more active defenders of their rights. It can also have a divisive effect on potential opponents as not everyone is affected in the same way. In Western Europe the phasing-in periods set by recent reforms have been particularly long. The full implementation of the French reform of 2003, for instance, will only take place in 2020; in Germany, the 1999 reform will be fully implemented around 2025, and the 2006 reform in 2029; the Italian structural reform, legislated in 1995, will be fully effective in 2035 (Bonoli & Palier 2007; and the recent rise in retirement ages in the UK, legislated in 2007, will be implemented between 2024 and 2046. Long phasing-in periods are also necessary to give individuals and families the time to adapt their life plans and choices to the new institutional context. However, they are not without costs. They obviously delay the onset of the budgetary easing that they are aimed at. Moreover, they may raise doubts among the population on the likelihood that costly reforms will be effectively implemented in the future, so that adaptation is stifled. They also pass the political costs of really applying controversial legislation on to the following governments, who may be tempted to renege on them. And finally, they may lag behind the evolution of the structural challenges they are supposed to respond to; e.g. if life expectancy increases more quickly than the phased-in increase in retirement age.

Another way is to divide potential opponents by introducing cutbacks or reducing generosity for one occupational group and not for others. Obviously, losers may also be acknowledged and compensated in other domains. Instead of direct cutbacks, a further key strategy of reform throughout Europe has been to operate via incentives: incentives to work, incentives to save, and incentives to retire later (Arza & Kohli, 2008a). Incentives are politically easier to apply than compulsion because, in principle, people can choose whether to take them or not. In practice (but less visible), reform via incentives has often included some indirect compulsion, such as when rejecting the "incentive" to work longer means receiving lower benefits, or when those who decide not to take an incentive cannot opt out of paying the fiscal costs for financing the incentives taken by others (e.g. tax deductions for private savings).

The Power of Ideas

Reforms are more likely to be accepted if they appear as "inevitable." This has been part of the "crisis" discourse that has spread across Europe, contributing to building the idea that cutbacks were necessary and unavoidable (Cox, 2001). Accounting for the power of ideas, and of the "epistemic communities" of experts that coin and carry them, has recently made a comeback in policy analysis (e.g. Béland, 2005; Taylor-Gooby, 2005). 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), and changing this definition requires the implementation of convincing ideas. As another example, reforms involving a stronger link between contributions and benefits may be more appealing than bare retrenchment because they have a claim on equity and fairness. In a process of retrenchment that necessarily entails a distribution of losses, an effective political strategy is to make these losses derive from widely shared principles of fairness, such as "to each what each has contributed." Thus, NDC or similar schemes may be more legitimate and easier to package in a discursive framework appealing to shared values and norms than other parametric reforms such as direct cuts on replacement rates or retirement-age increases.

Schmidt's (2008) concept of "discursive institutionalism" provides an approach to these issues. Overbye (2008), in a similar vein, speaks of attempts at "winning the defining-the-situation game" through appropriate framing. The international diffusion of policy models may also partly be attributed to the diffusion of guiding ideas. A key question here is whether diffusion reflects voluntary "policy learning" through convincingly superior ideas, or rather the power of those that propagate the ideas (Simmons et al., 2007). International actors such as the World Bank and the OECD fall into this second category (Orenstein, 2008); their power, while limited in Western Europe, has been considerable in Eastern Europe, where it was coupled with economic incentives and sanctions (Vukov, 2010).

This applies not least to the rhetoric of "reform" itself. Existing institutions can lose their legitimacy if they are successfully framed as obsolete and in need of reform or "modernization." A number of governments have been persuaded over the last decade to abolish PAYG pension schemes because they allegedly would be more vulnerable to demographic changes than funded schemes. This idea has been sponsored by many powerful actors and has gained wide currency even though, as Barr (2002), among others, has shown, it is economically mistaken. Both funding and PAYG are ways of organizing claims on future output, so they are both adversely affected by a fall in output. Among the ten "myths" that Barr aims to dispel, the myth that "funding resolves adverse demographics" is his number one. It remains to be seen whether such efforts at myth debunking will succeed in reversing the flow of ideas.

