# The Privatization and Marketization of Pensions in Europe:
## A Double Transformation Facing the Crisis

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Abstract:

In response to the demographic challenges and fiscal constraints, many European welfare states have moved toward the privatization and marketization of pensions in order to improve their financial sustainability. The privatization of retirement income responsibility has led to a shift from dominantly public pensions to a multipillar architecture with growing private pillars composed of personal, firm-based or collectively negotiated pension arrangements. At the same time, marketization has led to the introduction and expansion of prefunded pension savings based on financial investments as well as stronger reliance of market-logic principles in the remaining public pay-as-you-go pensions. However, there are also important cross-national variations in the speed, scope, and structural outcome of the privatization and marketization of European pension systems. Liberal market economies, but also some coordinated market economies (the Netherlands and Switzerland) as well as the Nordic countries have embraced multipillar strategies earlier and more widely, while the Bismarckian pensions systems and the post-socialist transition countries of Eastern Europe have been belated converts. The recent financial market and economic crisis, however, indicates that the double transformation may entail short-term problems and long-term uncertainties about the social and political sustainability of these privatized and marketized multipillar strategies.

## 1 Introduction

For many years, the ageing of societies has been seen as a challenge to public pensions, particularly pay-as-you-go (PAYG) systems, in which the working population finances the pensions of the retired. In order to secure financial sustainability, international organizations and national policy experts recommended the shift toward a multipillar pension architecture with more funded elements. This would entail fostering (pre)funded supplementary pensions, while seeking to control public pension expenditure through cutbacks of benefits. The financial market crash in 2007/08, however, has challenged the merits of private funded pensions as their assets experienced a substantial decline within a short time (OECD 2010). As a result, trust in the expected long-term returns of funded pensions has been shattered at a time when saving for retirement has become more important. The privatization of responsibility for old-age income and the shift towards more funded pensions thus raises important issues that warrant to be revisited (see also Gilbert 2002 and in this issue).

My main argument is that we have witnessed a dual paradigm shift of privatization and marketization in pension policy that needs to be reconsidered after the financial market crash. Although they have been advanced in tandem as responses to the public finance problem, demographic ageing, and the diffusion of neo-liberal economic doctrine, the two processes should be analytically separated. *Privatization* is the process of shifting responsibility for old age income support to private actors, whereas *marketization* is the process of increasing (quasi)-market mechanisms in the allocation of resources. A paradigm shift can thus be seen in two often linked transformations in pension policy. On the one hand, responsibility for old age income has been shifted from state to private actors, thus increasing the reliance on collective, firm-based, and/or individual private pensions. On the other hand, old age pension benefits are more and more commodified, that is, they become dependent on market logic, be it through tighter coupling of benefits with contributions or financial returns on investments. This dual transformation has shifted the responsibility and financing logic of old age income support fundamentally with both processes fostering each other in intricate ways. The retreat of the state from status maintenance to a mere anti-poverty orientation leaves a gap for income maintenance in old age that needs to be filled by private actors, if not employers or social partners then by individuals themselves. Hence, privatization can be a consequence of marketization. Moreover, marketization takes hold not only in the private sphere but also in the public system, for instance, by introducing quasi-market principles such as benefit reductions for early exit (based on actuarial principles) or through mandatory public pension contributions to prefunded schemes.

Drawing on the experience of European countries with already mature and still expanding multipillar systems, this comparative analysis will explore universal trends toward more private funded pensions, but will also show the cross-national variety in the public-private mix and pension fund capitalism (see also Ebbinghaus 2011). After first discussing the known challenges of ageing, the analysis will briefly point at the multipillar paradigm as the consensual solution for the financial sustainability issue in ageing societies. We will then revisit the two transformations in pension reform. The cross-national

comparison will then show the variety of pension arrangements that resulted in recent years. Subsequently, the analysis will discuss the short-term and long-term impact of the post-2007 crash development on both public and private pensions. After pointing at problems of social sustainability, that is, the long-term increase in old age poverty and social inequality, the conclusion will discuss the political sustainability of the thus far dominant multipillar paradigm. As part of the "new politics" of reform, the state has more and more retreated from its responsibility to maintain income in old age (Myles and Pierson 2001) and left funded pensions to the "drift" of private actors (Hacker 2005). However, following the crisis, there seems to be an increasing need and mounting political pressure for state regulation if not intervention in securing not only financial sustainable but also adequate pensions in the future.

