The Politics of Pension Reform

Institutions and Policy Change in Western Europe

Giuliano Bonoli
University of Fribourg

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Introduction

The 1990s have been a decade of big changes for welfare states. The adaptation process which in the United States and in Britain started in the 1980s has become part of policy-making also in continental European countries. The main objective of reform is to restore the compatibility of social policies with the changing economic and demographic contexts. In most cases, this objective is pursued by retrenching existing social programmes. Welfare retrenchment, thus, is not any longer an Anglo-Saxon idiosyncrasy. Countries such as Sweden, France and Germany, in which social policies are widely praised and contribute to the structure of national identities, have all curtailed their welfare states in the last few years.

In both waves of retrenchment, pension schemes have been a privileged target of governments' attempts to reduce spending on welfare. Pensions generally constitute the largest single item of social expenditure, so that successful cost containment in this area of policy is particularly beneficial to governments' budgets. In addition, pensions are directly exposed to the twin pressures of economic and demographic change. Economic changes, like globalisation, are reducing governments' ability to generate revenues. On the other hand, population ageing is resulting in increased pension expenditure. This is a powerful incentive for governments to take action. It explains why pension reform has been high on the agenda in most advanced industrial countries over the last decade.

In general, however, continental European welfare states are proving to be less vulnerable to cuts than their Anglo-Saxon counterparts. One way to explain this is with reference to their higher degree of middle-class integration. The United States, and to a lesser extent Britain, were retrenching residual welfare states. In the United States, the losers of welfare reforms had little potential for political mobilisation, and were de facto unable to influence policy-making. In Britain, although the inclusiveness of welfare arrangements before the Thatcher decade was significantly stronger, a political system which concentrates power in the Cabinet helped to neutralise the effects of external opposition to cuts in welfare programmes.

Welfare retrenchment in continental Europe seems to be different. The higher levels of coverage and generosity of social programmes there make social policies meaningful to larger sections of the population, including politically influential middle-income voters. Either through informal mobilisation or threats of electoral punishment, pro-welfare interest groups have managed to maintain strong pressure on governments, and to moderate their retrenchment initiatives. In addition, few political systems in western Europe offer the same level of power concentration of the Westminster model. Instead, most of them provide veto points, which can be used by external groups to prevent the adoption of unwanted legislation. This is perhaps most clearly the case in Switzerland.

This book, in fact, originated from a comparison of welfare retrenchment in Britain and in Switzerland. In the early 1990s, Switzerland went through its worst economic downturn since 1945, and the neo-liberal ideas that had inspired the Thatcher reforms of the 1980s gradually gained ground among Swiss elites. Employers, the powerful banks and the political right wing were increasingly arguing in favour of a more radical approach in economic and social policy, based on lower social expenditure, a more flexible labour market, lower taxes and so forth. The conditions were ripe for a shift in public policy like the one experienced by Britain in the 1980s. Nevertheless, Swiss policy-makers had to operate in a substantively different political system with different political institutions.

In Switzerland, policy decisions are generally the result of compromises that are indirectly supported by some 80 per cent of the electorate. As political scientists have pointed out, this is not due to a particular listening attitude of Swiss policy-makers. Rather, it is the Swiss constitutional structure which makes provision for power-sharing and offers veto points, such as referendums, to unsatisfied minorities. The result is that Swiss governments have tended to incorporate potential dissent, in order to reduce the risk of being unable to get legislation accepted. For this reason, the legislative process in Switzerland is among the most lengthy in Europe, and innovative policies are rather unlikely. Typically, viable compromises can be achieved only via incremental change.

As policy-makers started embarking on a rethinking of the welfare state, it became clear that Swiss political institutions were going to constitute a formidable obstacle to the neo-liberal ambitions of economic and political elites. The sort of reforms they were advocating were unlikely to generate the level of consensus that is usually needed to legislate in that country. Reforms were likely to be unpopular with large sections of the electorate, and were thus at a high risk of defeat in referendums. A 'Thatcherite revolution' was probably impossible in the Swiss institutional context, but could policy change be achieved at all?

To try to answer this question was the initial stimulus for this study, which, in general, is more concerned with the impact of constitutional structures and political institutions on the process of welfare state adaptation. I chose to concentrate on the particular area of pensions because that is where such institutional effects are more likely to be visible. In most industrial countries, public pension schemes are widely supported by the population and have an impact on the lives of large sections of the electorate. As a result, pension reforms are likely to generate strong opposition. Those who oppose reform will tend to exploit institutional veto points where available. Arguably, this will make the institutional obstacle to retrenchment more visible. For it is not institutions *per se* that impede retrenchment. They can provide an opportunity to influence policy, but there needs to be a social group prepared to take up this opportunity; otherwise the potential impact of institutions on policy remains unnoticed.

