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### **Stream 15: Reforms of pension system in the light of socioeconomic interdependencies**

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# Embedded pension reforms in Europe: The forces towards a renewed welfare system for the elderly

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## *Abstract*

Pension systems have been and continue to be the largest part of social protection, not least due to demographic ageing. Given 'blame avoidance' strategies of politicians, there seems not much opportunity for a 'new' welfare system in respect to the entrenched policy area of pensions. But many changes have altered the welfare system for the elderly towards a more privatized, partly funded, less secure and more delayed income support in old age. Adopting a comparative perspective, the chapter discusses four transformative changes in pension systems across Europe that alters considerably the welfare system for the elderly. First, the shifts from public to private responsibility are discussed. Second, the variations in pension fund capitalism are compared and the differential impact of the recent financial crisis. Third, a paradigm shift occurred also through attempts to reverse the trend toward early retirement and postpone exit from work. Fourth, the increased reliance on employment-related or defined-contribution benefits will increase the risk of poverty and increase inequality in old age, given the new social risks concerning employment chances. The retreat of the state from its old age protection goal may increase the pressures for its increased role in securing and regulating old age income provision in old age.

*Key words:* Europe; pension reform; funded pensions; early retirement; poverty; public-private mix.

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## 1. Introduction

Social protection for the elderly and people with disabilities has been and continues to be the largest part of welfare activity. Not least due to demographic ageing, age-related social expenditure is expected to increase further. Social insurance against income losses due to old age and disability represents a major pillar in the more than hundred year old Bismarckian welfare systems in Continental Europe, but also the postwar Beveridge reforms in Anglophone or Nordic countries extended means-tested to universal basic pensions to all residents. The postwar 'welfare state' has been relying on the intergenerational contract between past and current cohorts, between current and future generations. The commonly shared expectation has been that the working population pays for the retired because they had previously paid into the system during their working lives and have therefore earned their retirement. However, the old welfare system for the elderly has come under severe economic, fiscal and demographic pressures. European welfare states face multiple problems due to persistent unemployment, fiscal restrictions on public spending and the challenges of an ageing society. Will these challenges lead to a new 'leaner' welfare systems for the elderly across Europe? Will people have to provide more for themselves, work longer, and retire later, while being more at risk of poverty in old age?

Some observers have claimed that the welfare system for the elderly is difficult to change because of the intergenerational contract. The 'new politics' of the welfare state perspective, prominently advanced by Paul Pierson (2001b), used pension policy as the prime case of path-dependent inertia and policy feedback. In the case of pay-as-you-go pensions, rewriting the intergenerational contract would be difficult due to the double-payer problem, the fact that those who pay contributions, which are used for current pensioners' acquired rights, would additionally need to save for their own future pension (Myles and Pierson 2001). Given 'blame avoidance' strategies (Weaver 1986), vote-seeking politicians would be unwilling to opt for radical reforms in order not to upset the growing older population as well as those working people who have already paid into the system and who expect to receive their promised pensions when retiring. Moreover, trade unions and senior citizen groups mobilize against and use their channels of political influence to oppose such systemic reforms. Given these powerful status quo interests, there seems not much opportunity for a 'new' welfare system in the entrenched policy area of pensions to arise. But haven't we nevertheless seen major long-term changes in recent years?

Demographic and economic pressures cannot be ignored forever and these have led to some pension policy changes over the last decades. Indeed there have been ongoing transformations that will alter the welfare system for the elderly as we know it towards a more privatized, partly funded, more delayed and less sufficient income support in old age. These changes have not always been the result of high politics, some happened largely unnoticed as the consequence of (un)intended (non)action by non-state actors such as employers, financial institutions, trade unions, and individuals. Pension policy thus provides an interesting – seemingly 'least likely' – case to discover the politics of the *new* welfare system, this is, the very rationale for studying this policy area in this volume!

The analysis of the transformation from the old pension system to a converted one needs to take into account the historically derived cross-national diversity in the public-private mix of pension systems in Europe. The comparative analysis will therefore focus on Europe's variety of pension systems that

represents different public-private mixes (Ebbinghaus 2011). The analysis will include countries with dominantly public pensions following the Bismarckian tradition in Continental Europe (Austria, Belgium, France, and Germany) and Southern Europe (Greece, Italy, Portugal, and Spain), these provide earnings-related state pensions for most occupational groups but leave rather limited space for private funded pension development. Furthermore, the Nordic countries (Denmark, Finland, Sweden, and Norway) represent different variations of the Beveridge-tradition with basic income security but also different public or private solutions for earnings-related supplementary pensions. Moreover, we consider mature multipillar pension systems (Britain, Ireland, the Netherlands, and Switzerland) with basic pension provisions for all and rather developed private pensions, in particular (quasi-) mandatory occupational pensions. Finally, the analysis will also cover the development in some of the new EU-members in Central and Eastern Europe (Czech Republic, Estonia, Hungary, Poland, Slovakia and Slovenia), which over the last two decades reformed their public pension systems with more market-oriented complements.

This chapter will discuss four transformative changes in pension systems across Europe which alter considerably the welfare system for the elderly. First, the pension architecture has been changing toward a multipillar system, with increased shifts from first pillar public to second pillar occupational and third pillar private personal pensions. Second, as part of the transformation toward private pensions but also in some cases as an integral part of public provision, pre-funded pensions increase in scope as they are seen as a solution to the demographic challenge. However, the recent financial crisis has revealed some potential problems with relying mainly on funded pensions. Third, a paradigm shift occurred also through attempts to reverse the trend toward early retirement and postpone exit from work through changes in old age and disability pensions, long-term unemployment insurance, and other benefits systems. Fourth, the increased reliance on employment-related or defined-contribution benefits will increase the risk of poverty and increase inequality in old age, particularly for those new social risk groups with precarious employment. Flexible employment, low female labour force participation, and long-term unemployment together with other social inequalities will lead to lower income protection in old age. The comparative analysis thus maps four major challenges for the renewed welfare system for the elderly.

## **2. The retreat of the state from old age income protection**

Old age and disability pensions are a key pillar of modern welfare state architecture and a cornerstone of the “European social model”. Thanks to public pensions, older people are able to withdraw from their working lives at a societally granted retirement age or even earlier when they fulfil special conditions. Since the 1970s, retiring around age 65 or even earlier has become the social norm for the “Third Age” in all European welfare states (Kohli et al. 1991). Combined with societal ageing this led to the paradox trend that people live longer, while retiring earlier and for a longer period than ever before. This has been questioned given that European welfare states have grown to their limits (Flora 1986) as a consequence of rising mass unemployment, increased early retirement and inflationary pressures following the first oil crisis in 1973. Pension expenditure (about 12% of GDP in the EU-27) represents the largest social protection programme in European welfare states (about 45% of social expenditure that represent 27% of GDP in EU-27). As a consequence of the on-going ageing of societies the demographic dependency ratio, the share of older people (65 and older) in relation to the working age population (15 to 64 years of age), will double for the European Union to over 50 percent until 2050. Parallel to such demographic

developments, global economic challenges have placed considerable constraints on welfare states in times of “permanent austerity” (Pierson 2001a).