## 2 The Multipillar Paradigm Shift

The demographic and economic challenges to the financial sustainability of pensions have been well known for decades. Pension expenditure represents an economically large burden in Europe (currently about 12% of GDP); indeed it is the largest social protection program (about 45% of social expenditure, which amounts to 27% of GDP in EU-27 after the crash). Until recently, Europeans tended to retire ever earlier despite the fact that they will live longer than ever before (Ebbinghaus 2006), thus increasing the pressure on social expenditure over the last decades. More generally, the ageing of societies caused by increasing life expectancy and lower birth rates has been seen as a "time bomb" (Bosworth and Burtless 1998) to the financial sustainability of public pensions, since more and more retirees have to be supported by a shrinking working age population. In particular, public pay-as-you-go (PAYG) systems that finance current pensions out of incoming contributions by working people suffer in particular from ageing. Increasing old age dependency ratios (people aged 65 and older in percent of the working population aged 15-64) have been forecasted over the next fifty years: the European Union (EU-27) ratio is expected to double from 26% in 2010 to 54% in 2060 (Eurostat 2010). This will have long-term consequences on the political influence of the elderly. However, there is also a considerable cross-country variation between the "pensioners' states" of Germany and Italy on the one hand and the relatively young Irish and Cypriot societies on the other. Moreover, it is less the population ratio that matters but the employment rate; therefore, Continental Europe due to low female participation and early retirement is again in a more strained situation (Ebbinghaus 2006).

The need for cost cutting may not be immediately evident. Additional retirement costs could be financed by increased social contributions, higher taxes or more borrowing. Indeed, many European countries have initially increased the revenue side as well as augmented public debt (Bonoli and Palier 2007). For instance, the pension costs of German reunification were largely paid for by increasing contributions in the early 1990s. However, such revenue and debt strategies could only solve immediate problems and had severe knock-on effects. Given global competition, increasing social contributions can price labor out of work, thus further increasing the number of the unemployed and early retired, the vicious circle of

"welfare without work" (Esping-Andersen 1996). Moreover, global financial markets and EU policies, in particular the European Monetary Union (EMU) since the late 1990s, limited the fiscal capability of public policy to promising non-funded pension rights. In fact, several major pension reforms occurred during the 1990s in the run up to the EMU, most prominently the 1995 pension reform in Italy. Thus demographic pressures, economic rationale and fiscal limits have all increased pressures to restore financial sustainability.

In order to make pensions more financially sustainable, policy experts recommended to shift the balance from the dominant public PAYG pensions to more private (pre)funded pension pillars. The recommendations by international organizations shaped the policy discourse on pension reforms for several decades. Since the late 1980s the Organization of Economic Co-operation and Development (OECD) has been active in providing reports on the demographic ageing (OECD 1988), calling for "Reforms for an Ageing Society" (OECD 2000) that advocated a shift to more private funded pensions. In recent years, however, it has also taken notice of the problem of poverty and inequality in old age (OECD 2001) and more recently of the consequences of the financial market crisis on pension savings (OECD 2009). The OECD, however, provides only statistical information and policy expertise; it has limited impact on steering national policy development other than providing policy-makers with background information, influential as this may be (Ervik 2009).

The World Bank propagated its multipillar pension model in developing countries (World Bank 1994), advocating the introduction of private funded pensions by following the Swiss three-pillar model (Leimgruber 2012). The World Bank's influence was particularly strong among the transition countries in Central and Eastern Europe (CEE), which moved from state-socialist to more market-compatible social protection (Holzmann and Hinz 2005). Indeed, several CEE countries introduced funded pensions as a result of low levels of trust in the state, the need to boost domestic financial markets and the financial dependency from the International Monetary Fund (IMF). While the European Union (EU) attached no pension model to its membership accession conditions, CEE policy reformers "out-liberalized" others in adopting the World Bank model (Orenstein 2008).

Since the late 1990s, the EU has become increasingly involved in discussing social protection issues. The Lisbon process has shaped policy debates about modernizing social protection, maintaining economic growth, and increasing employment. For instance, it set the goal to raise employment of older workers (aged 55-64) to more than 50% by 2010. The renewed 2020 Strategy has now streamlined these policy goals (Marlier, Natali and Van Dam 2010), including the targets to increase the employment rate to 75% and to reduce poverty by 20 million people by 2020. These broad goals have had only partial impact on national policy-making, as the targets have been met only by some and not all EU member states thus far. In addition, the open method of coordination (OMC) in pensions was launched, though with less clear goals and targets than in employment policy (Anderson 2002). The OMC in pensions was later integrated with a parallel OMC in social inclusion and poverty. The main purpose of OMC is learning from others through peer-review and common indicators, thus "soft" governance, while financial constraints set by the EMU are more stringent. In

addition, the EU has some say in harmonizing public pensions and regulating occupational pensions in Europe's single market. The most recent EU White Paper 2012 (EU-Com. 2012; Natali 2012) has led to a controversy over the future course after the crisis.