Since the UK and Switzerland are two rather extreme versions of majoritarian and consensus democracy respectively, I decided to include in the analysis a third country, France. This is a country that is generally ranked close to Britain with regard to its government's ability to impose policy change. However, in the area of pension policy, the involvement of the trade unions in the management of social security and the strong level of public support enjoyed by the welfare state have contributed to reduce the extent of governmental control over policy-making. In addition, a division within the executive in the 1993–5 period further diminished the level of power concentration. The result was that, in that period, the French government was forced to accept compromises to a more substantial extent than is normally the case.

This book also aims to explain why given paths to pension reform are adopted in some countries but not in others. It argues that the political limits to welfare retrenchment are country-specific and that, as far as pensions are concerned, they depend on the interaction between political institutions and the design of pension schemes. The former provide opportunities to affect policy, the latter structure patterns of interests in relation to pension policy. Political institutions can generate veto points and opportunities to influence policy-making for external interests. Pension scheme design, in turn, affects the perception of actor's self-interests, and may or may not create opportunities for politically feasible reforms. The way in which these two institutional effects interact is likely to have a powerful influence on the direction of reform.

The first conclusion of this study is that governments committed to reform pensions, and operating in political systems which offer substantial veto points, are likely to pursue their retrenchment initiatives in combination with concessions targeted on key potential opponents, and that such

strategies can work. In Switzerland, the inclusion of measures which had been demanded by the left and by the labour movement in a pension reform package managed to strengthen its electoral appeal. The reform was eventually accepted in a referendum. In France, a government weakened by a division within the executive and worried about an upcoming presidential election managed in 1993 to obtain the acquiescence of the most radical sections of the labour movement by including some carefully designed *quid pro quos*, which responded to long-standing demands of the trade unions.

The significance of this finding relates to the initial questions from which this study grew, i.e. whether fragmented political systems, such as Switzerland's, had the capacity to adopt politically difficult reforms in the areas of pension and social policy. In the case studies reviewed here, fragmented political systems did manage to secure the adoption of unpopular cuts in pensions, when these were combined with *quid pro quos* for key external actors. This suggests that welfare state adaptation is politically feasible in systems characterised by numerous veto points, but will be less unilateral and will tend to include retrenchment as well as improvements in provision.

This is not to claim that a focus on political institutions alone can produce predictions with regard to policy outcomes. By looking at these rules we can get a hint of how the positions of the various actors will be aggregated, but we can say little on the final outcome unless we know what each actor wants. Actors' preferences in pension policy, however, are structured to some extent by the institutional design of the relevant programme, so that a combined focus on political and pension institutions can improve the predictive capacity of this model.

This brings me to the second finding of this study, which refers to the existence of a common pattern of *quid pro quos* in pension reforms adopted in countries which have pension schemes of Bismarckian inspiration. In France, but also in Germany and in Italy, the recent pension reforms and the proposals for future policy change have tended to combine cuts in the generosity of the schemes with a restoration of the original character of pension policy. In particular, the non-contributory elements which were integrated in these schemes to achieve general social policy aims are being removed and taken on (including financially) by governments. In all three countries the separation of non-contributory and insurance-based benefits is a key demand of the trade unions, which typically regard social security as an insurance plan covering the entire working population, as opposed to an area of state policy. The inclusion of such measures in reform packages that are mainly concerned with reducing expenditure can secure trade union support, or at least acquiescence.

These institutional effects are likely to become more important in future, as the main political cleavage in social policy-making seems to be shifting from the left–right axis to an opposition between governments, to a large extent regardless of their political orientation, and a pro-welfare coalition of interest groups, which is often led by the labour movement. This has long been the case in France where the Socialist governments of the 1980s clashed with the unions on a number of occasions. As new left-of-centre governments have been voted into power in Europe, this shift in the dominant cleavage in the politics of social policy has become more evident. In Germany, Italy and, to a lesser extent, Britain, the left-of-centre governments of the late 1990s are committed to continue reforming their welfare states, and the main confrontation is between themselves and the labour movement. Economic conditions allow very narrow room for manoeuvre and as a result the left, even when in power, has little choice but to adopt retrenchment policies in the area of welfare.

If, as I argue, the main cleavage in social policy reform is shifting from the left–right axis to an opposition between governments and a pro-welfare coalition, then the institutional explanation of policy outcomes will acquire additional relevance and possibly replace the 'politics matter' thesis as one of the key approaches to social policy analysis. The degree of influence that pro-welfare interest groups have on policy depends to a large extent on the opportunities provided by the political institutions. Absence of veto points means that governments will be able to go much further in the restructuring of their welfare state. In contrast, political systems that offer veto points will find it more difficult to adapt their welfare states and pension systems to a changing economic and demographic environment. As a result, they will need to develop more sophisticated strategies to secure the adaptation of their welfare arrangements.