These economic and demographic problems challenge the financial sustainability of public pensions, particularly in pay-as-you-go (PAYG) systems that use incoming contributions for current pensioners. International organizations such as the World Bank and OEC, but also national policy-makers and their economic advisers advocate for a shift away from PAYG-financed public pensions towards mainly prefunded private pensions (OECD 1998; World Bank 1994). This is largely motivated by an economic logic of financial *sustainability* in ageing societies under fiscal austerity, though a secondary aim is often also to boost financial capital markets in order to foster economic growth. The transformation from public to private pension was introduced since the 1980s rather gradually, as radical approaches to reshape pension systems were constrained by the specific institutional structure already in place, thus the Thatcher government’s effort to abolish the state second pension failed (Pierson 1994). Nevertheless, there have been considerable sequences of changes even in Bismarckian welfare systems of Continental Europe (Bonoli and Palier 2007; Palier 2010) that have led to a restructuring of the welfare system for the elderly.

The new pressures and challenges translated into different problems depending on the existing arrangements and governance institutions. Pension systems vary in the historically evolved public-private mix, following either a more Bismarckian tradition of maintaining income through earnings-related state pensions or a Beveridge-model of combining public basic pensions and (mainly private) supplementary pensions. We can distinguish different public-private configurations and subsequent problem loads (Ebbinghaus and Gronwald 2011): the Continental dominant public pension systems that are late in developing a multipillar system, the Nordic pension systems with hybrid privatization tendencies, and mature multipillar systems (Britain, the Netherlands and Switzerland). Countries with an expensive PAYG-financed Bismarckian public pension in Continental Europe engaged in introducing new pillars of occupational and/or personal pensions, while fostering cut backs in the public pension. The Nordic countries combine universal public pensions with specific second-tier pensions that represent very hybrid multipillar solutions. Countries with developed multipillar systems were mainly concerned with the improvement of the regulatory framework for private pensions under the new economic conditions. Since the 1990s, the transformation of socialist to market-oriented systems in new EU member states in Central and Eastern Europe (CEE) led to the introduction of private funded pensions in addition to rather meagre public old age pension insurance (Orenstein 2008a).

The cross-national variation in public-private mix can be seen in the public, mandatory private and voluntary private pension expenditures (see Figure 1). The Bismarckian pension systems of Continental Europe (Austria, Belgium, Germany, France, and Italy) spent since the 1980s a substantial share of resources (more than 12% of GDP) on old age and disability pensions, largely through public pay-as-you-go schemes (only Belgium has a significant share of voluntary expenditures). Also Spain, Portugal and Greece have expanded their pension expenditure since their democratization and EU membership in the mid-1980s, but they still have not reached the expensive level of the Italian ‘pensioner state’ (Ferrera 2000). The new EU members from Central and Eastern Europe provide largely public pensions, varying from a very lower level in Estonia and Slovakia, to a medium level in the Czech Republic to a rather high “Bismarckian” level in Hungary, Slovenia and Poland. The newly introduced private funded pensions are not yet mature, instead the public pay-as-you-go systems still determine current retirees’ income. Among the Beveridge multipillar systems with basic public security, Ireland spends a relative low level due to its

young population, while the Netherlands, the United Kingdom and Switzerland spend a medium level (around 10%) via public pensions and a substantial share of private funded pensions. Among the Nordic countries, a high share of expenditure is still provided by public pensions but mandatory personal and negotiated occupational pensions have grown in recent years. Thus Europe is more in line with Japan and the OECD average than with the liberal United States, with the exception of low spending Estonia, Slovakia and Ireland.

<FIGURE 1>

The recent transformation of the public-private pension mix varies across Europe. Some of these changes have been relative slow 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. Yet there were also important path ‘departures’ in the public pillar, most notably the pension reforms in Sweden and Italy in the mid-1990s. These reforms introduced ‘notional’ defined contributions (NDC) which make public benefits dependent on individual working life contributions and the macroeconomic-demographic development. Also elsewhere demographic adjustment factors were introduced to make PAYG-systems more sustainable in aging societies. For instance, such a ‘sustainability’ factor was introduced in Germany in 2001. Also notable were the introduction of funded personal pensions in public first pillars (an important component of the Swedish reform) and the introduction of voluntary personal pensions, for instance, in Germany, Finland, and France. Most notable for a shift toward funded systems was their introduction in CEE countries in the late 1990s or early 2000s, in particular Estonia, Hungary, Poland, and Slovakia (Müller 2001; Orenstein 2008a).

Institutional change occurred often as twin processes in public and private pensions: reduction of the former increased the push for expansion of the latter. These new private pension arrangements add a new layer to the multipillar, multitier retirement income system. They bring about transformative change without completely altering the public pillar, though there is a long-term conversion from the status maintenance to a basic income function in the Bismarckian systems. These reform steps indicate a gradual path departure moderated by institutional layering, conversion or displacement (Streeck and Thelen 2005) depending on institutional capacities and preconditions. In the long-run these institutional changes may be the first steps towards a more substantial change in the public-private mix to come in the future. While the state partially retreated from its responsibilities to finance adequate state pensions, the scope for public regulation and control of private pensions increased, at least potentially. The need for regulation and the political relevance of pensions has increased due to privatization, in particular with the shift towards funded pensions (Leisering 2006). In respect to their social outcome, the transformation of the welfare system for the elderly have made pension benefits far more dependent on individual labour market performance. This is the case through NDC or point systems in earnings-related public pensions systems as well as through firm-sponsored DB or personal DC contributions in private funded pensions. The future pension system will thus be more detrimental to those with atypical or lacking employment due to family care responsibilities, unemployment and low employability.

### **3. Financialization and pension fund capitalism**

Following the advice from international organizations and national economic policy advisors private funded pension systems have gained in importance in Europe and across the World (Brooks 2005; Orenstein 2008b). While PAYG-systems are seen as unsustainable given the ageing of societies and public

finance constraints, the claim is that funded systems will rely on savings for old age retirement independent of demographic developments. Moreover, funded pensions also foster capital markets, thereby at least partly increasing also domestic economic growth. Although some countries have a long tradition in pension fund capitalism, other European countries have only recently decided to change from dominantly public to multipillar pension schemes (Ebbinghaus and Wiß 2011). The Anglophone 'Liberal Market Economies' (LME), the United Kingdom and Ireland, have extended pension fund assets given the rather limited basic pensions and long tradition of occupational pensions. However, there are also two Continental European countries that have developed considerable funded occupational pensions on top of first tier public pensions: the Netherlands with negotiated supplementary pensions and Switzerland with mandatory occupational pensions. In addition, there is wide variation in respect to Nordic pension systems, including funded elements as part of mandatory public pensions (Sweden), mandated occupational pensions (Finland) and negotiated occupational pensions (Denmark). The Continental European countries with a Bismarck public pension tradition were late in developing funded pensions, though recent reforms might be able to alter this in the future. Finally, following the introduction of market economies, major reforms in pension systems of Central and Eastern Europe have growing private funded pensions, particularly in Hungary, Poland and the Baltic countries (Müller 2001; Orenstein 2008a).