## 3 The Reform Politics of the Dual Transformation

Although the economic rationale and international recommendations propagate a shift from public pay-as-you-go (PAYG) to private funded pensions, the reform process seemed rather stony. Comparative politics scholars have attributed these problems to the "veto points" provided by political institutions (Bonoli 2001), the electoral competition between political parties (Immergut and Anderson 2007), and the feedback of past policies (Pierson 1993). Most prominently, the "new politics" thesis advanced by Paul Pierson (2001) used pension policy as the prime case of path-dependent inertia. It is difficult to rewrite the intergenerational contract in PAYG pensions due to the "double-payer" problem: those who currently have to contribute to the pensions based on past promises would also have to save for their own future retirement (Myles and Pierson 2001). Adopting "blame avoidance" strategies (Weaver 1986), politicians would be unwilling to opt for too radical reforms for fear of electoral backlash from the growing older population.

Yet demographic and economic pressures cannot be ignored forever. A transformation toward multipillar systems has been undertaken across Europe over the last decades, leading to more privatized, partially funded, more delayed, and less sufficient income support in old age. In line with the "new politics" thesis politicians used strategies of "obfuscating" retrenchment efforts, phasing in reforms gradually or diffusing blame through political consensus building (Myles and Pierson 2001). Societal consensus building through social pacts with unions and employers has been used by governments to facilitate parliamentary passage and to overcome non-parliamentary resistance (Natali and Rhodes 2008; Schludi 2005). These changes have not always been the result of high politics; some happened largely unnoticed, as the consequence of (un)intended (non)action or "drift" by non-state actors (Hacker 2005), such as employers, financial institutions, trade unions, and individuals.

Nearly everywhere in Europe the pension systems transformed their public-private mix through privatization (Clark and Whiteside 2003; Ebbinghaus 2011), increasing the scope for occupational and personal funded pensions in addition to public PAYG-pensions.[1] Some of these changes have been relatively path dependent in retrenching the public pillar, in particular the more generous pensions, and by introducing measures in reaction to the increased need to regulate occupational and personal pensions. There were also a few path departing developments, most notably the pension reforms in Sweden (1994) and Italy (1995) that introduced *national defined contributions* (NDC), that is, making individual public benefits dependent on contributions during working life and the economic-demographic development, thus introducing marketization in the public pillar. Also in other public systems, demographic adjustment factors, such as in Germany, were introduced to make

[1] The boundaries between public and private responsibility in financial and regulatory matters, however, remain rather fluent and subject to change (Ebbinghaus and Whiteside 2012).

PAYG-pensions more sustainable in ageing societies. Also notable were the introduction of funded personal pensions as part of the public mandate (e.g. Sweden's premium pension as part of the state pension contributions) and the fostering of voluntary personal pensions (Germany, Finland, France). The largest impact of the multipillar paradigm can be found in the parallel establishment of mandatory funded pensions in many CEE transition economies during the late 1990s, with few exceptions such as the Czech Republic (Orenstein 2008).

Institutional change toward multipillar systems occurred in Europe often as "twin processes" in the public and private pension realms (Ebbinghaus 2011): reduction of the former increased through the pension income gap the push for expansion of the latter. Marketization of public pensions has become thus an engine of further privatization. Most remarkable for privatization are those reforms that newly introduce private pillars: new non-state funded pensions add a new layer to the multipillar, multitier retirement income system. They bring about transformative change without completely altering the public pillar, at least initially. Given the phase-in retrenchment of public pensions and the long-term building up of private funded pensions, there will be a slow conversion from status maintenance to a basic income function in many Bismarckian systems over several decades. These reform steps indicate a gradual path departure moderated by institutional process such as layering, conversion or displacement (see Streeck and Thelen 2005) depending on institutional capacities and preconditions. In the long run these institutional changes may prove to be the first important steps towards a more substantial shift. We should thus distinguish for analytical purposes the two trends in pension reforms: marketization and privatization (see Table 1).

<Table 1 about here>

With *marketization* we describe an increase of the market logic in response to the demographic challenge of ageing societies and the fiscal constraints of welfare states. The most pronounced marketization is the shift from a pay-as-you-go to a prefunded financing logic: pensions will no longer be paid from current contributions of those expecting to receive benefits in the future but from the investment (accumulated capital) that has been saved thus far. Prefunding is not necessarily always private; some countries have introduced reserve funds for their public pensions or require individuals to invest part of their mandatory state contributions in (private) prefunded schemes. Funded schemes depend on the portfolio of investment as to what degree they are dependent on financial risks. In *defined contribution* (DC) schemes these risks are borne by the individual if there is no regulation on the financial product that provides some safeguards. In *defined benefit* (DB) systems, such as company schemes and pension funds, financial responsibility might be shared in case of underfunding, when promised benefits cannot be financed from the current and future investment. Private pensions are more likely to be funded pensions since a pay-as-you-go arrangement such as book reserves requires considerable trust in their future ability to pay such a commitment. There is a second mechanism of marketization that introduces quasi-market principles in public pensions, that is when benefit calculations are more strictly tied to contributions (lifetime point systems), when benefit indexation is dependent on wage or

price development, or when actuarial principles are applied to non-funded PAYG benefits as if they were contributory saving schemes.