More generally, this book argues that, despite the emphasis in current research on public policy on institutional resistance to change, governments in different political systems have been able to devise specific strategies which managed to bring about substantial policy change. Carefully designed reform packages stand a good chance of being adopted even in fragmented political systems, but then lead to qualitatively different adaptation processes. Veto points can be neutralised by integrating potential opponents in policy-making, or by targeting some key concessions on them. After all, the landscape of social policy in Europe is perhaps not as frozen as it might seem. The new problems that have emerged in the 1990s have demanded a quick response, which most governments were unable to deliver. However, as learning processes begin to produce results, we might see an acceleration in the restructuring of the European welfare states.

The book begins by looking at the socio-economic pressures on pension schemes, in particular those related to demographic change. It provides a picture of the factual background against which current pension policy-making takes place (ch. 1). Next the focus moves to theory. The questions and the hypotheses which have been briefly presented in this introduction are spelt out in a more detailed manner, and they are related to some of the most influential views on social policy-making (ch. 2). There I put forward a model for the analysis of pension reform which focuses on political institutions as an independent variable of pension policy. Chapters 3 to 5 are accounts of the political processes that led to the adoption of pension reforms in Britain, Switzerland and France. As far as possible, I have tried to follow a similar structure in the presentation of the case studies. First, I look at the institutional and political context in which reforms have been adopted; second, I provide a description of the country's pension system; third, I concentrate on the pension policy-making process; and, finally, I focus on the link between what has been observed and the theoretical framework presented in chapter 2. Finally, chapter 6 highlights the key elements that emerge from the comparison of the case studies, and links them to the theoretical discussion of chapter 2.

1 Dimensions of the pension problem: institutions, economics and politics

The long-term sustainability of current pension arrangements is one of the major issues with which advanced industrial societies will have to deal over the next few decades. The projected increase in the size of the older population, combined with a reduction in the number of workers, constitutes a significant challenge to the viability of existing pension systems, which, according to many commentators, need to be substantially reformed. While these general views are widely accepted, there is little agreement as to what the actual size of the pension problem is now and will be in future. Those who have analysed the phenomenon have reached conclusions that range from apocalyptic scenarios in which, if nothing is done, the elderly will appropriate increasing large shares of national income with massive detrimental consequences for the welfare of younger generations (World Bank 1994a; Thurow 1996), to less pessimistic ones, in which the occurrence of an increase in pension expenditure is accepted as a likely development, but it is felt that this will not constitute a major economic problem (Johnson and Falkingham 1992; European Commission 1995).

The evidence reviewed in this chapter suggests that gloomy predictions of a 'demographic time bomb' have little credibility. However, it seems clear that, when the baby-boomers born after World War II reach retirement age, pension expenditure will increase quite dramatically over a relatively short period of time. Most likely, this will result in a financing problem.

What is more, concern for pension scheme finances has been heightened by recent economic and political developments. First, the ongoing process of economic internationalisation is putting pressure on governments to reduce, or not to increase, rates of taxation. To do otherwise would put the competitiveness of their national economies at risk, with potentially serious consequences for their countries' prosperity (Gough 1996; Rhodes 1996). Second, countries willing to participate in EMU need to respect a number of economic criteria. In particular, a government budget deficit higher than 3 per cent of GDP is not considered as

acceptable. As a result, countries committed to joining and remaining in the European single currency (such as France, Germany or Italy) have been forced to take steps to reduce public expenditure. Pensions, generally the largest single item of social expenditure, are an obvious target for saving measures. These elements, combined with the threat of a substantial change in the demographic structure of the population, constitute a powerful pressure on governments to take action. In this study, the term 'pension problem' refers precisely to this series of pressures on pension policy.

This chapter discusses some of the aspects that contribute to defining the pension problem. Above all, it aims to establish what are the conditions in which the pension problem emerges and in which debates on the future of pensions take place, or, in other words, the factual background against which political actors operate. In this respect, it constitutes the basis on which to build an analysis of the politics of pension reform.

First, it provides an overview of provision for retirement in industrial countries. It looks at the differences between pension systems and at their origins. Starting points can be important for the course of reform, because, as is increasingly being recognised, they tend to channel developments and debates in some given directions. Second, it focuses on the socio-economic pressures that are likely to affect pension policy over the next few years. The discussion covers demographic and expenditure projections as well as the variation in the living standards of the retired population. This review of empirical evidence concludes that there are real pressures on governments to take action in the area of pension policy, in order to continue providing income security in old age. Third, the chapter looks at the main options for reform available to policy-makers. These are analysed mainly in relation to their economic effects, although it is clear that they have different implications in so far as politics is concerned. That is why the chapter concludes by making the case for an analysis of the politics of pension reform. Pension systems are highly sensitive distributional mechanisms. They transfer huge sums of money across generations, time, occupational groups, income groups, genders and so forth. Their distributional equilibrium reflects the power relationship between the different political actors who designed them. The result is that, once a settlement is reached, departures from it are likely to be extremely delicate exercises. In particular, when the objective of reform is to achieve savings, policy change is likely to create winners and losers. That is why pension policy in general and especially the recent pension reforms have been characterised by an impressive level of political controversy.