The difference in the scope of pension fund development depends on the timing and degree of state or collective regulation as well as on the need and incentives to save. In addition, general tax incentives or special subsidies for low income groups provide also possibilities for fostering the development of private pension savings, a rather 'hidden side' (Howard 1997) of welfare state activity. Thus direct intervention (mandatory membership by law), intermediary action (extension of collective agreements) or indirect means (tax incentives) together with self-regulatory collective agreements are crucial in extending the scope of funded private pension systems. In addition, the long-term changes in public pay-as-you-go pension systems that will lower future benefits increase the pension gap to maintain living standards and thus increase the pressure toward private pensions. We would expect the reversed effect of past 'crowding-out' when public pensions are scaled back in the future, thus the retreat of the state from old age income maintenance would be linked to the growth of funded private pensions. However this is dependent on additional factors, not least the willingness of the social partners, the employers or individuals to save for old age.

In contrast to the current private pension expenditure already discussed, the scope of current pension fund assets (see Figure 2) provides a more significant indicator of the potential impact of private pension on old age income (OECD 2011), though it is more difficult to evaluate its future scope. In Iceland, the Netherlands and Switzerland autonomous pension funds have invested more than the annual economic activity, followed by the United Kingdom and Finland (around 50%) as well as Ireland and Denmark (40% of GDP). In addition personal pensions via life or group insurance contracts play also an important role in the Nordic countries, in particular Denmark. In contrast, Continental Bismarckian systems and all Central and Eastern European countries still have underdeveloped pension funds (less than 15% of GDP). Except for Portugal, Poland and Hungary, all other countries have thus far developed rather unimportant pension funds (less than 10% of GDP in 2009). Also in respect to contributions, these are relatively unimportant (below 1% of GDP), except in the Slovakia, Poland and Hungary. Given the rather late start and low accumulated savings thus far, these recently introduced funded private pensions are not paying out much in benefits thus far (less than 1% of GDP), though this will change in the future.

<FIGURE 2>

The financial crisis hit capital markets considerably in late 2008, immediately impacting on pension funds. Within a year, assets declined by more than 25% in the US and Ireland, while most other European pension funds had a nominal decline by more than 10% but less than 20% with few exceptions (OECD 2010; Pino and Yermo 2010). Given the partial recovery thereafter, the assets have recuperated but not necessarily made up for the losses. The differential losses are largely determined by the investment portfolio, in particular risky stock market investments (equities, currencies, hedge funds, commodity trading) vis-à-vis more conservative investments (in particular, public bonds, non-risky loans, and domestic real estate). Regulation with explicit portfolio standards can be crucial in limiting the exposure to risky investment: the particularly high losses in Ireland are due to the large exposure to foreign risky investment, while the exceptionally unbuttered Danish pensions are a result of their investment in bonds. Besides regulation, also the governance of pension funds, that is who decides and who controls pension investments will be crucial (Ebbinghaus and Wiß 2011). Private funded pensions thus depend on a set of regulations by the state and other collective actors as well as many decisions by employers, social partners and individuals.

The immediate consequences of the financial market crash for current and future pensioners are very different depending on the scope and maturity of funded pensions. In already mature multipillar systems, the current financial crises had direct effects for all those close to or already on retirement if they had not yet transferred their savings into life annuities. Lower than expected pension returns and therefore delaying retirement would be the most likely consequence. In the Netherlands, Switzerland, and the United Kingdom, funded private pensions are already contributing to more than 40% of pension income for more than half of the elderly population (Ebbinghaus and Neugschwender 2011). Any decline in private pensions will make maintaining living standards more difficult but whether it affects poverty depends on the minimum income protection through public basic pensions or means-tested assistance. In the countries in which private funded pensions are still developing, the current crisis has led to a blow in public expectations and could affect future savings behaviour in voluntary systems. In the CEE countries, there have been attempts to revisit the funded pension strategy and refocus on public pay-as-you-go systems that would provide less financial market risks, most notably is Hungary's turn-around in nationalizing prefunded pensions (Orenstein 2011).

There are also further consequences of the financial crisis on the financing mechanism of funded pensions, revealing the particular problem of who will be responsible of liabilities and who owns surpluses. The crisis put particular pressure on defined benefit (DB) systems, where employers or a collective fund promises retirement benefits in return for contributions. In fact, DB systems are threatened by underfunding of its liabilities, thus requiring an increase in contributions, and/or a cut in benefits, though it depends on the regulations in place (for instance, in the Netherlands the underfunding ratio was made less strict). Also in defined contribution (DC) with a guaranteed minimum rate of return, similar problems can arise (for example in Switzerland, the minimum rate was lowered by the Federal government). In general, pressures on companies to withdraw from DB schemes will be further propelled, thereby increasing even more the tendency to individualize the financial risks on individuals. While employers had used DB schemes for binding skilled workers to their firm and using surpluses in pension funds to finance early exits in order to restructure their workforce, a further shift toward DC schemes will

enhance transportability but also individualize financial risks, while employers do no longer take any particular responsibility for old age income.

Private funded pensions are not new to European welfare systems, but they have grown in importance or changed their character where they already existed for a longer time. They were set-up to provide more economically sustainable protection against income insecurity in old age in ageing societies. However, we learn from the two financial crises of the 2000s a lesson taught already by the Great Depression of the late 1920s that prefunded pensions may entail considerable uncertainty about the risk of short-term financial crisis and unfounded expectations of long-term rates of return. We face a double paradox: the more policies will seek to lower the financial risks of prefunded pensions, the less these will be able to offer higher benefits than pay-as-you-go systems, while the more financial market risks are allowed, the more we will be uncertain about whether the risk of old age income security can be fully insured. The increased privatization and financialization of pensions thus entails considerable insecurity, in addition to the social differences entailed by different employment and income prospects across social groups.

#### **4. Reversing early exit from work and active ageing**

Since the 1970s, early exit from work before the age of 65, has become a widespread social practice in most advanced welfare states for adjusting to social and economic pressure in a socially acceptable way (Ebbinghaus 2006; Kohli et al. 1991). As a consequence, the transition from work to retirement was no longer exclusively regulated by the statutory old age pension but depended on the personal and social situation of older workers as well as general economic and firm-related conditions. Both the availability of preretirement benefits (the ‘pull’ factor) and an economic environment leading to labour shedding (the ‘push’ factor) led to massive early retirement in many European economies. Variations across welfare regimes, however, were significant: Continental European social insurance systems facilitated massive early retirement, whereas the Scandinavian welfare states aimed at maintaining old age employment levels and Anglophone liberal market economies induced shorter waves of early exit during economic downturns. In the 1990s, less than every third man aged 60-64 was still working in Continental European welfare states and in most of Central and Eastern European new transition economies, whereas about every second in the Nordic welfare states and the Anglophone liberal economies. Since the OECD’s 1994 Job Study and EU’s Lisbon Strategy in 1999, international and national policy-makers called for reducing disincentive to work and increasing employment rates. A paradigm shift has occurred in both pension and employment policies, instead of early retirement as a passive labour market policy, the aim is today to retain older workers longer in working life and postpone retirement. This will not only reduce expenditure but also increase social or tax contributions and lead to higher economic growth.

