

The PEN-REF Project

**Thinking about
Pension Reform:
Discourses,
Politics, and Public
Participation**

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Preface

The following paper is the inception report for the PEN-REF project. This report will provide :

- an overview of the basic ideas and concepts economists use to think about pension reform (Section 1),
- an overview of institutional policy discourses about pension reform (Section 2),
- an outline of theories in political science and policy analysis that may help explain pension reform processes (Section 3),
- the research questions for the later stages of the PEN-REF project (Annex 1)
- an outline of research instruments (Annex 2)
- an outline of the options concerning focus groups (Annex 3)

In sum, the Inception Report provides the theoretical background and frames the research object for the work of the PEN-REF project.

Introduction

Pension reform has proved to be a persistent policy issue across Europe. No matter where one looks, all European countries, small or large, rich or poor, EU Member State or Accession Country, have addressed the issue of reforming old age pensions at some point during the 1990s. While policy-makers in some countries, particularly in central and Eastern Europe, have radically reformed their old systems, others, typically those in affluent continental Europe, have been far more cautious opting instead for incremental changes to existing pension systems. Others still have managed to implement fairly broad changes without making pension reform an explicit policy issue.

Not only has pension reform been a persistent feature across different political systems, it has also shown incredible resistance to resolution over time. Just as policy-makers seemingly despatch the problem, pension reform worms its way back onto the policy agenda giving rise to a new round of what is, more often than not, a politically divisive and conflict-ridden policy debate. In short, no matter whether the particular country reforming old age pensions is affluent or in transition, corporatist or market-oriented, a net EU contributor or a net EU beneficiary, pension reform is difficult.

The PEN-REF project has set out to understand why pension reform in Europe is so difficult. As we will see below, the question in itself is not particularly new. However, the PEN-REF consortium will answer this question in an innovative way. Whereas social science conventionally concentrates on the technical aspects of how to optimally, efficiently and effectively reform old age pension systems, the PEN-REF project will primarily look at how political discourses of pension reform affect reform debates themselves. How, in other words, does the way policy actors think about pension reform lead to a specific set of institutional reform practices? Here, the underlying hypothesis stipulates that it is precisely these institutional practices that make pension reform so difficult. What is more, the PEN-REF project will explore whether or not introducing more public participation may lead to a new set of institutional reform practices.

Understanding the way systematic sets of ideas impact on pension reform policy implies that we need to know what ideas are 'on the market'. The following report, then, reviews selected literature pertaining to two core issues of the PEN-REF project: the policy discourse of pension reform and the political economy of pension reform. Since any attempt to comprehensively review any of these fields, let alone all three, is a huge undertaking, the following report will concentrate on the literature that will allow us to focus and sharpen our research questions.

Section 1 will briefly outline the way economists typically think about reforming old age security systems. Here, we will look at both the basic rationale underlying pension systems as well as different pension design options.

Section 2 will review recent ideas and policy stories concerning pension reform. Rather than focusing on the more scientific literature, this section will look at the way international organisations, such as the World Bank, the ILO, or the EU, have defined the challenges of pension reform.

Last, Section 3 will briefly outline the literature concerning the political economy of pension reform. Here, the term political economy refers to the study of those socio-economic, political and cultural factors that affect pension reform processes. Again, rather than a comprehensive review of the literature, we will concentrate on different approaches of explaining why pension reform is so difficult.

1 Issues and Concepts

Pension systems are very complicated financial, legal and administrative animals. To add insult to injury (from the view of the researcher at least), pension systems have developed differently in different economies: no one pension system is exactly the same. Yet, in order to think about reforming old age retirement systems, researchers need a language or a set of ideas that allows them to compare and assess different pension designs. In this section, then, we will briefly review the language and the ideas researchers and policy-makers use to understand pension systems.

1.1 What Should Pensions Do?

It is fair to say that the dominant language in which policy actors discuss pensions issues is standard economics. Here, the world, or at least the facet of the world we are interested in, consists of rational economic agents that need to consume in order to live. These rational economic agents meet their consumption needs via claims on current income. When working, this income derives from paid labour or production. Yet when economic agents no longer work (by choice or by compulsion), they can rely either on time-consistent individual actions of the past (savings), informal group action (informal transfers from family or community), and collective action (formal public pension systems) (World Bank, 1994, p.2). From the vantage point of the individual, old age security systems enable consumption even though this individual, for whatever reasons, has left the labour force. In terms of the economy as a whole, pension systems transfer income from the working to the retired.

More specifically, and here international organisations agree, pension systems should fulfil three interrelated functions: they should enable savings, they should protect against old age poverty by redistributing income, and they should insure against the risks of ageing.

1.1.1 Savings

One way for economic agents to provide for their old age income is to forego consumption now in order to consume after retirement. In other words, individuals can save. Yet, economists point out that individuals tend to heavily discount the future, meaning they do not save enough to provide them with an adequate income in old age (Willmore, 1999, p.7).

There are several reasons why individuals do not save enough for their retirement. First, individuals may be myopic, or short-sighted. Although the term “short-sightedness” implies a lack of judgement on part of the individual, people may choose not to save for very good reasons. Informational asymmetries, fundamental uncertainties concerning future health, income capacities, the cost of living at the point of retirement, the financial stability of savings products confound any attempt at rationally assessing when and how much to save.