1.1 The institutional level: an overview of pension systems

As in other areas of social policy, there are substantial cross-country variations in pension systems,[1] even if the analysis is restricted to a fairly homogeneous geo-political area, like western Europe. Similarity exists in the sense that virtually all countries have legislated old age pension programmes. Beyond that, it becomes more difficult to find consistency between different pension systems (Palme 1990: 147).

Several attempts to make sense of these variations have been made, some of which are reviewed below. In particular, researchers have tried to identify ideal-types of pension provision, which can be found in a more or less pure form in a number of countries. To a large extent, this exercise overlaps with the more general effort aimed at classifying welfare states, as pensions typically constitute the largest social programme and are often seen as the backbone of a welfare state.

The classification of welfare states in recent years has tended to revolve around three types, or regimes (Esping-Andersen 1990), or four depending on whether or not one considers southern European welfare states to constitute a distinctive category. This approach focuses mainly on the outcomes of social programmes, in terms of decommodification[2] and social stratification. A socialist or social democratic regime is found in Nordic countries. In this model, welfare arrangements (including pensions) cover the whole population and perform a fair amount of vertical redistribution, and access to benefits is less dependent on labour market participation than is the case in other countries. A second model, referred to as corporatist or conservative, is found in continental European countries. The key social programmes cover the working population only and grant earnings-related benefits which guarantee the maintenance of status differentials at times of inactivity. Those who do not participate in the labour market have to rely on often stigmatising social assistance schemes. Finally, a liberal regime is found in English-speaking countries. Its most distinctive characteristic is the preference for programmes targeted on the poorest sections of the population. It reinforces social divisions because

[1] Throughout this study the notion of 'pension system' is used to designate the totality of transfers to the older population which are either compulsory, provided by the state or encouraged by legislation (e.g. through tax concessions). This excludes other sources of income for the elderly such as earnings, private savings, social assistance and intra-family transfers. A pension scheme, by contrast, is understood here as a single arrangement which has the aim of providing income to older people. In virtually all industrial countries pension systems consist of various pension schemes.

[2] Decommodification is defined as 'the degree to which individuals or families can uphold a socially acceptable standard of living independently of market participation' (Esping-Andersen 1990: 37).

the affluent have no stake in these programmes. In addition, since benefits are often very low, it does not constitute an alternative to individual provision. The existence of a fourth regime of southern European welfare states has been postulated (Leibfried 1992; Ferrera 1996b). Its key features are a highly fragmented income maintenance system with a strong emphasis on old age pensions, the persistence of clientelism and a stronger reliance on the family as an alternative to labour market participation.

While works aiming at classifying welfare states like Esping-Andersen's have tended to focus on outcomes, studies dealing only with old age pensions have typically concentrated on the institutional design of the various systems and on their evolution in a historical perspective. Reference is often made to two distinct models of pension provision which were introduced at the end of the nineteenth century in Germany, Denmark and New Zealand. In 1889, Germany instituted a pension scheme for industrial workers. The scheme was meant to guarantee retirees a level of income related to their earnings while in work. Denmark (1891) and New Zealand (1898), in contrast, introduced means-tested pension schemes targeted on the poor (Myles and Quadagno 1997; Overbye 1996a).

These two models of pension policy had two very different underlying objectives. In the German case, the scheme introduced by Bismarck was part of a political project aimed at containing the rise of the labour movement. The adoption of a pension scheme, as well as of other social programmes introduced more or less simultaneously, was meant to buy the allegiance of the rapidly emerging working class. As a matter of fact, Bismarckian social legislation was accompanied by laws which banned the political organisation of workers (Alber 1986: 5; Baldwin 1990: 59–65). Understandably, the schemes were confined to industrial workers, as other groups did not constitute a threat to social stability, and Bismarck had no immediate interest in improving their conditions. The Danish scheme, in contrast, did not have such an overt political aim. Its introduction constituted mainly a modernisation of the existing system of poor laws. Its objective was to alleviate poverty across the whole population (Baldwin 1990: 65–76). Given their different goals, the two original approaches to pension policy used different means as well. The German scheme was financed by contributions shared equally by employers and employees (with a state subsidy); it granted earnings-related benefits; and entitlement to a pension was based on having paid contributions. Its overall result was status maintenance in retirement. In Denmark, by contrast, the 1891 pension scheme was tax-financed and means-tested, and granted flat-rate benefits. As such, it continued in an ameliorated form the tradition of poor relief enshrined in the previous system of poor laws.

In subsequent years, other countries followed the example set by

Table 1.1 *Original model of pension policy in selected countries (first compulsory or comprehensive nation-wide scheme)*

Social insurance (Bismarck)	Poverty prevention (Beveridge)
Germany 1889*	Denmark 1891
Italy 1919*	New Zealand 1898
France 1932*	UK 1908
United States 1936	Sweden 1913
Switzerland 1948	Norway 1936

Note: * for industrial employees only
Source: Adapted from Overbye 1996a.