Reversing early exit from work has proven difficult as the trend toward early retirement has been common in European welfare states, particularly in those providing multiple ‘pathways’ to early exit from work (Kohli et al. 1991). Focusing on the pull effect of welfare benefits, economists seek to explain early retirement as a worker’s individual choice. According to this labour supply model, early exit from work pays off when the wealth accrual from preretirement benefits exceeds the net wage earnings from continued work; therefore, economists recommend an increase in retirement age and defined contribution schemes to eliminate disincentives to work (Gruber and Wise 1999). This incentive model neither explains why some welfare states facilitate early retirement more than others, nor why older workers have a higher

risk of dismissal and unemployment. Comparative studies have shown that there are considerable regime-induced variations in the availability of ‘pathways’ to early exit, both public programmes and firm-sponsored plans (Kohli et al. 1991).

Old age pensions provide an exit pathway, though this represented often an unintended consequence of socially motivated policies. Due to paternalist concerns, women were granted an earlier statutory pension age in some countries (e.g. Britain and Italy), though these rules are being phased out, partly because of EU law and fiscal concerns. In addition, flexible pensions allow earlier drawing of benefits, sometimes with no or small reduction in benefits, though again financial penalties have become more common across systems. Where flexible pensions are unavailable (e.g. British or Dutch basic pensions), occupational plans by firms may top up or replace public benefits, albeit the move from DB to DC occupational pensions makes this less attractive. Taking into account long working lives, some Continental European countries granted workers under 65 early statutory pensions or special seniority rules, though most of these programmes have been gradually closed since the 1990s. Largely motivated as labour reduction policies, unemployment benefits and special preretirement schemes are additional pathways. Given their higher risk of joblessness, older workers could draw on long-term unemployment benefits without active job-search, except in liberal welfare regimes. In addition, governments or the social partners set up preretirement schemes, some of which required replacement by a job-seeker, but already during the 1980s several of these schemes were reduced or closed due to their high costs and limited employment effects. Disability pensions for workers with age-related health impairments are a further pathway. While Britain pays meagre benefits and apply medical considerations only, most Continental and Scandinavian disability schemes provide generous benefits, grant ‘partial incapacity’ benefits, and consider the labour market situation. Again there have been reforms limiting the take-up of disability pensions, most notably in the Netherlands in the 1990s.

In addition, economic ‘push’ factors are at work. In the face of increased deindustrialization, mass unemployment, and international competition, the available exit pathways provide opportunities for labour shedding. Early retirement can facilitate downsizing or restructuring of a firm’s workforce in a consensual way. It also allows circumventing employment protection law, union-imposed seniority rules (‘last in, first out’), and age-related wage scales. Politicians, unionists and workplace representative initially embraced ‘early exit’ as a way to reduce labour supply and open up positions for job-seekers. In Continental Europe, the externalization of adaptation costs onto publicly financed schemes was often facilitated by self-administration delegated to the social partners. Scandinavian governments have been more committed to active labour market policies and subsidies of partial pensions, at least until the unprecedented unemployment in the early 1990s. Given limited public pathways, large British companies use firm-sponsored plans to induce early retirement, but increasingly risks are shifted to individuals. In general, ageism in hiring, work organization, training and firing contributes greatly to older workers’ labour market problems. Thus, early exit is also a consequence of firms’ production strategies and ‘human resource management’ (Naschold and de Vroom 1994).

Massive use of early retirement, particularly in Continental Europe since the 1970s and CEE countries since the 1990s, has been driving up social expenditure and labour costs, reinforcing—not alleviating—unemployment problems. The OECD recommends that ‘public pension systems, taxation systems and social transfer programmes should be reformed to remove financial incentives to early retirement, and financial incentives to later retirement’ (OECD 2000). Employability of older workers and

continued training ('lifelong learning') are other areas for action, particularly promoted by the European Employment Strategy. Nevertheless, welfare state reforms affecting exit from work still occurs in the national arena in response to the particular problem load, institutional capacities and political reform coalitions. Retrenchment occurred mainly on the incentive side, motivated by fiscal considerations, bringing social expenditure under control and making transfer systems sustainable. Although past practices provide major obstacles for reform as actors at various levels have grown accustomed to early retirement, recent reform efforts have led to a slow change. Some countries have accelerated their way out of the impasse, most notably the Netherlands, Denmark and more recently Germany, while some still remain stuck in an undecided switch of direction. A major reason for this difficulty in reversing early exit from work is the institutionalization of early retirement practices in welfare state and production systems as well as the interest coalitions of workers and employers supporting these.

As part of its Lisbon Strategy, the European Council in Stockholm 2001 set a target employment rate of 50% among women and men aged 55 to 64 by 2010 (see Figure 3). The Continental European countries have had a long history of relatively low employment. Even by the target year 2010, the old age employment rate is below the EU target in the Bismarckian welfare states of Austria, Belgium, and France as well as of the southern European countries (Italy, Greece and Spain), with the notable exception of Germany and Portugal with recent turnarounds. Not only early retirement among older men but also relative early and low level of employment among older women has led to the low employment levels in Continental Europe. Similarly, the CEE transition economies experienced massive early exit and low levels of old age employment, though Estonia is an exception. The Anglophone liberal welfare states, but also after recent turnarounds, the Netherlands, Denmark and Finland exceed the EU target, while Switzerland has always had a high level of activation, similar to the high level achieved in Norway and Sweden. While there are still notable gender differences, these are particularly small in some of the Nordic countries (and Estonia).

<FIGURE 3>

In order to lower early retirement and postpone exit from work some of the following measures have been embraced over the last two decades (Ebbinghaus 2006): raising the pension age (ending special rules for women or long-term contributors); reducing disincentives to work (shifting to actuarially-fair flexible pensions and defined contribution benefits); closing special schemes (or tightening replacement conditions); limiting unemployment pathways (benefit retrenchment, introducing active job search and training); tightening disability conditions (restricting labour market consideration, reforming implementation). However, interventions in one pathway often simply lead to substitution with the second-best alternative, merely shifting costs between public programmes, unless privatization transfers the burden to firms or workers. Given the social partners' interest in early exit and its overall popularity, retrenchment attempts met considerable political resistance. Thus, some governments have engaged in social dialogue, negotiating phased-in reforms and delegating some issues to collective bargaining. Some of the recent phased-in reforms to extend retirement age in the future have been widely discussed. Most notable, Greece and Spain, hit by the financial market and sovereign debt crisis, but also France with a long early retirement tradition, have introduced recent pension reform efforts that met wide public outcry. Also in the future, the renewed welfare systems across European countries will continue the substantial push toward delayed exit from work and higher activation rates among older workers. The main concern

will be whether those unable to find suitable work will meet long periods of old age unemployment and suffer from low pension income.

As long as the underlying push factors remains potent, welfare cut backs will not be very effective or even counterproductive. There is also a need to adapt working conditions to prevent impairments and to better suit older workers' needs are areas for improvement at the workplace level. Partial pensions, pioneered in Sweden, could smooth the transition from work to retirement and help retain experienced workers, but its success depends on employers' offering part-time jobs. Laws and information campaigns against discrimination are means to combat ageism in hiring, training, and firing. Also, public labour market policies need to embrace activation and training measures for older unemployed workers, while the social partners should reconsider age-related bargaining policies that intensify the early-exit push (Jespen et al. 2002). Given early retirement's complexity as a social practice and the large cross-national variations, no one solution can reverse the early-exit trend and provide a solution for all. We need sound policies to promote active ageing and sustainable pension policies to meet the new exigencies otherwise unemployment and poverty may further increase for older people.