Second, pension insurance markets are subject to well-known market failures. In particular, insurance companies are prone to so-called adverse selection problems. These arise when insurers have less information about life-expectancy than the insured. As a result, “good” risks (somewhat tastelessly referring to those who die young) and “bad” risks are pooled

which drives up the premiums. This, in turn, deters good risks: premiums continue to spiral until they become financially prohibitive (World Bank, 1994, p.37; Willmore, 1999, p.7). Another insurance market failure is so-called “creaming”. This occurs when regulators prohibit insurance companies from differentiating risks in any other form except age. When insurers have to offer the same price to everyone in a particular age cohort, insurers will attempt to ‘cream’ the good risks (chain smokers, stunt men, miners, etc.) (Willmore, 1999, p.7).

Third, market structures themselves may not provide the appropriate financial instruments for saving. This may be due to underdeveloped capital markets and insecure financial institutions often resulting in insecurity and lack of credibility with economic agents (World Bank, 1994; ILO, 1999).

Last, and most importantly, poverty may effectively inhibit individuals from saving. Many may simply not be in the position to forego present consumption for consumption later in life (World Bank, 1994,p.38).

Since individuals are not likely to save at all or not save enough for their retirement, pension systems should encourage or mandate individual savings.

1.1.2 Redistribution

As we have seen, individuals may not save enough for their retirement simply because they are too poor. Perhaps not surprisingly, the ILO (1999) elaborates this aspect in detail. The ILO argues that redistribution, that is the transfer of income from life-time rich to life-time poor, has been and will continue to be an important objective of any pension system.

The legitimisation for redistributing income may vary. People who experience a life-time of low-income labour or infrequent employment may barely be able to meet current consumption from their income, let alone save for old age. Apart from unemployment, other factors such as disability or family responsibilities (affecting mostly women) may hinder individuals from accruing sufficient pension benefits or savings. Another justification for redistributing income, the ILO maintains, is to compensate that generation who experienced low incomes, poor working conditions, and much diminished career options during times of depression and war (p.10)

In order to avoid poverty in old age, the World Bank (1994), ILO (1999), and the Commission (1999) agree, pension systems should progressively redistribute income.

1.1.3 Insurance

Planning for ageing and retirement involves making judgements about the future. However, many aspects of both an individual's and society's future are inherently imponderable and uncertain. Uncertainty, in turn, implies risk.

What, then, are the risks of ageing? The World Bank (1994) provides a set of four risks:

- 1) *Investment Risks*. Retirees or their pension fund managers may make poor choices in investing pension funds. This may lead to a lower level of benefits than a more prudent investment would have made possible (World Bank, 1994, p.83).
- 2) *Disability Risks*. Individuals' earning careers may be disrupted due to illness or disability.
- 3) *Longevity Risk*. Individuals may outlive their savings.
- 4) *Political Risk*. The political framework in which individuals accrue pension benefits or savings may change. At worst, this may mean that the entire governmental edifice collapses (as, for example, in some republics of the former Soviet Union, notably the Ukraine). Commonly, however, political risk refers to "...the possibility that the rules of the game will change in such a way that income in retirement turns out to be much less than was promised" (Willmore, 1999, p.3).
- 5) *Company Insolvency Risk*. Private insurance companies may simply go bust. The ILO (1999) expands this risk to include the break down of government regulation and the collapse of public pension management (p.11)
- 6) *Inflation Risk*. Pension wealth may be insufficiently protected from price instability. In this case, the real value or purchasing power of retirement incomes may decline.

Larry Willmore (1999) adds another type of risk:

- 7) *Volatile Investment Returns*: Although investment returns may be adequate on average in the long-term, retirement income may be subject to considerable and protracted fluctuations in the rate of return. This is what Landis MacKellar (2000) means when he points to the possibility of people retiring into a 'bear market': adverse market conditions may force pensioners to sell assets they purchased dearly at a relatively low price. The ILO (1999) refers to this risk as 'economic risk' and includes unexpected changes in the rate of real wage growth.

The ILO (1999) proposes two more risk categories:

- 8) *Demographic Risks*: Unexpected changes in demographic developments (such as population ageing, see section 1.4.1 below) may exert downward pressure on pension benefits.
- 9) *Individual Risks*: These risks refer to the uncertainties inherent in an individual's career path (promotions, redundancy, etc.) (p.11).

These risks are inherently imponderable and may quite severely affect an individual's retirement income. In addition to ensuring a sufficient level of savings and redistributing income to the life-time poor, pension systems also need to co-insure against the risks of ageing.

1.2 Types of Pension Systems

What is the shape of old age security systems? Informal old age security arrangements, including family and community structures, are, the World Bank (1994) contends, an effective way of caring for the old. However, as societies become more complex, more impersonal, formal systems of societal interaction, such as the market, erode the functionality of personal, informal structures. Thus, the more economies modernise, the less policy-makers can rely on family and community structures to care for the aged.

An alternative to informal community and family transfers are formal pension systems. Willmore (1999) suggests that we distinguish different types of formal systems within two dimension. The first dimension refers to the way pension systems are financed: a pension system can either be funded or unfunded¹. In a funded pension scheme, also referred to as a Capital Reserve (CR) or advance-funded pension system, individual contributions accumulate in a capital fund which later provides the basis for pension benefits. Conversely, an unfunded system, commonly known as a Pay-As-You-Go (PAYG) scheme, finances current pension benefits with current contributions. The second dimension describes the way benefits are calculated: pensions may be a “defined benefit” or “defined contribution”. In defined benefit schemes, pension managers define and, in theory, guarantee the level of pensions benefit in advance and vary the contribution rate. In contrast, defined contribution plans fix a certain amount of contributions and vary the benefit level. These two dimensions provide a simple 2x2 matrix:

	Unfunded	Funded
Defined Benefit	Traditional PAYG system	Traditional Occupational Pension
Defined Contribution	Notional Accounts	Mandatory and Voluntary Savings Plans

Source: Willmore (1999), p.2

An additional question, one that, as we shall see below, certainly inflames policy debate, is whether these systems should be managed in the public or the private sector².