Germany and Denmark. In general, the German lead was followed in continental Europe. In France this came as a result of the re-annexation of Alsace and Lorraine after World War I. As these two regions had been part of Germany before the war, they already had a compulsory system of social insurance. This was extended to the rest of France in 1930 (Saint Jours 1982: 95). In Italy a compulsory pension scheme, covering industrial employees only, was introduced in 1919 (Artoni and Zanardi 1997). Switzerland was a latecomer, as a compulsory pension scheme at the federal level was introduced only in 1948 (see ch. 4). In contrast, the Danish (and New Zealand) model was followed in other Nordic countries (Salminen 1993), though with some variations, and in other English-speaking countries (such as the UK in 1908), with the notable exception of the United States, which in 1936 introduced an earnings-related scheme closer to the Bismarckian tradition (Overbye 1996a). Table 1.1 shows the initial choices in the area of pension provision in a number of countries.

These two initial models of pension provision can also be seen as ideal-types in the analysis of past and current developments in pension policy. In fact the distinction between the two is often used to classify pension schemes and systems. In the literature, different terms are found in relation to these two models; however, perhaps somewhat anachronistically,[3]

[3] In fact, as the above discussion shows, the schemes that are commonly referred to as 'Beveridgean' were introduced well before the publication of the Beveridge report of 1942. In addition, in its predominant use in comparative social policy, the word 'Beveridgean' refers to tax-financed schemes, which is in contrast with Beveridge's preference for contribution financing (Silburn 1995: 92–3). This peculiar understanding of the term 'Beveridgean' in comparative social policy probably developed because of the focus on the overall objective of Beveridgean social policy – poverty prevention – rather than on the instruments he suggested using (see also Bonoli 1997a).

the two traditions can be conveniently labelled with reference to Bismarck and Beveridge, two key figures in the development of modern welfare states who had very different motives for their actions. The Beveridge plan, in fact, set out to achieve 'freedom from want' and as such it was consistent with the objectives of the Danish and New Zealand social reformers. As seen above, Bismarck was worried more about social stability in the context of rapid industrialisation and the rise of the labour movement.

Like all classifications, the one presented here is a crude simplification of the real world. In fact, other authors have suggested more complex ways of categorising pension schemes. Some (Ferrera 1993b; Overbye 1996b) further distinguish between (Bismarckian) insurance programmes which cover the whole population of a country (Switzerland, United States) and those in which different groups are covered by different arrangements (Germany, France, Italy). Niemelä and Salminen (1995) have put forward a four-type classification, which uses the basis of entitlement to discriminate between pension schemes (instead of the objective). The result is a categorisation in which pension schemes are grouped according to whether entitlement depends on citizenship, social condition (need), employment or private contract. The approach is not too dissimilar from the one reviewed above, the main difference being the distinction between means-tested and universal schemes and the introduction of private schemes.

While most countries initiated pension policy by adopting one or the other model discussed above, the overall trend in subsequent years, but in particular after World War II, has been towards a convergence in pension provision (Chassard and Quintin 1992; Overbye 1996a). In general, the first step taken in either of the two 'worlds' was to expand provision so as to cover larger shares of the population. In Bismarckian countries, this was done by progressively including other occupationally defined groups into the existing social insurance system. In 1911 Germany introduced a new scheme for white-collar employees, and one for farmers in 1957. In France, the *régime général*, which was meant to cater for the whole population, was set up in 1946 (see ch. 5). In Italy additional compulsory schemes for farmers, non-industrial employees and the self-employed were created throughout the 1950s and 1960s. In addition, with the notable exception of Germany, countries which initially followed the Bismarckian lead, such as France, Italy, Switzerland and the United States, introduced income-tested pensions, either within the insurance system or as additional schemes to provide for those who did not have a sufficient contribution record to afford them an adequate pension.

A similar trend towards enlargement in pension coverage can be

observed in countries that started with means-tested pensions, which were expanded into universal schemes. In most countries this occurred after World War II. In the Nordic countries expansion took the form of a citizenship pension (Salminen 1993), while in the UK the same goal was achieved through a contributory scheme, which, because it grants flat-rate benefits that are below the social assistance level, remains closer to the Beveridgean ideal-type than to the Bismarckian one. Because universal flat-rate benefits were rather low, especially for those on relatively high incomes, the post-war period saw a rise in occupational provision in these countries. In some countries, like Sweden and the UK, supplementary earnings-related coverage was made compulsory for employees.

In most countries, the result of convergence has been a two-tiered pension system, in which a basic pension aims at guaranteeing a subsistence level to the whole population, while the second tier allows retirees to maintain a living standard close to the one they had while working (Chassard and Quintin 1992; Overbye 1996b). The notion of convergence seems accurate to describe developments in the functions fulfilled by pension systems. The guarantee of a minimum income combined with a partial replacement of earnings is a common feature to almost all pension systems. The exceptions are Germany, which does not guarantee a minimum pension, and Denmark which does not include a compulsory earnings-related element in its pension system.