Many of the policy steps that currently go under the label of "reform" consist of retrenchment; in other words, of reducing entitlements or exposing them to market risk. More neutral terms for what is going on would be "change" or "transformation." The choice of terms is clearly not innocuous. Using the term "reform" for pension cutbacks or privatization is a specific way of framing. We follow this usage here because it has become the standard terminological currency. It also has some basic arguments going for it, in the sense that existing pension schemes need to be improved in order to live up to the challenges they face. But the translation of these challenges into specific institutional reform schemes owes much to the framing efforts of actors such as the World Bank and the OECD and, more generally, of the epistemic community of economics and finance with its basic conviction that markets perform better than governments. This should be kept in mind when speaking of "reform."

THE FUTURE OF PENSIONS

Contrary to widely held expectations about the political immobility of pension systems, they have been changed and scaled back considerably over the past two decades throughout Europe. Consequently, they have been made better equipped to deal with the challenges of demography and economic openness, with expenditure growth prospects having been contained. Whether this will be enough to keep pension costs within the limits that societies consider tolerable is an open question. Uncertainties loom large; the upward trends in longevity may overstretch the capacities for reform. Retirement ages have been raised in spite of broad opposition, but usually with long phasing-in periods. Many countries still lag behind, e.g. with retirement ages that are clearly unsustainable. This poses difficult issues of European-wide convergence and coordination. One recent example is the Greek financial crisis of 2010. Greek workers staged massive public protests against raising the retirement age to help solve public budget problems, while German workers opposed the idea that they should work longer in order to make Germany able to support the Greek budget so that Greek workers could retire earlier. On the other hand, the reforms already implemented in many countries have decreased future benefit levels to a point where adequate income protection for all pensioners will not be given any more. Pensions may still cost too much and achieve too little.

Pensions and Financial Market Risks

The 2007–2010 international financial crisis has shattered the belief that the risks of private pensions are fully under control. In OECD countries, pension funds lost an average of 23% of fund value in 2008. The impact on benefit entitlements across countries varies with the particular combination of pillars and layers that each country has. Workers in countries that rely heavily on private or occupational DC systems, where each individual saves for retirement in a personal pension account and the value of the benefit depends in large part on investment performance, have suffered most. The worst affected have been workers close to retirement, who will have no time to compensate current losses with better performance in the future. The crisis may also affect public pensions indirectly, through its impacts on employment and economic growth, two factors that are critical for resources and benefit levels; but here the losses are likely to be much smaller. As a result of these recent experiences, the crisis may also reduce the appeal of private pension reform ideas and discourse, and thus have an effect on future reform trajectories.

Falling Entitlements and New Life Course Risks

The thrust of most reforms has been to decrease future pension entitlements. Mean replacement rates of public schemes are projected to decrease considerably. This may increase again the risk of old-age poverty, which had been successfully tackled with the development of pensions over the second half of the twentieth century. Moreover, flexible labor markets and changing family patterns create new social risks that pose new challenges for pension policy. Obsolete skills and atypical jobs increase the risk of unemployment, forced early exit, and low wages, while having to care for children or frail relatives (a non-remunerated work usually performed by women) leads to interrupted labor market participation and part-time employment. Extended periods of education and training delay the entry into the labor market, and young cohorts of workers in some countries find it increasingly difficult to get a career job, shifting instead from one temporary low-wage job to another for some time. These new social risks negatively affect the capacities of workers to build adequate pension entitlements. As pension reforms have strengthened the link between contribution history and benefits, the impact of working careers on future entitlements has become more salient. Future pensions will need to be adjusted to a context in which the life-long protected worker of the Fordist period is no longer predominant, which may lead to gaps in contributions and be another factor that increases the likelihood of old-age poverty.

Pensions in the Political Economy

The key theme of all this is that pensions cannot be addressed in isolation. They are embedded in the broader political economy and in the broader set of public policies. If pensions become part of a social policy shift towards what is variously called the "activation," "workfare," "investment," or "competition state," this needs to be backed up with appropriate policies that facilitate remaining active and competitive; e.g. policies that address the labor market for the elderly, the access to life-long (public or company-provided) education and retraining, and health prevention. In other words, the issues of income protection in old age cannot be solved by pension policy alone. The challenges for aging societies are not only about the elderly, but about the earlier life phases as well. The experience of the past decades seems to show that people can be persuaded to accept welfare cuts if they perceive the burden-sharing as fair. This implies political recognition of the full patterns of intergenerational exchange and of the whole life course.

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