### **5. The return of old age poverty**

Pension reforms over the last two decades cut back public pension benefits, gradually extended the official retirement age, and fostered privately funded pensions, although many of these changes will be more visible in the future. While the sustainability endeavour was driving much of these pension reforms, the *adequacy* of retirement income has often been neglected from current public debates, partly because poverty in old age seems no longer to be such a pressing concern in Europe's advanced welfare states. Poverty and income inequality varies across pension systems in Europe; they are also on the rise due to the continued retreat of public pensions and the larger reliance on voluntary prefunded private pensions. The shift towards more occupational and personal pensions has had and will have major repercussions for the income situation of older people today and in the future. While public insurance provides more universal and redistributive social benefits by mandating wide coverage and by pooling risks, private pensions tend to reproduce if not amplify market-income inequalities existent during working life in the period after retirement. Unless mandated by law or enforced by collective agreements, voluntary private pensions are less widespread and provide non-redistributive benefits that depend solely on contributions. Furthermore, private pensions are increasingly based not on defined benefits (DB) but rather on defined contributions (DC) that are fully funded and dependent on returns of capital. This shifts financial risks onto individuals. Quite clearly, the financial and economic crises around 2001/02 and 2008/09 indicated the sometimes substantial risk of funded pensions: in countries with high-risk investment strategies, invested assets declined substantially.

Cross-national comparison shows considerable variation across Europe (Ebbinghaus and Neugschwender 2011) when we analyze poverty rates measured at 40, 50 or 60 per cent of median income (see Figure 4). An analysis of severe and conventional poverty rates in old age (measured at 40% and 50% of median income) reveals that Beveridge basic security is not always capable of effectively reducing poverty despite the explicit purpose to do so, while some contributory Bismarckian systems are better suited to reduce poverty, despite focusing on status maintenance. The lowest poverty rates are found in the case of the relative generous Dutch basic pension as well at the Danish basic pension (and tested supplement). Before recent reforms, Finland and Sweden showed very low poverty rates for the universal

basic and earnings-related pensions (Kangas and Palme 1996) and the new system with transfer-tested pension guarantees fares very well. In contrast, Ireland, the United Kingdom and Switzerland with basic security and Belgium, Greece, Italy and Spain as well as Slovenia with social insurance pensions have the highest severe and conventional poverty rates, particularly Ireland, Spain and Greece come close to US levels. Considering the at-risk-of-poverty rate (at 60%-level), the elderly population is more at risk than the working population with the exception of the social insurance systems of France, Germany, Czech Republic, Hungary and Poland as well as the Dutch multipillar system. In the other countries, whether Beveridge multipillar systems (Britain, Ireland, Switzerland), mixed systems of all Nordic countries or pure Bismarckian systems (Belgium, Greece, Italy, and Spain), the contributory earnings-related elements of public or private pensions lead to significant levels of at-risk-of poverty for more than every fifth elderly person.

<FIGURE 4>

The impact of multipillar systems in comparison to dominantly public pension systems on poverty and inequality in old age is rather mixed, suggesting that the effect of privatization depends not merely on the public-private mix as such but much more on its design (Rein and Turner 2004). To reduce severe poverty among those of retirement age, minimum income security via first-tier pension arrangements, in particular sufficient basic, guaranteed or minimum pensions are important. This will become even more crucial given the interrupted and non-standard employment careers of the current and future workforce. In addition, the earnings-related pensions are essential for maintaining living standards for the majority of those who expect more than a minimum provision. While Bismarckian systems traditionally provide such earnings-related public pensions, the Beveridge basic pension systems rely on second-tier state pensions or on private occupational and personal pensions. While state pensions provide some redistributive features, in particular social credits, for instance for child caring activities, private pensions rarely achieve social goals, unless tax subsidies, state regulation, or collective agreements intervene. Among current pensioners, most multipillar systems achieve lower poverty and inequality than the Bismarckian earnings-related pensions, though Britain and Ireland perform badly on both. Since pension benefits are the major income source for the majority of retirees, inequalities in old age derive largely from the design of the public-private pension mix.

Access conditions, contribution records, and benefit regulations are all crucial factors affecting the impact of private pensions on old age income inequality. Mandatory supplementary pensions (as in Finland, France, and Switzerland) as well as wide-spread collective agreements (as in Denmark, Netherlands, and Sweden and, more recently in Belgium, Germany, and Italy) are important to increase coverage among current workers. The British 'contracting out' of private pensions and the German tax incentives for personal pensions are also means to increase coverage, but at the cost of tax expenditures. Today's rate of recipients depends on past efforts, thus only the mature multipillar systems have achieved a high and more equal distribution of private pensions with respect to gender, household type, and income group. Among current recipients, the public pillar still dominates in Belgium and Italy, while Germany and Denmark have assumed medium levels and the other multipillar systems already have widespread second and third pillar pensions, although some vulnerable groups may be underrepresented. There are significant disparities with respect to gender, household, and income group: women, single pensioners, and low income households rely much more on public pensions than do the other social groups (Ebbinghaus and Neugschwender 2011). In multipillar pension systems (such as Britain, Denmark, Netherlands, and

Switzerland) the highest income group profits most from supplementing their public retirement income via funded pensions. As a consequence, in these countries private pensions have become a major cause of the reproduction of market income inequalities in old age—at least above the level of public basic security. The Bismarckian systems, designed to maintain status, effectively have reproduced inequalities from their early days. Although these countries have increasingly introduced socially redistributive elements such as child rearing credits, the recent reforms will again reduce public pension benefits, which will provide room for market-induced inequalities through voluntary private pensions, unless state or collective regulation succeeds in increasing coverage and socially redistributive elements.

Although public pensions, particularly in multipillar systems, have reduced the risk of poverty and the degree of inequality in old age, the different combinations of public-private mix still entail a relatively similar overall reproduction of social inequalities found prior to retirement (Ebbinghaus and Neugschwender 2011). Individual pension income and inequalities in resources in old age derive from particular features of the pension system design: in the Bismarckian dominantly public pension systems via their general equivalence principle, in the mature and emerging multipillar systems via the major importance of earnings-related pensions for the income of the broad majority in the future, and in the hybrid systems via their mixed structure, which also links current labour market integration to later benefits. Recent policy reforms will have major effects, many of which will only become visible in the coming decades. The increased emphasis on occupational and personal pensions results from attempts to offset the costs of public insurance in ageing societies and under fiscal austerity. However, public pensions that provide universal minimum income in old age will become even more important in the future. Moreover, as European welfare states have been challenged by the financial and economic crises of the 2000s, individuals relying on funded pensions have also faced increased financial risks and these may continue to grow as the reliance on private funded pensions increases. Only broad-based public policies and collectively negotiated self-regulation can pool risks and redistribute social benefits to effectively counteract social inequalities in the lengthening phase of life after retirement. In the future, the on-going trend of privatization will lead to a gradual convergence of countries as their pension systems become multipillar. As shown in these ten pension systems, the shift toward increasing privatization amplifies the already existing level of social inequality in these ageing societies.