Convergence, thus, has occurred mainly with regard to the functions of pension policy (poverty prevention and income maintenance). However, when analysis shifts from the functions to the details of the various components of pension systems, the variation that can be observed across industrialised countries is still impressive. Important differences exist with regard to benefit formulas, source of financing (taxation or contributions), financing method (funded or pay-as-you-go) and in the roles played by private and occupational provision. In general, the initial choice in terms of the Bismarck or the Beveridge model still affects the current shape of a pension system.

The institutional features of pension systems are important, as they can affect both the extent of the pension problem and the likely path to reform. Depending on the rules that govern pension provision, the impact of population ageing on pension expenditure can be magnified or reduced. These rules, moreover, are likely to affect the economic adequacy and the political appeal of the various possible measures that can be used to contain pension expenditure. In this respect, pension scheme design constitutes an important independent variable of pension policy.

1.2 The economic debate: ageing, pension financing and pensioners' welfare

Debates on the present and future of pension policy usually make reference to three different socio-economic developments which are likely to affect the financial viability of pension schemes. First, demographic ageing, or the increase of the proportion of older people in the total population, constitutes an ever present background to any discussion on pension policy and pension reform. According to currently available projections, in industrial countries, particularly in Europe, the population age structure is expected to change dramatically over the next fifty years as a result of a decline in birth rates, an increase in life expectancy and a reduction in the scale of migration, with possible consequences on the financial viability of pension schemes. Second, pension schemes' receipts and outlays depend on a number of developments in the sphere of production. In particular, increases in productivity and increases in labour market participation rates can have a substantial impact on the financing side of pension schemes, and possibly offset the negative effects of demographic change. These developments, which cannot be predicted with any accuracy, are nonetheless crucial in any discussion on the viability of pension schemes. Third, particularly in English-speaking countries, there is growing concern with regard to notions of intergenerational equity. It is assumed that the older population today constitutes a relatively affluent group in society. As population ageing will increase this group's financial requirements, it is considered fair that the elderly contribute to solve this problem, possibly by accepting reductions in pension expenditure and in their living standards (Longman 1987; Thurow 1996; for a critical discussion, see Quadagno 1989 and Walker 1994).

These demographic and economic variables constitute the overall background against which debates on the future of pensions and policy changes take place. They are the starting point of virtually any discussion on pension policy. Possibly because they are characterised by a significant degree of uncertainty, they can also be instruments in the hands of political actors aiming at redefining existing distributional equilibria in the area of old age pensions. In this respect it is important, prior to any discussion on the politics of pension reform, to establish what the reality of these variables is. On the basis of studies carried out by international agencies, this section will try to provide a picture of the socio-economic component in the pension debate.

Table 1.2 *Population over sixty-five as a percentage of total population in selected countries*

	1995	2000	2010	2020	2030	2035
France	14.5	15.5	16.3	20.2	23.3	24.3
Germany	15.2	16.2	20.2	22.5	28.1	30.6
Sweden	17.5	16.5	18.4	20.4	23.1	23.8
Switzerland	15.1	15.8	19.1	23.3	27.5	28.8
UK	15.8	15.9	17.0	19.7	23.0	24.6
USA	12.6	12.5	13.6	17.5	21.8	22.8

Source: World Bank 1994b.

Demographic change

There is relatively widespread agreement among demographers about the fact that the proportion of older people in western societies is going to increase over the next decades. This is the result of recent trends in fertility rates, which have been declining since the 1960s, and in life expectancy, which has constantly increased since World War II. As table 1.2 shows, population projections produced by international agencies tend to confirm this view. However, they also highlight the existence of substantial differences between countries in the expected transition pattern.

The World Bank demographic projections reproduced in table 1.2 show the various patterns of expected demographic change in some industrial countries. While all countries will experience an increase in the proportion of older people, the demographic transition is expected to be more severe in Germany and Switzerland, where it is expected that by 2035 the older population will make up about 30 per cent of the total population. In contrast, in the United States, and to a lesser extent in the UK, Sweden and France, the transition seems to be less dramatic. In all countries, however, the demographic structure of the population around the year 2030 is likely to be very different from what it is at present. This is likely to have substantial policy implications, particularly in the area of pensions.

On the other hand, it is certain that these projections have to be looked at with caution, particularly when they refer to long-term developments. What they say depends on assumptions made on the likely developments of three key variables which can be fairly volatile and difficult to predict – fertility rates, life expectancy, migration – and the current age structure. Demographic projections are particularly sensitive to assumptions made

with regard to future fertility rates,[4] as this determines the size of the new generations that feed into the age pyramid and over time affect the size of the different age groups. Fertility rates, however, are also particularly difficult to predict (Johnson and Falkingham 1992: 21; OECD 1988a: 16). The overall trend in fertility rates in western countries has been one of decline for the past century. However, after World War II there was an upswing in fertility, followed by a decline since the 1960s. There are a number of factors behind these developments. Economic expectations are usually considered to be the main determinant of people's decisions with regard to having children (Ermisch 1983). Nevertheless, it seems clear that other factors have played an important role in recent developments in fertility, and are likely to do so in future. The availability of contraception, the increased participation of women in the labour market and the character and scale of family policies are all factors that have probably influenced recent trends in fertility.

