The Politics of Structural Pension Reform in Advanced Industrial Countries:
Common and Distinctive Challenges

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Public pension systems face common challenges of:

- Adequacy
- Equity
- Sustainability
Despite commonalities in pension challenges, advanced industrial countries differ greatly in:

- **economic-demographic challenges**
- **current policy regime “baselines”**
- **political institutions and social environments**
Because of these differences:

• Fundamental restructuring has been limited in most countries

• different groups of countries face
  – distinctive policy challenges and
  – opportunities for structural reform in the coming decades

• likelihood of convergence around a single model of public pension provision is quite slim
Countries vary substantially in their anticipated ratio of elderly to working age population

There is also wide variation in the burden of Social Security payroll taxes

Social Security Contributions as % of GDP in 2000

Source: OECD
Countries also differ dramatically in their labor force participation rates for older workers

Male Labor Force Participation Rates
age 60 to 64 c. 1980 and 1999 (approx.)

Pension Regimes and Patterns of Change
Wealthy OECD countries undertake pension reform from very different starting points:

- “Bismarckian” social insurance countries (e.g., France, Germany)
- “Bismarckian Lite” regimes with heavy reliance on social insurance but relatively low replacement rates and payroll taxes (U.S., Canada)
- Notional Defined Contribution Pension systems (Sweden, Italy, Latvia)
- “Mixed” public-private countries (e.g., U.K, Denmark, Switzerland, Netherlands)
- Universalist flat-rate pension countries (New Zealand, Ireland)
- Residual income- or means-tested countries (Australia prior to 1990s)
Potential strategies to address crises in retirement income systems:

- *retrenchment* in eligibility and benefits
- *refinancing* programs by finding additional revenue sources
- *restructuring* programmatic commitments by
  - eliminating or replacing old programs
  - creating new pension tiers
  - changing the philosophy of existing programs
A common repertoire of incremental pension retrenchment strategies has been widely used throughout the wealthy OECD countries, including:

- less generous benefit indexation mechanisms and ad hoc indexation cuts, while leaving the principle of indexation intact
- phasing in higher retirement ages (usually 65), and equalizing them on gender lines
- restricting pension benefits for upper income retirees
- increasing the earnings period over which initial benefits are calculated to lower pension replacement rates
- moving to a closer linkage of contributions and benefits
But there have been counter-trends to the general move toward retrenchment in benefits and eligibility:

• Both expansion and cuts in early retirement programs
• Increased pension credit for years spent out of the paid labor force as a caregiver in many countries
• Improved benefit floors for poorest seniors in some countries
There have also been some common patterns of pension financing strategies:

- **General increases in pension payroll tax contribution rates over the past 20 years, with the United States as an exception**

- **Increased efforts to stabilize contribution rates in recent years, especially in “Bismarckian” countries, e.g.,**
  - Target payroll rate caps in Germany
  - NDC-based fixed rate of 16 percent in Swedish income public tier
Most wealthy industrialized countries have at most undertaken modest restructuring:

- **NDC and “quasi-NDC” reforms to**
  - Link benefits more closely to contributions
  - Stabilize contribution rates
  - Depoliticize benefit adjustments as populations age

- **Mandatory individual accounts:**
  - on top of dominant state system (Sweden)
  - as major tier in countries with no prior public earnings-related pensions (e.g., Australia, Denmark)

- **Quasi-mandatory employer-administered individual accounts on top of dominant state system (Germany)**

- **Collective investment “buffer” funds added or expanded in PAYG systems (Sweden, New Zealand, Canada)**
...and restructuring has not led to convergence in pension programs across countries

<table>
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<th>Pension Regime Types</th>
<th>Country Examples, c. 1995</th>
<th>Country Examples, c. 2004</th>
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<tr>
<td>Notional Defined Contribution</td>
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<td>Bismarckian</td>
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* Indicates addition of a substantial mandatory or quasi-mandatory individual account tier.
Countries differ in political and social conditions that affect the likelihood of successful restructuring, notably:

- Number and structure of veto points within government
- Political incorporation of labor and seniors
- Availability of mechanisms to “depoliticize” pension decisionmaking
Distinctive Challenges, Distinctive Futures
Challenges for Bismarckian social insurance systems:

• **Keep pension payroll taxes at politically sustainable levels through combination of retrenchment and refinancing**

• **Address problems of low labor market participation in 55-64 age group in the face of continued high unemployment**

• **Consider restructuring public tiers, e.g.:**
  - full or partial move to NDC
  - adding mandatory private tiers when those options are exhausted
Challenges for “Bismarckian Lite” social insurance systems:

- Develop adequate mechanisms to deal with senior poverty
- Adapt to changes in supplementary occupational and personal pension sectors
- Address long-term pension funding problems in the absence of an immediate funding crisis
Challenges for NDC-based systems:

- Keep pension payroll taxes stable
- Avoid lengthening of phase-ins and imputing of credits when no contributions were made
- Retain flexibility to make additional changes in flawed NDC systems despite making “property rights” in NDC accounts more visible
- Decide on socially acceptable mechanisms to supplement NDC benefits with “social pensions”
- Resist pressure on statistical agencies to forego projections that trigger politically unpopular benefit changes.
Challenges for “Mixed” Pension systems:

- Integrate public and private tiers and provide transparency, equity and universal coverage
- Control administrative costs and market risks in private tiers
Commonalities in pension policy change are likely to continue as a result of:

- **Common challenges**
- **EU pressures on expenditures**
- **Cross-national learning**

But…
..., convergence of pension regimes in the wealthy countries is likely to remain limited because:

- different policy regimes pose distinctive policy problems and opportunities for change
- Different political and social environments pose different opportunities for social change
- European Union has limited leverage to integrate basic pension regimes in member countries
- Although NDC offers common basis for “scoring” past pension contributions:
  - Some countries are likely than others to move to NDC
  - Countries have very different preferences and starting points on
    - Replacement rates
    - Income floors
    - Mix of public and private provision
OECD countries remain very different in how much senior poverty they have before public pensions...


NB: Australia has no social insurance-based retirement system for the elderly and in Sweden the effect of private pensions cannot be separated from social insurance.
In how much poverty reduction occurs through quasi-universal and social insurance tiers...

Elderly Poverty Reduced Through Universal and Social Insurance Transfers


NB: Australia has no social insurance-based retirement system for the elderly and in Sweden the effect of private pensions cannot be separated from social insurance.
...and through income-tested pension tiers.

Elderly Poverty Reduced Through Universal and Social Insurance Plus Income-Related Transfers


NB: Australia has no social insurance-based retirement system for the elderly and in Sweden the effect of private pensions cannot be separated from social insurance.