In contrast, *privatization* is the second transformation, entailing a shift toward a multipillar pension system; this involves the introduction or expansion of the importance of private pillars. This privatization is foremost a process changing responsibility for retirement income from state to non-state actors, these may include employers, social partners, and individuals. The move toward a multipillar architecture is a response to the overburdening of the public welfare state, but is also in line with neo-liberal ideas of strengthening private self-reliance, individual responsibility, and consumer choice. The distinction between a *second* (occupational) and *third* (personal) pension pillar indicates the differences in governance structure, principal-agent conflict of interests and employer-employee relations (Ebbinghaus and Wiß 2011). In the case of collectively negotiated occupational pensions, responsibility is shared between employers (or employer associations) and employee interests (or trade unions), that is the social partner. These schemes can introduce more solidaristic elements that come closer to public schemes. In company-sponsored schemes, labor relations matter too, but employees are less powerful vis-à-vis the employer who can determine the conditions of such schemes or abstain from them. Finally, in personal pensions individuals are responsible for making the main decisions, but this depends on their financial literacy, individual foresight, and income situation. Besides these differences in governance, the state as regulator can also regulate conditions, provide tax incentives, and setup controlling agencies. Thus privatization as a retreat of the state from primary financial responsibility does not preclude state intervention through other means.

## 4 Varieties of Pension Mixes

Europe's pension landscape varies in the importance of private funded pensions, depending on the gap left by more or less generous public pensions (Ebbinghaus 2011). Pension fund capitalism as revealed by the size of pension fund investment has a major impact on financial markets and corporate governance. Based on the Varieties of Capitalism approach (Hall and Soskice 2001) we would expect that there is a strong relationship between the importance of financial markets in Liberal Market Economies (LME) and their reliance on funded private pensions, whereas in Coordinated Market Economies (CME) in Continental and Nordic Europe but also on Mixed Market Economies (MMEs) in Southern and Eastern Europe there is a larger reliance on patient capital and non-funded pensions (book reserves) by private sector firms. Current pension systems differ in their public-private mix (see Table 2): The Anglophone LMEs have a large share of private pensions, although Irish voluntary pensions lag behind the UK's occupational and personal pensions that could opt-out of the state second pension. Already a considerable share of overall pension benefits were paid out before the 2008-crash by Icelandic (61%), Dutch (52%), Swiss (48%), Belgian (30%), Danish (28%), Swedish (23%), Norwegian (12%) and also Finnish (no figure available) private schemes. In the other countries current pensioners receive still more than 90% of their

retirement income from public pensions; although this will change given recent reforms phasing in prefunded pensions.

The maturity of private funded pensions can be seen from the assets already accumulated (see Table 2). The correlation between financial markets and funded pensions is very strong for liberal Britain, while pension fund assets in Germany's coordinated market-economy are still relatively small though growing. Similarly, France and Southern European countries are laggards in pension fund asset growth (only Belgium had some liberal insurance tradition). But there are two Continental CMEs that have developed considerable funded occupational pensions on top of public first tier pensions: the Netherlands and Switzerland. These two "liberal" CMEs outperform the UK in pension assets, as substantial investments are made by the Dutch collectively negotiated and the Swiss mandatory pension funds. Moreover, the Nordic CMEs now also have substantial funded pillars as part of public or private pensions. But there remains a wide variation, including funded elements as part of mandatory public pensions (Sweden), mandated, partly funded occupational pensions (Finland), negotiated occupational pensions (Denmark), and Norway's oil-financed global government pension fund (*Statens pensjonsfond utland)*. The other Continental and CEE countries have thus far collected far less than 20% of their GDP; they are lagging far behind the LME's, the Netherlands, Switzerland or the Nordic countries in respect to pension fund capitalism.

The future impact of private pensions can also be seen from the current contribution rates (for 2012, see Table 2). Anglophone LMEs show a high percentage of above 3% of GDP (no figure for Ireland available), but this is again outperformed by Swiss (8%), Icelandic (6%), Danish (7% in 2010), Dutch (5%), and Swedish (no figure available) private pension schemes. In continental Europe, due to its Bismarckian tradition of rather generous public pensions, the trend toward funded pensions has been much longer delayed (Ebbinghaus 2011), they still save only little in economic resources in private funded pensions. Finally, following the transition to market economies, major reforms in CEE countries have led to the building up of private funded pensions, particularly in Hungary, Poland, and the Baltic countries (Orenstein 2008). This can also be seen in the figures on contributions; private pensions in CEE countries collect somewhat more than in Bismarckian countries (between 0.3% and 1.4% outside the Baltics, but less than prior to the crash).