The World Bank's and OECD's population projections are based on the assumption that fertility rates will remain constant until 2005 and that they will then gradually increase and converge (on 2.1) in 2030. Similar assumptions are made by other agencies as well. However, recent developments, particularly in the Nordic countries, suggest that fertility rates may be more volatile than expected. For instance, in the case of Sweden, fertility increased from 1.6 in 1983 to 2.1 in 1990, but dropped back to 1.6 in 1996 (Calot and Sardon 1996). The upswing has been explained with reference to Sweden's work-friendly family polices, such as free child care and generous maternity leave, as a result of which Swedish women do not experience a trade-off between work and motherhood like many of their continental European counterparts (Esping-Andersen 1996b: 78). On the other hand, the recession of the 1990s and the fact that the generosity of the Swedish welfare state is increasingly being questioned are possibly the reasons behind the recent decline in fertility (Calot and Sardon 1996).

Changes in life expectancy, unless they are substantial, have a smaller impact on the age structure of a population, as they affect only the upper end of the age pyramid (Johnson and Falkingham 1992: 21). In addition, trends in life expectancy seem relatively easy to predict. In general, life expectancy has increased gradually in the past and can be expected to continue along the same lines (OECD 1988a: 16). The World Bank's population projections assume an increase in life expectancy at birth of about five years between 1995 and 2035. With regard to the problem of

[4] The fertility rate is defined as the number of children per women in the reproductive age range (fifteen to forty-five).

pension financing, however, what matters is not life expectancy at birth, but at the age of retirement. A study looking at twelve European Union countries has shown that the two can be quite different. Since the end of World War II, increases in life expectancy at the age of sixty accounted for less than 50 per cent of the total increase in life expectancy for men, and for about 25 per cent for women (Sturm 1992: 24). This suggests that the impact of increases in life expectancy on the relative size of the older population will not be as substantial as that of developments in fertility.

Finally, migration can also have a substantial impact on the age structure. Nevertheless, in so far as the economic impact of population ageing is concerned, migration is not likely to play an important role. In Europe, in fact, high levels of immigration occurred at times of labour shortage, which is not the case at present. Labour shortage is likely to occur only if there is a dramatic upswing in economic activity, which would by itself considerably reduce the difficulties involved in coping with population ageing.

In sum, there seems to be a relatively high degree of uncertainty with regard to long-term population age structure projections. Since the fertility rate is the most relevant factor and yet the most difficult to predict, projections are reliable only if they look at the generations who have already been born. For instance, the ratio between the above-retirement-age population and the working-age population is not going to be affected by changes in fertility for the next fifteen to twenty years, i.e. until when today's new-borns are going to enter the labour market. Current projections of the population above fifteen to twenty years of age, thus, should be considered as relatively reliable until around 2015. Beyond this time-horizon it is extremely difficult to produce useful projections. With regard to the next two decades, however, we can say that most countries will almost certainly see an increase in the relative size of the retired population. This development is likely to have an impact on the financial viability of pension systems.

Projecting pension expenditure

Age structure projections provide only one element for the assessment of the future viability of retirement systems. In fact, a number of other factors will affect receipts and outlays of pension schemes, the most important of which are increases in productivity and changes in labour force participation rates. The projections given in table 1.3 take these factors into account, assuming that current pension legislation is applied consistently throughout the relevant period. Variations reflect the differences in the expected pattern of demographic ageing as seen in

Table 1.3 *Projected public pension expenditure as a percentage of GDP in selected countries, 1995–2060*

	1995	2000	2010	2020	2030	2040	2050	2060
France	10.6	9.8	9.7	11.6	13.5	14.3	14.5	14.2
Germany	11.1	11.5	11.8	12.3	16.5	18.4	17.5	16.5
Sweden	11.8	11.1	12.4	13.9	15.0	14.9	14.5	14.8
Switzerland	6.8	7.1	8.4	9.0	11.7	12.0	N/A	N/A
UK	4.5	4.5	5.2	5.1	5.5	5.0	4.1	3.6
USA	4.1	4.2	4.5	5.2	6.6	7.1	7.0	7.4

Source: Roseveare *et al.* 1996: 17; data for Switzerland: author's own calculations based on World Bank 1994b and the same assumptions as in Roseveare *et al.* 1996 (see text).

table 1.2. This means that expenditure projections depend to a large extent on the assumptions made for demographic projections. However, the degree of variation here is even more substantial than in the simple demographic projections. While Germany is expected to reach expenditure levels of around 18 per cent of GDP in 2040, France and Sweden are forecast to spend around 14–15 per cent of GDP in the same year. In this comparison, the most striking case is the UK, where public pension expenditure is expected to remain at around the current level of 5 per cent of GDP until 2040, and then start declining.