## 6. Conclusion

The transformation of the welfare systems for the elderly across Europe has been happening and will continue mostly in slow motion. These changes occurred partly through some major systemic reforms, but more often through multiple smaller public policy interventions, sometimes through non-decisions by public actors, and by subterranean adaptations by non-state actors such as employers, unions and individuals. The main features of the renewed welfare state for the elderly have taken shape at least in its contours. The state no-longer guarantees the same living standard maintaining through public pensions for its current and particular future retirees as it did for former retiring generations. This chapter explored four transformations of pension policy and its impact on the new welfare system in Europe, discussing the differences across Bismarckian still mainly public systems and the Beveridge-type multipillar systems.

The *first* major transformation changed the goals of *public* policy for old age. After many more or less important reform steps, the pay-as-you-go public pension systems in Europe will provide leaner benefits due to the freezing of contribution rates, economic and demographic automatic stabilizers, and the larger

reliance on contributory benefits over the entire working life. The new welfare system for the elderly is one where the welfare *state* assumes more limited responsibility for providing minimum social protection and often retreats from guaranteeing achieved living standards. This retreat of the state, however, will not end but downscale its commitment of significant public resources. The state seems to have reached its limits fiscally and therefore will provide on average lower benefits for ever more pensioners. This may lead to a shift from broad pension policy for all to more targeted social measures, preventing poverty and compensating for some disadvantages, while leaving the maintenance of living standards to the market actors: employers, unions and individuals.

The *second*, parallel transformation has been the increased privatization of pension provision across Europe, in particular we witness a shift towards funded pensions with more individual responsibility and risk-bearing. The long-term conversion of the public pension systems is supposed to be compensated by private funded pensions through public mandate, collective agreements, employer benevolence or foresighted individual savings. However, it remains questionable whether this will be the case for all and whether these supplementary pensions suffices, this largely depends on the governance and regulation of these private pensions. Although all European countries move toward a multipillar system, pension fund capitalism first developed in the Anglophone, partly Nordic and some Continental European countries (the Netherlands and Switzerland). The current financial crisis has a significant impact on current and expected future returns of funded pensions, requiring immediate responses and long-term regulatory adaptation. The more funded pensions rely on risky investments and benefits are based on defined contributions, the more these financial risks will become individualized. In the countries with developing private pensions, particularly in Eastern and Southern Europe, the current crisis may have a dampening effect on future development, and some calls for a reversal have been voiced. Although the state may have retreated from direct commitments, through its tax treatment and regulation it indirectly supports and steers funded pensions. Also non-state actors, the employers, unions and the financial sector play a varying role in self-regulating funded pensions – this is the other hidden side of the ‘new’ welfare system. Governance matters for pensions: decisions by many corporate and individual actors about savings need to be adopting an appropriate savings strategy for old age income.

The *third* transformation is the reversal of early exit from work, in order to lower the number of those drawing pensions prematurely and increasing the share of those contributing through gainful work to pension financing. This policy change has been paradigmatic: it follows not only from policies to cut cost pressures but also from a new concept of ‘active ageing’ and employment growth, replacing earlier policies of labour shedding and redistributing work from the old to the young. Not only public pension policy has to be adapted to lower the disincentives to continue working for older workers, but also the rules of disability benefits, long-term unemployment and special preretirement programmes have to be altered. These interdependencies require coordination across several social policy fields. Yet pull-oriented social policy changes, though more steerable by government, do not suffice in order to achieve the policy goal of active ageing. Also economic push-factors need to be addressed, that is, the pressures of seniority wages, outdated skills and restructuring needs. This requires concerted action of many actors from firm to workplace representatives and older workers: ending ageist personnel policies of firms, investing in life-long continuing vocational training, adapting work environments and active labour market policies for older workers. If these accompanying policies fail and social protection has become more lean or unavailable, older workers may face not only long-term unemployment but poverty.

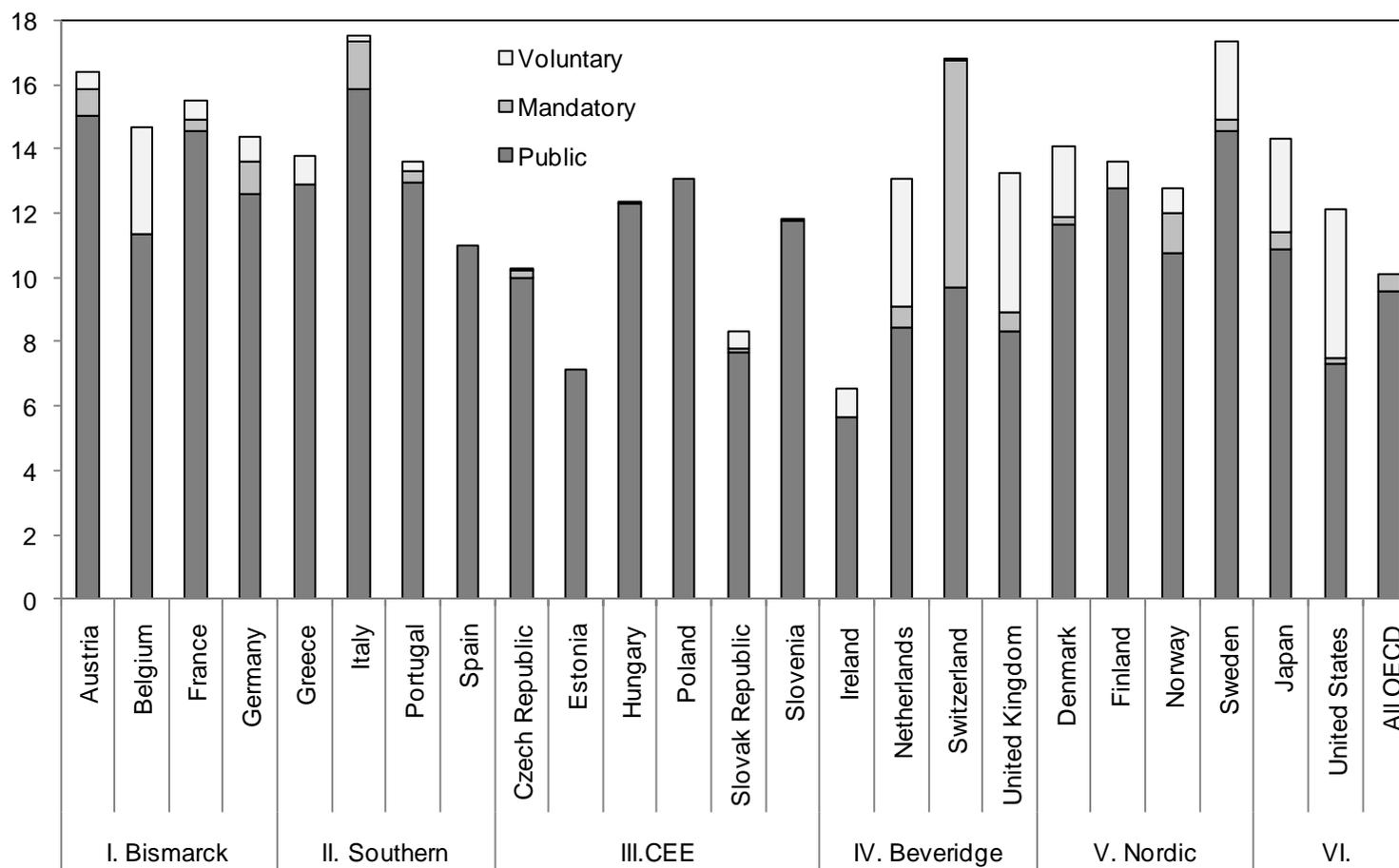
Finally, the *fourth* transformation, a potential increase in old age poverty for social risk groups, may result from the previously mentioned developments: the cutting back of public pensions, the insecurities of funded pensions, and potential threat of unemployment among older workers. The public pension system (including social assistance) remains to be the main protector against old age poverty. Both well developed Beveridge basic pension systems and relatively well developed Bismarckian system have been able to lower old age poverty thus far. However, old age poverty may indeed increase in the future, increasing political pressures to raise basic pension levels or provide guaranteed minimum income in earnings-related systems. The increased tightening of benefits to the employment relationship and contribution record in both public and private pensions will further lead to inequalities between those that have had advantageous employment and those with precarious jobs and new social risks. The retreat of the state from its old age protection goal may ironically increase the political pressures for its increased role in securing and regulating old age income provision in old age. The transformed welfare system for the elderly may thus require further adaptations by policy-makers and non-state actors.