1.2.1 Traditional PAYG Systems

The first type, the publicly managed Pay-As-You-Go (PAYG) system, is by far the most common formal pension arrangement in Europe. Public PAYG system come in many different guises. In general, PAYG systems define the level of benefits in advance (hence the term “defined-benefit” or DB). This implies that there is no actuarial relationship between

¹ This is, of course, jargon. All pension systems are funded in the sense that money flows in and out of them. What this term refers to is the way in which pension systems manage these flows of funds.

² Willmore (1999) rightly claims that there is little in economic theory that would suggest private management is more efficient than public management. Whether a policy actor comes down on the side of public or private sector management, he concludes, has more to do with ideological commitment than economics.

contributions and benefits³. Yet, the precise way systems define benefit varies widely. Some systems (e.g. Australia) provide a flat, universal benefit regardless of income or employment history. Others also provide a universal flat benefit but tie them to a certain number of contribution years (as in, for example, the UK). Defined-benefit systems can also pay means-tested benefits or minimal pension guarantees. Yet other PAYG systems peg benefits to earnings: this system, common in continental Europe, provides higher benefits for those workers with previously higher incomes (World Bank, 1994, p.114).

Most often, contributions to defined-benefit public PAYG systems take the form of payroll taxes. Here, employees pay part of their wages into the pension fund and employers contribute an equal part from profits⁴. Alternatively, policy-makers can partially fund public PAYG systems from general revenues, thereby relieving the upward pressure on unit labour costs.

The advantages of such a system are that it can easily and fairly efficiently redistribute pension income across different income classes. What is more, a public PAYG system creates an intergenerational contract since current pension contributions resemble future pension claims. In this way, younger generations are not only persuaded to forfeit consumption now for the prospect of consuming when they retire but also have a vested interest in the stability of the system. Additionally, public PAYG systems protect individuals from those risks relating to investment and market fluctuations as well as disability, longevity and individual risks. They remain, however, vulnerable to demographic risks and political risks.

1.2.2 Traditional Occupational Pensions

The second form of formal system is the occupational pension. Here, individual firms or entire industrial sectors institute a pension fund for employees. Occupational pension have the advantage that they involve relatively little administration costs. Moreover, firms can easily set up occupational pensions without much help (or, depending on your point of view, interference) from the public sector. Here, the World Bank (1994) argues that, in contrast to PAYG pensions contributions, workers will tend not to perceive contributions to occupational pensions as a tax.

In general, the private sector is responsible for managing occupational pensions. The particular management forms of occupational pensions vary widely. Occupational pensions are traditionally defined-benefit plans (although defined-contribution occupational schemes are becoming increasingly popular); they can be fully funded, partially funded, or completely unfunded; occupational pensions can be tied to one particular firm or to a industrial sector. In any case, occupational pension are subject to heavy regulation (World Bank, 1994; OECD,

³ Meaning what an individual pays into the fund need not have any actuarial relation to what they receive in terms of pension benefits.

⁴ However, employers will try to pass on the additional costs to workers in form of lower wages. If the economy features downward wage rigidities, employers will cut back labour demand.

1998; ILO, 1999). Accordingly, the risks these schemes are vulnerable to depends on the precise set-up of the plan⁵.

1.2.3 Mandatory and Voluntary Savings Plans

Whereas the previous two types of pension systems are well established, the latter two are forms are relatively new and not common. This type of pension scheme takes the form of occupational pensions (only if they are DC), personal saving plans and annuities. These can be either mandated by the government (as in many newly reformed Latin American countries, most notably Chile) or voluntary schemes where the government often offers financial incentives (such as preferential tax treatment as in the USA).

Essentially products purchased from financial institution, these plans provide individuals with a means of saving income for retirement. These defined-contribution plans are, by definition, fully funded meaning that benefits related directly to contributions plus any capital gains. Here, individuals bear the investment risk and the risk of volatile returns inherent in market operations. Although there is no reason why public sector institutions should not manage these types of plans, advocates of mandatory and voluntary savings plans argue that the private sector is best equipped to manage these plans⁶. This would insulate pensions against the risk of political manipulation and the associated risk of imprudent investment (World Bank, 1994).

1.2.4 Notional Accounts

An alternative to funded defined contribution savings accounts is the idea of notional defined contribution accounts. Here, workers accumulate pensions contributions based on a contribution and a notional interest rate (which can be the market interest rate or, as in Sweden, an alternative indicator reflecting economic growth). At retirement, pension managers transform the account into annuitised⁷ benefits. The scheme, however, is not funded: no actual capital reserves back up the accounts meaning that current contributions continue to finance current pensions.

The advantages of this approach, very recently introduced in Sweden, are to make the pension system more transparent by more closely relating benefits to contributions. Since the system is not funded in advance, the individual bears the longevity risks while society bears demographic risks and economic risks.

⁵ The World Bank (1994) provides an overview of how different design characteristics affect different types of risk (pp. 83-87).