## 5 Pensions Facing the Post-Crash Crisis

The financial market crash in 2007/08 and the subsequent crisis have immediate short-term and possible long-term repercussions for the financial sustainability of pensions, both public and private. For public pensions, the fiscal burden of rescuing the financial system limits even further the capacity of welfare states to finance public pensions and other social benefits. Although social protection provided a buffer to the economic crisis, the financial pressures to reform public social expenditure have further amplified with the sovereign debt crisis in Southern Europe and Ireland. Highly indebted countries, Greece in particular (Tinios 2012), have come under pressure to cut back on social benefits immediately and

reform public pension systems for the long-term. Lower levels of economic growth and high unemployment will also have long-term consequences for the financing of European welfare states. But the crisis will also affect the other pillars, the private funded pensions. In fact, the crisis has shed some new light on the pension privatization strategy, which has thus far been seen as the best way out of the pension sustainability problem in ageing societies.

<Table 2 about here>

Funded pension schemes faced major problems during the financial market downturns (Casey 2012; Ebbinghaus and Wiß 2011). Contributions are invested in capital markets for high long-term returns albeit with some risks which have already been exposed during the early 2000s. The 2007/08 financial market crash impacted on pension funds immediately, though with some cross-national variations. Within a year, assets dropped dramatically by more than 25% in the USA and 35% in Ireland and Iceland, while most other European pension funds had a nominal decline of more than 10%, but less than 20% with few exceptions (OECD 2009). Certainly, most funds have somewhat recovered after 2008 (in particular Danish and Dutch funds), but it will take several years until all have made up for their forgone growth. Moreover, the financial crash had various economic and financial repercussions that led to ad hoc interventions, particularly in countries with sovereign debt problems (Casey 2012).

The differential short-term impact is largely determined by the investment portfolio: particularly risky stock market investments (equities, currencies, hedge funds, commodity trading) vis-à-vis more conservative investments (public bonds, non-risky loans, and domestic real estate). The countries with the largest losses have the highest aggregate share of equities (OECD 2009: 34; Pino and Yermo 2010). There is indeed a strong negative relationship between post-crash losses of pension funds and their overall share in equities (and private investments) shortly before the crash (Ebbinghaus and Wiß 2011; Wiß 2014). More risky investments, most notably in the United States and Ireland, but also in the United Kingdom and the Netherlands, lead to higher negative investment returns than in countries like Switzerland and Germany with more prudent investment in bonds (OECD 2010). Among the OECD countries, LMEs tend to rely much more on a growth-oriented but more risky equity-based strategy, while CMEs (including Swiss funds) are more conservative in their investment, but are thus also much less severely struck during the crisis, even though they may have smaller long-term returns.[2]

## 6 Privatizing Financial Risks?

The crisis highlights the problems of shifting responsibility and thereby risks to private actors. The sudden losses and lower than expected returns affect employers or social

[2] Although investment returns improved after the 2001 'new economy' crash and the 2007/8 financial market crises, the long-term (inflation-adjusted) *net* rate of pension fund returns remained only in few countries (Germany, Denmark, and Norway) above 3% from 2001-2011 (OECD 2012: Fig. 1.1, p. 21).

partners as sponsors of *defined benefit* (DB) schemes as well as current and future pensioners relying on *defined contribution* (DC) personal pensions. Even if pension funds have been partly recovering after 2008, the effects of the crisis will undermine long-term growth expectations and trust in funded pensions. The impact of lower than expected returns plays out differently in pension plans (Ebbinghaus and Wiß 2011), depending on whether these are DB schemes that specify a predefined salary replacement, and DC schemes that do not make such promise. In DB schemes, the employer or social partners have the responsibility to cover pension liabilities in case of underfunding or adjust defined benefits, while they may profit from contribution holidays in good times as happened in Switzerland during the 1980s. In funded DC schemes, however, the financial market risks are completely individualized, thus lower than expected returns may lead to postponement of work exit or lower retirement income. DB schemes tend to protect employees' interests better than DC schemes (though some Danish and Swiss schemes are hybrid collective DC schemes); the DC (and collective DB) schemes allow pooling social risks across employees in a firm, across employers in a sector or even nation-wide. While in DC schemes individuals bear the financial risks and need the foresight to stick to a lifecycle portfolio investment strategy, DB schemes can balance risks by pooling and thus guarantee some predefined benefits.
While the majority of current pensioners is still covered by DB schemes, new schemes or plans for new entrants are in most countries increasingly DC schemes. The Netherlands and Finland are still standing out by providing DB schemes through occupational schemes with nearly full coverage. In collective schemes, such as the Dutch DB schemes, the social partners can function as mediators to balance the interests of current and future pensioners as well as between employers and employees. Via collective bargaining and involvement in the management of pension funds, burdens can be shared between employers (higher contributions) and (ex-)employees (lower or frozen indexations, higher contributions and lower benefits). Nevertheless, the social partners have thus to make as difficult decisions in underfunded DB schemes as governments for public PAYG pensions facing demographic and fiscal pressures. As a consequence of the crash and its repercussions, the group of those that trusted in pension funds dropped in the Netherlands by half from more than every second Dutch person in 2006 to only every fourth in 2009 (Casey 2012: 257).