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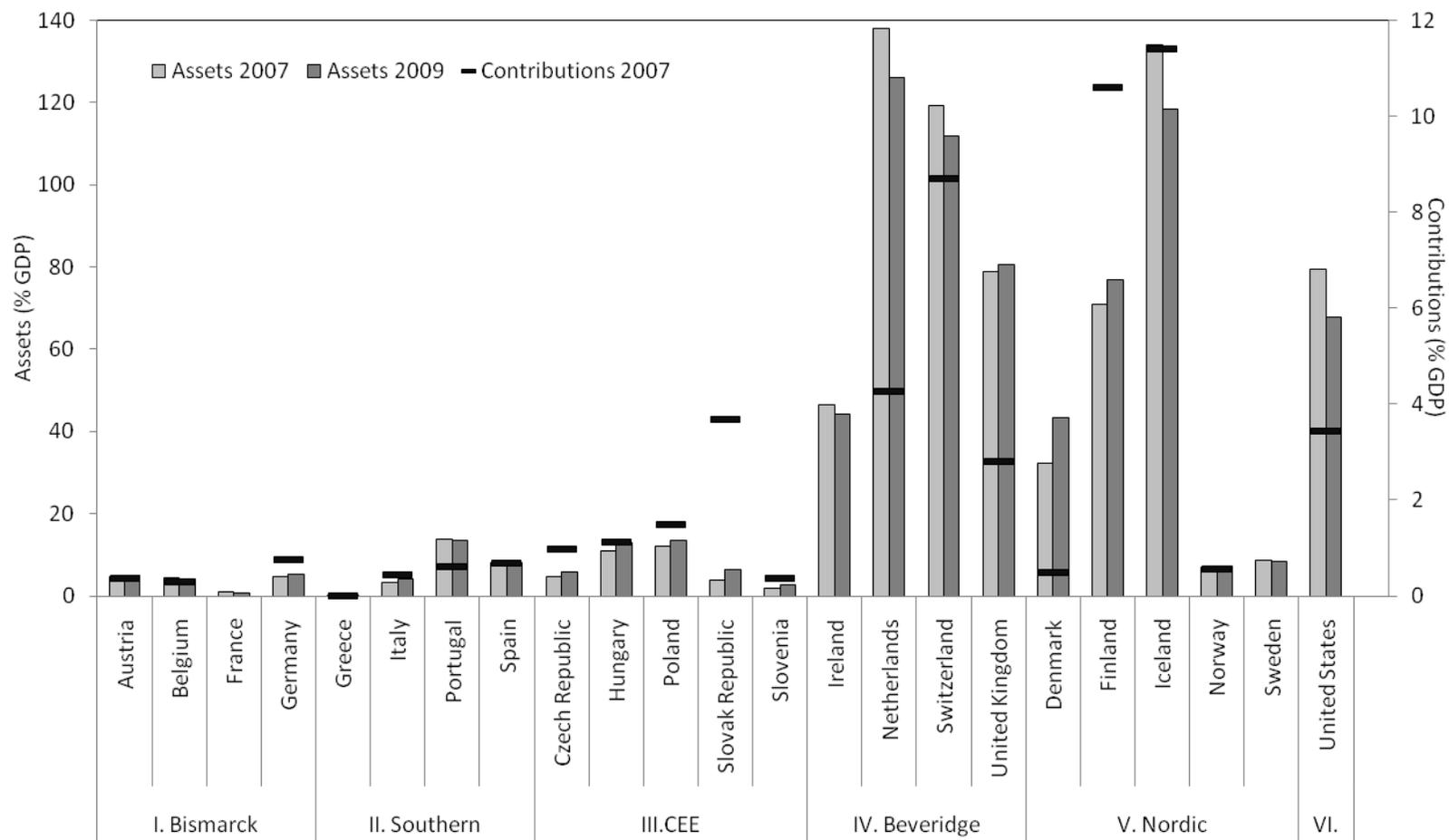
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Figure 1: Public, mandatory and voluntary expenditure on old age, survivor and disability pensions (%GDP) in 2007