⁶ Although this may have more to do with the inherent distrust of public sector institutions of public choice approaches. See Section 3.

⁷ To annuitise an account means to transform the funds in a pension account into annual cash benefits. In order to avoid longevity risks, pension managers pool the capital reserves and calculate benefits according to a fixed age of death, say 85. The assets of those that die relatively young finance those that live longer.

1.3 The Pensions System Mix

Although Willmore's matrix provides a neat classification of pension types, the reality of actual pension regimes is far more complex. Pension systems contain a complicated and highly variegated combination of defined contribution and defined benefit, funded and unfunded as well as private or public sector elements. The precise mix of private and public sector management, the ILO (1999) argues, depends on government policy. In particular, they continue, it will depend on six factors:

- i) the generosity of public sector PAYG benefits: the smaller the public sector benefits, the larger the incentive to make alternative arrangement for retirement income⁸.
- ii) allowing for opting out or contracting out of the public system.
- iii) mandating employer-provided benefits (as in Switzerland)
- iv) mandating contracts with private fund managers (as in Chile)
- v) providing incentives for private sector provision, such as preferential tax treatment of retirement income accounts (as in the USA or Canada)
- vi) the way in which the government regulates private sector pensions (ILO, 1999, p.5).

The real world of pension systems, then, depends on the interaction of government policy, individual behaviour and organisational policies. For this reason, it is very difficult to make any general observations of the distribution of public and private, unfunded or funded, or defined-contribution and defined benefit schemes in any given polity.

However, the ILO (1999) maintains, that in developed countries, about 40% of the elderly population lives off public transfers exclusively. The majority supplements their public pensions by either savings, occupational pensions, or work. The typical dominant system in developed countries is a defined benefit, public PAYG system (c.f. the MISSOC Report 1998). The state also provides additional benefits to retirees including disability benefits, survivors pension, unemployment benefits, and early retirement pensions. In order to prevent old age poverty among the life-time poor, governments often provide social assistance in the form of cash benefits, subsidies on basic goods and services, and preferential tax treatment (ILO, 1999, p.4).

⁸ The OECD makes a very similar point when they observe that the level of public pension benefits has little impact on the disposable income of households: "...on average, households in many OECD countries set targets for income just after retirement that are about 80% of income just before retiring. For most families, that amount does not depend directly on the generosity of public pensions benefits levels. People simply make other arrangements such as increasing private pensions contributions, saving more or working longer" (pp.56-58).

2 Policy Stories in the Pension Reform Debate

Part of the PEN-REF project is about understanding the impact of ideas on pension reform processes. More specifically, we are interested in how ideas and discourses shape and set policy agendas.

Why are ideas and discourses important? As we have seen, the pension issue is far from straightforward: not only are pensions systems highly complicated machines, no one pension system is exactly like another. Add to this the fact that the potential impacts of socio-economic change, most prominently population ageing, on pension systems is subject to considerable uncertainty and we have a complex, contentious and potentially divisive issue area.

Ideas and discourses allow policy actors to make sense of messy policy issues such as pension reform. They provide policy actors with a coherent framework or scheme for interpreting events and aspects of policy issues. By applying such a framework, policy actors construct plausible stories of what pension reform is about what ought to be done. Yet, by creating order in an “anarchic stream of events” (Rayner, 1991), ideas and discourses also provide a particular ‘spin’ to an issue. The assumptions that make up an interpretative framework elevate certain aspects while relegating others. This, however, does not mean that policy stories are mere fiction or that we should dismiss them as ‘ideology’: policy stories not only provide the basis for distinguishing ‘right’ from ‘wrong’ (i.e. the normative dimension), they also equip policy actors with a means of identifying and classifying what is to count as a ‘fact’.

The following discussion will draw from the publications of three major international organisations: the World Bank, the ILO, the European Commission, and, to a lesser extent, the OECD⁹. There are several reasons for this choice. First, although this selection is far from exhaustive, it reflects significant institutional and ideological difference: the World Bank represents ‘establishment’ economics, the ILO’s sympathies are closer to labour organisations, and both the OECD and the European Commission take a judicious state view. The second reason for limiting the analysis to international organisations is methodological. The following analysis plausibly (but, we suspect, inaccurately) assumes that international organisations set broad policy agendas for national policy-actors. This means that the policy stories international organisations tell directly or indirectly influence pension reform processes in individual polities: in other words, ideas flow from the top levels of governance (international institutions) down to the bottom levels (national policy-making arenas). To what extent this is true or not is an empirical question we will address in the later stages of the PEN-REF project (specifically WP2).

This section, then, lays out some of the policy stories that policy actors tell about pension reform. Like any good yarn, policy stories have settings (the basic assumptions), villains (the policy problem and who or what is causing them), heroes (the policy solution and who or what should be responsible), and, of course, a road leading to a happy end (concrete prescriptions for reform). Each contribution tells a slightly different story of the same issue:

⁹ The OECD (1998) does not make such a strong case for one type of reform rather than the other. The OECD position represents a hybrid between an economically-oriented policy story and a state-oriented policy story.

each identifies problems, apportions blame, and claims to provide solutions. Each story combines factual observation with fundamental beliefs about how to best manage pension systems. In short, each policy story frames the pension issue in a particular and conflicting way.

Yet, although both the diagnosis and the prescriptions differ, each story has a common point of departure: the phenomenon of population ageing.