The consequences of financial risks for individuals thus depend on pension plan designs. Workers might possibly have to postpone retirement (exit work later), pay higher contributions or accept lower than expected benefits if long-term returns are low. Under DC schemes, current retirees or those close to retirement are more likely to be hit by a financial market crash if savings are still in risky investments. Therefore, "nudging" rules in DC plans should insure life-cycle investment strategies (Thaler and Sunstein 2009), that is, a shift toward more conservative investments as retirement approaches and a transfer to annuities instead of lump-sum pay-out when reaching retirement. Pensioners covered by DB schemes are less directly affected by the financial crisis, but their benefits could decrease in real value when pension indexation is suspended as in the Netherlands. DB schemes place particular strains on the sponsors, the employer or social partners. Reinsurance against bankruptcy of

the sponsoring firm is needed; indeed premiums have increased, for instance, in Germany, the UK, and Switzerland (Ebbinghaus and Wiß 2011).

To restore sustainability in DB schemes, employers (or the social partners) are faced with either higher contributions or reduced promised benefits in the long-run. The funding ratio of Dutch pension funds has fallen below 95%, ten percentage points below the required minimum funding, but the government extended the period for recovery from three to five years. The UK average funding ratio has dropped by around 10% to 85% following the 2008 crash (Antolín and Stewart 2009: 128). Also the Swiss funding ratio in the private sector dropped to 97% in 2008; as a consequence pension indexation was suspended and contributions increased. An overall trend is a post-crash shift to less risky investments such as bonds and loans which, however, entail historically low returns, while more growth-oriented international diversification increases risks (Antolín and Stewart 2009). Another long-term impact (already instigated by the 2001 financial crisis) has been the further acceleration of the shift from DB to DC benefits, from more buffered to individualized risk exposure. The trend has been well documented for the US (Burtless 2012) and UK (Bridgen and Meyer 2005). The crisis in the early 2000s propelled a shift from final-salary to average-career-salary DB schemes, while the recent post-crash development led to a paradigm shift from DB to DC schemes or at least cutbacks in promised defined benefits.

The move toward multipillar systems has been pronounced in Central and Eastern Europe since the late 1990s, when governments faced a double problem of rising public debt due to the economic crisis and continued contributions to funded pensions with low returns. By 2010, the new pension funds had started to accumulate assets (ranging from 5% of GDP in Slovenia to 16% in Poland), given the considerable contributions (ranging from 0.6% of GDP in Slovenia to 6.8% in Estonia). However, the financial crisis provoked a moratorium if not reversal of the shift toward funded pensions in Central and Eastern Europe by governments responding to the crisis (Drahokoupil and Domonkos 2012). Given the severe economic crisis and the fiscal constraints, governments were revisiting the funded pension strategy and refocused on public PAYG systems. Most notable is Hungary’s turn-around in de facto nationalizing prefunded pensions by the right-wing government in 2010 in order to avoid further international credit (Simonovits 2012). The financial crisis has further shattered confindence in funded pensions; at least for Hungary it will be difficult to rebuild trust in private funded pensions. The shift toward marketization and privatization may thus not always be going in the same forward direction.

## 7 The Issue of Social Sustainability

In recent years, not least since the financial market crash, the social adequacy of pensions has become an important topic as a consequence of the response to financial sustainability problems. Concerns about growing risks of poverty and increasing inequality in old age as consequences of pension marketization and privatization of funded pensions have mounted in academic and public debates (OECD 2001). While economic and finance ministers have been the spokespeople on financial issues, the social and labor ministers have been more

outspoken about the need for "adequate" pensions. The differences in position have been observed since the early days of the EU's OMC in pensions, where the financial agenda of ECONFIN and the social concerns of the EU social protection committee (SPC) have become juxtaposed (Anderson 2002).

The issue of old age poverty and inequality has become more pressing because of the already enacted and further planned retrenchment of public pensions (marketization) and the shift toward private funded pensions (privatization), both advocated by a financial sustainability rationale. Except for widows, poverty in old age has become a less pressing problem than poverty among lone mothers and large families today. An academic and political debate (Lynch 2006, Bradshaw and Holmes 2013) emerged whether welfare states have tilted towards pensioners as a result of their voting power, and that there was a generational conflict between old and young. This view may, however, be myopic to future developments. Old age poverty and inequality will most likely increase as a result of welfare state retrenchment, labor market flexibilization and economic uncertainty (Hinrichs and Jessoula 2012). Hence, the problem of social sustainability is that policies to safeguard financial sustainability in response to an ageing society may very well increase the risk of poverty and inequality in the future. Through the backdoor this would then lead to an eventual rise in need for social assistance (or minimum income) for older people. Subsequently, increased poverty risks may also lead to more political pressure to improve minimum income provisions.