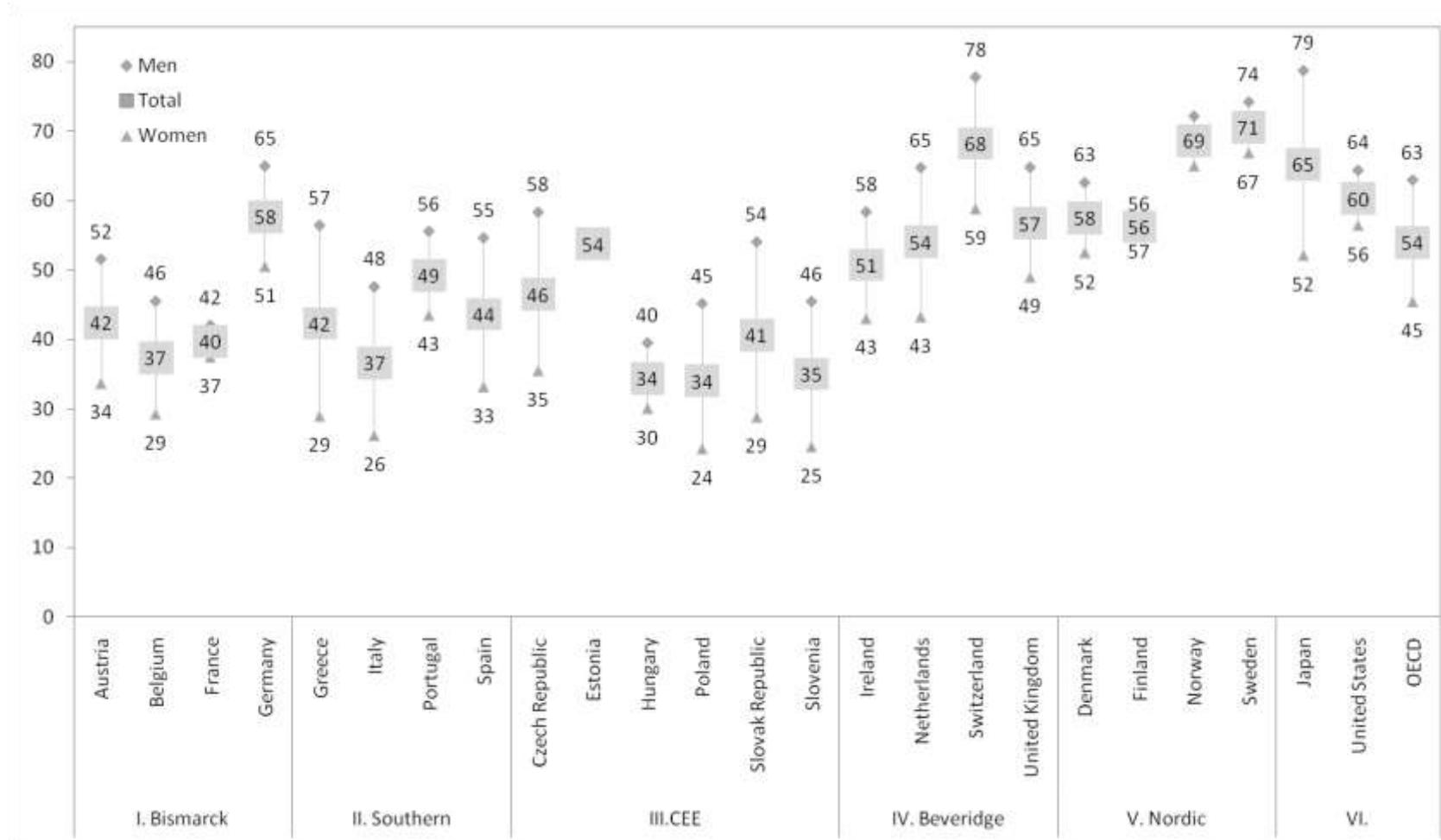
Source: OECD Social Expenditure Database 1980-2007, Paris: OECD ([www.sourceOECD.org](http://www.sourceOECD.org)), 2011.

Figure 2: Assets and Contributions to Private Pension Funds (%GDP) in 2007/2009



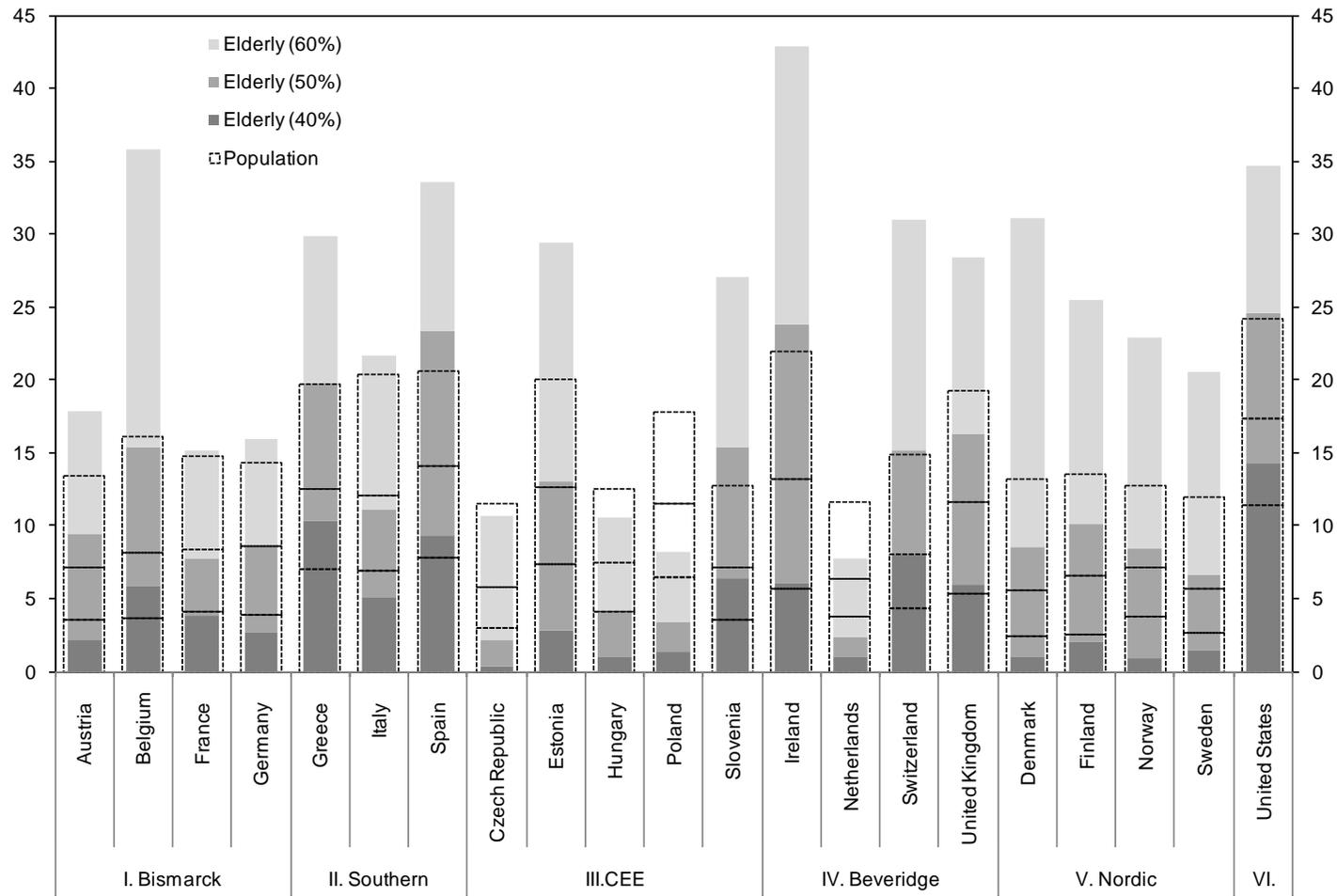
Source: OECD Pension Database, Paris: OECD ([www.sourceOECD.org](http://www.sourceOECD.org)), 2011.

Figure 3: Employment rate of older people (age 55-64) in 2010



Source: OECD Labour Force Statistics 1960-2010, Paris: OECD (www.sourceOECD.org), 2011.

Figure 4: Poverty rates of total and older population around 2005



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Note: Household adjusted poverty rates at 40%, 50% and 60% median income; elderly: age 65 and older; 2005 except Belgium: 2000.  
Source: Luxembourg Income Study, Key Indicators, Luxembourg: LIS ([www.lisdatacenter.org](http://www.lisdatacenter.org)), 2011.

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