2.1 The Demographic Challenges to Pension Systems

If one were to be unkind, one could easily depict social science as a locus of compulsive worrying. Whatever the issue, social scientists (including the present author) are permanently worried about the state of this set of institutions, the rate of decline or growth of that set of practices, or the general inappropriateness of societal beliefs and values. Some issue come and go (e.g. stagflation); others seem to have the uncanny ability to reinvent themselves. The concern for the growth rates of any given population belongs to the latter category. Ever since Thomas Malthus, social scientists have been following the developments of population growth with great interest and increasing methodological sophistication.

That is why it comes as no surprise that all international organisations and most experts agree on and, indeed, worry about two fundamental issues. First, populations are ageing. Second, population ageing is a serious problem for existing pension systems.

For many (World Bank, 1994; OECD, 1998; EU, 1999), the development of population growth is the root cause of the pension problem. In affluent northern countries, which include the EU Member States and, to a lesser degree, the Accession Countries, populations are ageing. Essentially, this means two things. First, due to improvements in areas such as medical care, nutrition, income, or working conditions, people in the affluent North are living far longer than their parents and their grand-parents. Since 1960, the average male life-expectancy has increased by eight years from 68 to 76 (OECD, 1998, p.10). Second, due to less apparent reasons such as increased female education, fertility rates in the North declined dramatically about 30 years ago. This has resulted in an decrease in the so-called support ratio (population aged 15-59 divided by population aged 60+). In other words, less young people have to support more old people that live longer lives. While in 1960 there was one retiree for every four employees, the OECD (1998) maintains that this ratio currently stands at three employees to every retired person (p.11).

Yet, ageing in itself is not the problem in the industrialised North. MacKellar (2000) points out that the age structure in northern countries will lead to an "ageing from the middle" of the age pyramid. Starting about 2010, the large age cohort, commonly referred to as the 'baby-boom generation', will start turning elderly and retire from the labour market (World Bank 1994; OECD 1998; MacKellar 2000). Thus, labour market growth rates are set not only to decline but turn negative around about 2010 (OECD, 1998; MacKellar, 2000) leaving a relatively small cohort responsible for a large retired population.

The European Commission has calculated that the share of the younger cohorts in the population will drastically fall. By 2015, the cohort of 0-14 year olds will fall from 17,6% of the population (1995) to only 15,7%. The decline in the 15-29 year olds, that is those that feed

the labour market, will be about 16% (European Commission, 1999, p.7-8). Contrast this to the rapid growth of older cohorts. Starting in 2010, the 60-64 age cohorts will grow by 26% which corresponds to 16 million people across the EU. The predicted growth rates of the aged and very old are particularly impressive: the 65+ age group will increase by 30% and the 80+ group will grow by 40% (European Commission, 1999, p.8). If productivity gains do not rise dramatically from their post-1973 annual average of 1,5%, and there are no compelling reasons to think that they will, then higher dependency ratios and lower labour market participation mean reduced economic output and a loss of material living standards (OECD, 1998, p.10). What is more, if we assume that real disposable income affects fertility decisions, then, other things being equal, falling real incomes are likely to depress fertility rates even further.

Thus, whatever the particular modalities of the pension system, demographic changes have thrown down the gauntlet: how can the product of a relatively small group of workers finance incomes of a large group of retirees?

2.2 **The World Bank Story: You Can't Have Your Cake and Eat It**

The World Bank's approach to pension reform has been hugely influential in setting pension reform agendas across the globe. The impact of both the publication *Averting the Old Age Crisis: Policies to Protect the Old and Promote Growth* (1994) and the World Bank's policy activity on policy agendas have been, of course, by no means uniform: whereas the World Bank undoubtedly exerted very direct influence on the pension reforms in Eastern Europe, the republics of the former Soviet Union, and, most notably, Latin America, the Bank's influence on pension reform in EU Members States has been far more indirect, opaque, and 'atmospheric'¹⁰.

This is not to say that the World Bank's ideas have found ready acceptance by policy-makers eager to reform old age security systems. The 1994 publication has been subject to harsh criticism by researcher and policy-actors alike; some of the most vociferous critics are voices in the World Bank itself. Nonetheless, the World Bank's ideas, as well as the terminology and language in which they present them, have become a discursive focal point for policy debate on pension reform anywhere.

2.2.1 **The Setting – The Basic Assumptions**

The World Bank, perhaps unsurprisingly, emphatically represents what MacKellar (2000) calls 'Establishment' economic thinking. The most fundamental underlying belief guiding the World Bank is that economic growth is the basic precondition for anything else governments or individuals may want to do: everyone, the World Bank argues, "...old and young, depends on the current output of the economy to meet current consumption needs, so everybody is better off when the economy is growing – and in trouble when it's not" (World Bank, 1994, p.3).

¹⁰ One of the questions of WP 2 will be to assess to what extent World Bank pensions discourse is a driving force for reform in EU Member States.