The shift toward multipillar systems poses concerns about the long-term social sustainability of both public and private pillars: will the consequences of pension retrenchment and privatization increase social inequality and poverty in old age income in the future? In the public pillar, the once generous pension benefits have been reduced in Bismarckian pension systems, while Beveridge basic pensions have also been remodelled (Ebbinghaus 2011). Following several reforms since the 1990s, Germany's once generous old age insurance has been transformed into a more meagre pension that no longer will suffice to maintain living standards if not supplemented by voluntary funded pensions. Even in countries that had not retrenched public pensions during the 1990s, in particular the Southern European countries, far-reaching reforms have taken place since the recent sovereign debt crisis (Casey 2011). Also past Beveridge models like Finland and Sweden were transformed into minimum income systems for those not receiving enough from the earnings-related pensions, which in turn have become partly funded. In general, we can observe a trend that public pensions serve more and more mainly a minimum income function (Lagoutte and Reimat 2013), while the mandatory earnings-related tiers have become more market-oriented and partially or fully funded. The increase in retirement age (or needed contribution records) has also the effect of *de facto* lowering pension benefits if older people cannot remain longer in full employment.

In the case of private pensions, social inequality might be particularly pronounced in voluntary pensions with uneven and low coverage (see Table 2), while collectively negotiated occupational and mandatory funded pensions provide more widespread

protection (Ebbinghaus 2011). Moreover, social benefits such as credited contribution years for child rearing and long-term care are usually not granted in private pensions but only in public pension systems. Also atypical employment and unemployment periods lead to interruptions in contributions or disadvantages in DB schemes in case of premature job termination. The flexibilization of labor markets (Hinrichs and Jessoula 2012) will thus pose a long-term risk for both public earnings-related and private contribution-based pension systems. Both the marketization of public pensions and the privatization of funded pensions will negatively interact with labor market flexiblization, thus causing doubts about the long-term social sustainability of the multipillar strategy.

The individualization of financial risks in DC pensions and the uncertainty about the future returns of funded pensions also raise concerns about the social sustainability of the multipillar paradigm. The financial crisis seems to have led to a general decline in trust into funded pensions, thereby dampening individual efforts to save for old age income. The choice of pension fund products often seems too complicated for individuals, particularly those less educated. Recent efforts towards "nudging" strategies have been advocated by behavioural economists (Thaler and Sunstein 2009). These include automatic enrolment in a funded standard plan, thereby requiring active opt-out to other options as for instance in the recent reforms in the UK (Mabbett 2012). Moreover, the European Commission proposes the introduction of minimum guarantees in DC schemes or new mixed DB/DC pension plans as well as more life-cycle portfolios in order to reduce short-term volatility (EU-Com. 2012).

## 8 Conclusion: Is it politically sustainable?

The dual shift toward a multipillar paradigm, marketization and privatization, has affected nearly all pension systems in Europe in one way or another. As funded pensions have grown in economic importance, individuals' retirement income will be more and more dependent on long-term financial market performance. The post-crash experience has shown that financial risks largely depend on the scope and portfolio of asset investments, more risky investments can lead to high volatility, and more conservative investment may entail rather low long-term net returns. In addition, public debt has further increased putting additional pressure on retrenching public pensions, thereby leaving an increasing income gap to fill in for private initiative. Moreover, the economic consequences of the crash have been increases in unemployment and the spread of flexible employment, thus marketization and privatization of pensions interact negatively with these aggravating labor market trends. The main lessons from the two financial crises during the 2000s are the need for stricter rules regarding public supervision, investment restrictions and partly new benefit protection mechanisms. This indicates that the role of private pension governance, including (state) regulation, continues to gain importance despite claims of privatization that suggest a retreat of the state. Furthermore, state regulation is often complemented by social partners' governance and regulation.

While the state partially retreated from its responsibilities to finance adequate public pensions, the scope for state regulation and control of private pensions increased, at least

potentially. Thus Lutz Leisering (2011) claims an increased need for state regulation due to the shift towards funded pensions (see also Mabbett 2012 and Mabbett in this issue). The retreat of the state from public pension commitments thus has not only increased the need to fill the retirement income gap by private funded pensions but has also led to demands for better regulation of these pensions by the state and the social partners. Without such regulation it may be questionable whether the funded pension route remains politically sustainable if it remains a rather risky business for more and more ordinary people facing retirement. While the old age poverty threat will particularly call upon governments to enhance the minimum income systems, the financial uncertainty and social inequality issue might provoke more political pressure from middle-class interests. Given the political economy of reforms, the large voting power of people nearing or beyond retirement age, the political pressure might indeed mount again to recalibrate public pensions and to regulate private pensions. Thus pension reform will remain on the political agenda, even though (or because) past reforms toward a multipillar paradigm were meant to solve the financial sustainability problem by market solutions. The financial market crash and its repercussions indicated that the thought solution of marketization and privatization is far from being the end of pension reforms.