Like age structure forecasts, projections of pension expenditure and financing should be looked at with caution. First, as seen above, there is little certainty on the validity beyond the year 2015 of the demographic projections on which they are based. Second, in order to produce expenditure projections one needs to make additional assumptions on variables which are extremely difficult to predict in the long term, such as labour force participation rates (LFPRs), increases in productivity and the extent to which such increases will be reflected in pension scheme outlays.

The OECD projections reproduced in table 1.3 are based on the assumption that LFPRs will remain constant after the year 2000. This might turn out to be too pessimistic, as recent developments in labour force participation suggest that we might see an expansion of LFPRs over the next few decades. There are two reasons for this. First, there are considerable variations in LFPRs in Europe. To a large extent this is due to differences in women's involvement in the labour market, and current trends seem to suggest that women's involvement in paid work will increase in future, especially in countries where it is comparatively low (Schmähl 1990: 167). Second, the demographic transition is expected, in

some countries at least, to imply a significant reduction in the size of the working-age population. If this trend is not accompanied by a corresponding reduction in labour demand, it is likely that LFPRs will increase and absorb part of the currently unemployed population. As the baby-boomers retire after 2005, they will free up more jobs for younger generations, so that the unemployment rate might decline and the proportion of the population employed might increase correspondingly.

A second important assumption refers to increases in productivity and to the extent to which these increases are reflected in benefits and on contribution/taxation revenues. The OECD projections reported above assume an increase in productivity of 1.5 per cent per annum. How much of this increase will be reflected in pension benefits and contribution/taxation revenues depends on national pension and tax legislation. In countries such as the UK, where increases in wages have almost no impact on benefits (with the exception of SERPS; the basic pension is flat-rate and indexed according to prices), increases in productivity have a substantial positive impact on the country's ability to finance pensions. In contrast, in countries like France or Italy, where benefits are earnings-related, part of the increase in productivity will result in an increase in benefits. In addition, if pension schemes are financed only through employment-related contributions (France), it is also important to know whether the increase in productivity is reflected in wages, as it does not otherwise contribute to the financing of pensions. With regard to France, one study has shown that between 1970 and 1993 the growth rate of wages was close to that of GDP. However, between 1970 and 1976 wages rose faster than GDP, between 1976 and 1981 they increased roughly at the same rate, but since 1981 salaries have risen significantly slower than GDP, on average by 1 percentage point per year (de Foucault 1994: 8). If this trend persists, increases in productivity might not be particularly helpful in paying for future pensions.

Overall, expenditure projections are useful to the extent that they provide a picture of the likely trend that pension expenditure is going to follow in a given country, although they are too uncertain to give a reliable measurement of the actual size of pension expenditure at any given time. In this respect, what one can conclude on the basis of the OECD projections is that there will be an increase in pension expenditure over the next few decades, and that such an increase will be more dramatic in some countries than in others. Beyond that, we enter an area of uncertainty in which data cannot be used as a basis for policy decisions. What is important, however, is that these trends are generally regarded by governments as a compelling reason for reforming their pension systems. In addition, even if there are going to be substantial increases in

productivity over the next few decades, the political and distributional sides of the pension problem might nevertheless remain topical. As noted in an earlier OECD report, 'the shift in the demographic structure is manageable even assuming a quite moderate rise in real income, but then requires a major redistribution of resources between generations' (OECD 1988b: 41). This means that the future viability of pension systems will depend also on the willingness of the working population to share part of its income with retirees. To some extent their support for public pension schemes is likely to depend on the way in which they look at the retired population and on their notions of appropriateness in relation to pension provision.

Pensioners' living standards and the debate on generational equity

If the effectiveness of old age policy is measured by the extent to which the living standards of older people have improved over the years, state intervention in the area of pensions has been a success story in most countries. It is widely accepted that during the post-war period pensioners as a whole have moved from being a relatively deprived group in society to one enjoying conditions of relative affluence. This is a result of the overall expansion in pension provision that has taken place over the last fifty years in western European countries. Public schemes have become more generous and coverage has been extended. In OECD countries between 1960 and 1985 expenditure on old age pensions as a proportion of GDP increased by 146 per cent, mainly as a result of changes in eligibility and in the level of benefits (OECD 1988b: 26). In addition, in almost all western European countries, there has been an important expansion of occupational pensions, and more recently of private plans, as a result of which the overall intergenerational transfer has increased over the years.

The relatively favourable economic situation enjoyed by many older people, combined with the concern associated with the expected increase in the proportion of elderly people in industrial societies, has sparked a debate on the issue of fairness and equity in intergenerational transfers. OECD studies show that, because of differences in cohort size and in pension contribution rates, some generations end up being net contributors to the state system while others are net beneficiaries. The debate is not confined to pensions, but it covers other areas in which expenditure is related to age (such as health care and social care) as well as the debt policy of a government. A recent OECD report summed up the results of a comparative study as follows: 'The calculation reveals generational imbalances in favour of living generations. If policies do not change