Consequently, the World Bank assesses pension systems according to two criteria:

- Is the pension system good for the economy (since economic growth is the basis of all prosperity)? This means
 - does the system reduce hidden costs including reduced national savings, reduced employment, misallocation of labour and capital, evasion, heavy fiscal burdens, high administrative costs?
 - is the system financially sustainable?
 - is the system simple and transparent?
- Is the pension system good for the old? This means
 - does the system encourage savings?
 - does the system insure against the risks of ageing?
 - does the system redistribute to life-time poor? (World Bank, 1994, p.98)

Moreover, the World Bank thinks in terms of trade-offs: more of this invariably means less of that, achieving this with a particular policy instrument means not being able to pursue that with the same instrument. The World Bank repeatedly contends that setting up or reforming pension systems involves “crucial” and “tough” choices: within each mandatory scheme, the World Bank claims, there “...are numerous policy options – some of which are much better than others” (p.17). Unfunded systems have different impact on the economy than funded systems; defined contribution schemes affect labour markets in one way and defined benefit schemes ‘distort’ labour supply decisions in another; public management has different economic implications to private management. Whatever the policy choice, it comes with a price tag: in short, the World Bank reminds policy actors that they can’t have their cake and eat it.

Last, the World Bank’s mode of thought betrays a deep suspicion of the public sector. Although never explicit, the World Bank paints a none too flattering image of public officials. Since public officials and politicians are sheltered from the stark and disciplining winds of market competition, there are few effective checks on rent-seeking behaviour, fraud and corruption. As a rule, politicians will promise anything to be re-elected and public officials will not shy away from misallocating pension funds to increase the power of their bureaus¹¹. Throughout the publication, the World Bank regales the reader with stories of political skulduggery and public sector malfeasance that have, the World Bank claims, undermined the confidence in publicly managed pension arrangements. Some of the wrong-doings include preferential treatment of social groups (such as, say, civil servants) in benefit provision, investing public pension funds in projects that yield a below-market rates of return, and renegeing on pension promises by directly or indirectly reducing pension benefits.

¹¹ This is, of course, the basic depiction of the public sector in the Public Choice literature (Downs 1967, Tullock 1976). See section 3 for a more in-depth account of Public Choice approaches to pension reform.

2.2.2 The Villains – The Policy Problem

The villains of the World Bank tale are both public PAYG defined benefit systems and the socio-political support structures. Although, the World Bank maintains, existing pension systems (which tend to be public PAYG DB systems) have managed to alleviate old age poverty, they have done so at an increasingly unacceptable price to the economy. The price, the World Bank contends, have been market distortions and inequities.

Market Distortions

Public unfunded DB systems introduce inefficiencies and distort markets. These effects basically work through four interrelated mechanisms:

- the distortion of labour markets,
- negative impacts on labour market participation,
- negative impacts on savings and capital markets,
- adverse effects on the fiscal balance.

First, since DB systems sever the actuarial relation between contributions and benefits, rational economic actors perceive pay-roll pension contributions as a tax (vicious) rather than as a price (virtuous). Unless labour supply is inelastic to real wage, workers will try to evade the tax by withdrawing their labour supply (preferring leisure over income) or transferring their labour into the informal sector. What is more, unless employers can pass on the pay-roll tax to workers in the form of lower wages, employers will reduce labour demand (World Bank, 1994, p.120; James, 1997, p.2).

Second, the World Bank (as well as the OECD and the European Commission) argue that public PAYG systems have encouraged early retirement from the labour force. Not only does early retirement increase the burden on the active labour force, it also starves the economy of experienced workers (James, 1997, pp. 2-3). The reasons for promoting early retirement are, Estelle James (1997) maintains, less than public spirited: early retirement promises "...are tempting to policy-makers because they hide unemployment or constitute a give-away to special groups" (p.2).

Third, when thinking about how an individual saves and consumes throughout a life-time, economists refer to the Life-Cycle-Hypothesis (LCH). Put simply, the LCH states that individuals will save when young, peaking at middle ages, and will draw on their savings in old age. Theoretical and empirical problems aside (see MacKellar, 2000, p.8), the LCH predicts that an ageing society, particularly one in which a small working age cohort supports a large retired cohort, will save less on aggregate. In terms of standard economics, other things being equal, this will lead to a lower level of aggregate investment (since Savings \equiv Investment) and a lower level of economic growth. Whereas even the World Bank admits that empirical evidence does not conclusively show that unfunded pension systems lead to a lower level of national savings (World Bank, 1994, p.125; James, 1997, p.3), they do claim that funded systems (particularly if they are of the mandatory type) will increase savings.

Moreover, while the impact of public PAYG systems on national savings may be unclear, the impact on the development of financial markets is not. Unfunded public pension arrangements are “lost opportunities” for so-called capital deepening. This means that if pension contributions were to flow into capital markets rather than public coffers, these markets would expand, grow, and professionalise (World Bank, 1994, p.126)¹².

Third the World Bank emphatically argues that public PAYG systems almost invariably lead to a misallocation of public funds. When PAYG systems are young, meaning that a large group of workers supports a relatively small group of retirees, they tend to accumulate pension reserves. States use these reserves to purchase public goods. Since pension contributions are a hidden tax, that is this type of public spending is less accountable than official public expenditure, states will often invest the funds in public goods with little social value (p.128). When mature, meaning that a large number of retirees depends on a relatively small number of workers, pension deficits (the difference between legitimate pension claims and available pension funds) drains public resources. As a result, pension deficits crowd out other valuable public investments (into, say, education or the environment) (James, 1998, p.3).