**Table 1: Marketization and Privatization of Pensions**

| Process | Marketization | Privatization |
|---|---|---|
| *Principle* | Increasing the market-logic and market-dependency (*commodification*) | Shifting responsibility to non-state actors (*risk privatization*) |
| *Aims* | Financial sustainability, reducing public expenditure | Retreat of the state, self-regulation, consumer choice |
| *Instruments* | Employment-related pensions<br>Longer working life<br>Actuarial treatment of benefits<br>Pre-funded pensions | Mandate for private actors<br>Collective bargaining<br>Employers commitment<br>Voluntary/individual choice |

Source: own compilation.

**Table 2:** Pension assets, coverage, contributions and expenditure in Europe and USA

| | Pension expenditure (%GDP) 2012 | | | Private coverage 2011 | Assets (%GDP) 2010 | | Private pensions (%GDP) 2012 | |
|---|---|---|---|---|---|---|---|---|
| | Total | Private | (%) | [%] | All funds | Public funds | Contri-butions | Benefits |
| **LMEs** | | | | | | | | |
| Ireland | [a]4.5 | [a]0.9 | [a](20.1) | [41.3] | 64.9 | 15.9 | | |
| UK | 9.4 | 3.2 | (34.2) | [43.3] | 88.7 | — | [d]2.9 | [d]3.2 |
| US | 11.4 | 4.6 | (40.3) | [47.1] | 137.9 | 17.9 | [d]4.0 | [d]4.6 |
| **Lib-CMEs** | | | | | | | | |
| Netherlands | 9.4 | 4.3 | (46.0) | [88.0] | 128.5 | — | 5.5 | 4.3 |
| Switzerland | [b]11.3 | [b] 5.0 | [b] (44.3) | [70.5] | 113.7 | — | 8.2 | 5.0 |
| **CMEs (North)** | | | | | | | | |
| Denmark | 11.2 | 5.1 | (45.4) | [61.9] | 177.8 | — | [c]6.9 | [c]5.1 |
| Finland | 10.5 | 0.6 | (5.9) | *[74.2] | *91.0 | — | 10.2 | *11.2 |
| Iceland | 7.4 | 5.7 | (77.0) | [84.4] | 131.9 | — | 6.4 | 5.0 |
| Norway | [b]7.0 | [b]1.6 | [b](23.1) | [68.1] | ***136.2 | 5.6 | 0.5 | 0.2 |
| Sweden | 9.5 | 1.3 | (14.0) | [>90.0] | 84.1 | 27.2 | | |
| **CMEs (Centre)** | | | | | | | | |
| Austria | 13.7 | 0.2 | (1.7) | [>38.6] | 5.5 | — | [c]0.4 | [c]0.2 |
| Belgium | 13.7 | 3.7 | (27.0) | [45.2] | 8.8 | 5.0 | 0.4 | 0.3 |
| France | 14.1 | 0.4 | (2.5) | v[20.9] | 13.1 | 4.6 | [c]0.6 | [c]0.4 |
| Germany | 11.4 | 0.2 | (1.8) | [71.3] | 5.4 | — | 0.3 | 0.2 |
| **MMEs (South)** | | | | | | | | |
| Greece | 13.1 | 0.0 | (0.0) | [>0.2] | 0.0 | — | 0.0 | 0.0 |
| Italy | 15.8 | 0.3 | (1.8) | [14.0] | 5.3 | — | 0.6 | 0.3 |
| Portugal | 12.8 | 0.5 | (3.5) | [>8.4] | 17.9 | 5.6 | 0.5 | 0.3 |
| Spain | 10.0 | 0.7 | (6.9) | [18.6] | 18.7 | 6.1 | 0.4 | 0.4 |
| **MMEs (East)** | | | | | | | | |
| Czech Rep. | 8.9 | 0.6 | (7.2) | [62.1] | 6.3 | — | 0.9 | 0.6 |
| Estonia | 7.9 | 0.0 | (0.3) | [68.9] | 7.4 | — | 1.4 | 0.0 |
| Hungary | 10.1 | 0.2 | (1.9) | [20.0] | 14.6 | — | 0.3 | 0.2 |
| Poland | 11.8 | 0.0 | (0.1) | [56.5] | 16.6 | 0.7 | 0.5 | 0.0 |
| Slovak Rep. | 7.1 | 0.1 | (1.6) | [44.4] | 7.4 | — | 1.2 | 0.1 |
| Slovenia | 11.8 | 0.9 | (7.7) | [38.2] | 4.9 | — | 0.5 | 0.2 |

Sources: own calculations; expenditure (2012): Pension Market in Focus 2013; coverage: OECD Pension Outlook 2012, Tab. 4.1, p. 105; Public pension funds: OECD (2011): Table 4; Private pension funds: OECD Global Pension Statistics database.

Notes: (%) % of Total; [*] occupational and personal pension coverage in % of working age population; > underestimated; includes mandatory occupational pensions (partly funded private schemes); a) 2007; b) 2008; c) 2010; d) 2011; f) total includes Norwegian state pension fund (122.8 % GDP, financed by oil receipts).

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