Inequities

Apart from distorting markets, public DB PAYG systems also create inequities within and across generations. An objective of pension systems, as we have seen, is intragenerational transfers or progressive redistribution. Policy-makers have, the World Bank claims, repeatedly justified public pension systems on grounds that the system transfers income from life-time rich to life-time poor. However, the World Bank contends, there are little intragenerational income transfers from rich to poor. On the one hand, affluent workers both live longer and enter the labour market at a later age: this means that they contribute less and receive more (World Bank, 1994, p.131). On the other hand, structural arrangements, such as earnings-related benefits or income ceilings on pension contributions (both common in continental Europe), exacerbate potential intra-cohort inequities. Moreover, argues the World Bank, public PAYG systems also feature many hidden and “capricious” redistributions: examples include transfers from dual- to single-wage households and from working women to housewives (World Bank, 1994, p.131).

Inequitable redistribution of income across generations, that is from young to old, is, according to the World Bank, a characteristic of all unfunded schemes. In PAYG schemes, rates of return on pension contributions fall as the system matures: the first generation of retirees in unfunded systems collects a windfall gain by receiving a pension without having to pay contributions¹³. Once these windfall gains cease, intergenerational transfers need not necessarily be inequitable if younger generation have a higher income than retirees. Since,

¹² The question that invariably arises is: why should workers trust underdeveloped capital markets with their retirement income? Unfortunately, the World Bank does not provide us with an answer. Larry Willmore, however, does. He points out that many developed countries with mandatory saving plans regulate investment to avoid capital market risks. This may take the form of restricting investment in private funds or mandating international diversity in portfolio investment. Where does this leave capital deepening? Willmore concludes: “Of course, investment in London and New York does nothing to develop local equity markets. But should forced [mandatory] savings of workers be put at risk in this manner?” (p.6)

¹³ This, incidentally, is one of the theoretical arguments showing that PAYG pension systems reduce the level of national savings. The first generation of pensioners can consume without having saved.

the World Bank contends, net wages have not grown rapidly in the past two decades, PAYG systems force younger workers to subsidise wealthy retirees (World Bank, 1994, p.134).

The World Bank bases these arguments on quantitative socio-demographic and economic indicators from a wide variety of sources. Evidence for economic inefficiencies emerges from looking at labour market participation rates (particularly estimates for informal sector participation), the increase in pay-roll taxes over time, national savings rates, early retirement trends (where data is available) and actual as well as projected public sector debt. In turn, the World Bank points to household- and age-specific income patterns as well as to falling rates of return on public pension contributions underline how public PAYG defined-benefit systems redistribute income inequitably both within and across generations.

2.2.3 The Heroes – Policy Solutions

How, then, can pension systems fulfil the dual objectives of providing retirement income (by enabling savings, redistributing to the poor, and insuring against risks) while promoting economic growth.

At least two of the objectives, the World Bank argues, contradict one another. In order to encourage savings, a pension system must be actuarially fair or actuarially neutral: people ought receive at least what they contributed into the system. Yet, if the system is to redistribute income, it has to divorce contributions from benefits so that those who are poor can draw more than they contributed. Any pension system, then, that relies of one type of pension arrangement (PAYG, occupational, or savings plans) will invariably fail to fulfil one of the objectives.

As a result, the World Bank suggests that objectives be separately ascribed to different types of pension arrangements. These different pension arrangements form the 'pillars' of the pension system. In particular, the World Bank urges policy-makers to separate the savings from the redistributive functions. A mandatory public PAYG pillar, financed by taxes, should take care of redistribution of income from lifetime rich to lifetime poor. The particular form of financing pensions, the World Bank argues, will depend on the socio-economic and political context of the specific polity in question. Either policy-makers introduce means-tested benefits, a minimum pension guarantee, or a universal or employment related flat rate (World Bank, 1994, p.16)¹⁴. Last, the World Bank suggests that benefits be kept fairly low in order to stimulate demand for other pillars of the pension system.

In order to encourage and maintain an adequate level of savings, the World Bank suggests that policy-makers institute a second pillar. This pillar would take the form of a mandatory savings plan managed by the private sector. To be able to secure an appropriate level of savings, these schemes, which could be occupational pensions or personal savings plans, need to be fully funded and defined-contribution plans. Since they are privately managed, second pillar instruments would not be subject to political manipulation. Further, privately managed savings plans would not introduce the market distortions associated with public PAYG plans and would contribute to capital deepening. Last, a functioning second pillar would greatly reduce the demand for benefits from the public PAYG system: not only would

¹⁴ Note that earnings-related benefits, the most common pension formula in continental Europe, is conspicuous in its absence.

contribution rates fall, public pension managers can also more accurately target benefits (World Bank, 1994, p.16).

The last pillar consists of voluntary savings plans, i.e. financial products offered by money markets. This pillar, the World Bank contends, provides extra income to those individuals who desire more protection in their old age. Clearly geared towards higher income workers, this pillar is supposed to relieve the other two mandatory pillars: rather than the rich draining scarce funds from beleaguered public PAYG systems (as they do in earnings-related PAYG schemes), this pillar would provide market returns on investments from private capital markets.

What about insuring against the risks associated with ageing? In order to diversify pensioners' risk portfolio, each of the three pillars should assume insurance functions. The first pillar insures against disability, longevity, and investment risks: should individual workers not be able to save enough for retirement due to bad health or bad luck, modest but sufficient public benefits would prevent an individual falling into poverty. Similarly, should an individual workers outlive their accumulated savings, the public system would provide a social safety-net. The second and third pillars, depending on the particular modalities of the financial products, can insure against political and inflation risks.

The solution, then, to the pension problem is fairly simple: if current public pension systems are overburdened by attempting to fulfil both the savings and redistribution objectives, policy-makers should institutionally separate these functions. This implies a shift from a single pillar system to a multi-pillar system.

2.2.4 In Sight of the Happy End – Pension Reform Pathways

Yet, how should policy-maker go about these reforms? Reform in the public PAYG pillar is the precondition for erecting alternative forms of pension finance. Here the World Bank provides a catalogue of policy recommendations. First, policy-makers must encourage labour participation of older workers by raising actual retirement ages and eliminating incentives for early retirement (p.21). Second, where pensions benefits are 'overgenerous'¹⁵, reforms should aim to reduce pension benefits, flatten the benefit structure and thereby reduce inequities. In terms of taxation, policy-makers should aim to reduce the payroll tax rate and, wherever possible, broaden the tax base to relieve existing contributors.

In order to counter the shortfall from cuts in the public scheme, the World Bank argues, policy-makers must establish a second mandatory savings pillar. Preferably managed by the private sector, this pillar should tie benefits closely to contributions (thus providing an incentive to save). Where suitable financial institutions are absent (mostly in the developing world but also in part of Eastern Europe), reforms should establish functioning capital markets.

The problem here is the transition period. Here the World Bank suggests following a three step reform strategy. Policy-makers should

- gradually downsize the public PAYG pillar

¹⁵ Unfortunately, we are left to wonder what an overly generous pension benefit may be.

- hold benefits constant where they are modest, cut them where they are overly generous, and increase contributions in order to finance the second pillar,
- recognise and pay accrued pensions entitlements while launching a new system (p.22).

All these steps, the World Bank suggests, should be accompanied by a “extensive” public information campaign.

Whereas, the World Bank concludes, the first two steps are incremental, the last step is a radical departure from pensions policy practice.

In sum, the World Bank perceives great need for reform in the face of demographic changes. Apart from distorting markets and jeopardising economic growth, the modalities of existing pension systems are blatantly unfair. Not only do they provide pay-offs for privileged and wealthy groups within age cohorts, they also redistribute from the relatively poor young workers to wealthy retirees. The only viable option, then, is to shift the bulk of responsibility for providing retirement income from defined-benefit public PAYG systems to defined contribution private mandatory savings plans.

2.3 The ILO Story: Crisis? What Crisis?

The ILO (1999) approach to pension reform is altogether less alarmist than the World Bank approach. While demography certainly is a challenge to current pension systems, policy makers should be careful not to throw the baby out with the bath-water. The last century has witnessed staggering increases in the standard of living. These improvements, the ILO argues, “...can be attributed to the creation of social security pensions which must be considered as one of the greatest social developments of the last hundred years” (p.1). Before the introduction of pension systems, life of older workers was “...nasty, brutish and short” (p.1)¹⁶. The aim of pension reform, then, cannot be to limit social security pensions but to expand them.

2.3.1 The Setting – The Basic Assumptions

Unlike other international organisations, the ILO is explicit about the values that guide their thinking on pension reform. They summarise the normative basis for policy in five points: policy should

- extend pension coverage to all people,

¹⁶ Whether conscious or not, Hobbes’ quote paints some very interesting images. Hobbes, who wrote the Leviathan during the English civil war, depicted a state of nature, that is a fictitious state in which there is no government, as a “war of all against all”. In short, unlike Locke, Hobbes’ state of nature was thoroughly unpleasant and uncivilised. The implication seems to be that dismantling pension systems is a return to barbarity.

- protect against poverty in old age, during disability, or after death of the main wage earner,
- provide an income as a replacement for voluntary or involuntary loss of income for all contributors,
- adjust income to take into account inflation or the general increase in living standards,
- create a favourable environment for developing additional voluntary provisions for retirement income (ILO, 1999, p.13).

While these points provide the normative core of the ILO's approach, they list further important considerations. These include

- the principle of compulsory affiliation,
- the equality of treatment (women and men, nationals and non-nationals),
- the provision of guaranteed, predictable benefits up to a certain level,
- the democratic management of pension schemes (implying that worker's and employer's be represented in pension fund management),
- that the state needs to ensure that conditions for effective service delivery are met,
- the establishment of benefit and contribution ceilings to limit the state's obligation to high income workers (ILO, 1999, p.14).

Note that the issue of economic growth is conspicuous in its absence. The ILO clearly values old age retirement security, universal coverage and democratic participation more than growth of private sector firms.

2.3.2 The Villains – The Policy Problem

While the ILO concedes that population ageing poses a serious challenge to pension systems, the main pension issue is not financial sustainability or labour market distortions. Rather, the ILO points to two fundamental problems.

- First, most of the world's workers and dependants are not covered by any form of old age social security system.
- Second, where workers are covered, pension management, or, to use the ILO's terms, governance has been poor.

While these may not be a pressing problem in the industrialised North, it affects a vast number of workers in developing countries.

Typically, workers in the informal sector, in agriculture, household workers (mostly women), and the self-employed have no entitlements to retirement income. Coverage, the ILO argues, usually depends on several factors. These include the level of economic development and

the age of the pension systems: the richer the country and the older the pension system, the higher the coverage is likely to be. Further, the way in which governments finance pensions as well as the capacity of the social security administration have an impact on coverage: defining the contributions base as well as enforcing contributions payments significantly affect the level of coverage policy-makers can realistically achieve. Last, the ILO argues that government policy, that is to what extent pensions are a policy priority, will significantly affect coverage (ILO, 1999, p. 8).

The second major pension issue, the ILO contends, is the governance of pension schemes. In the past, public and private management of pensions, at least for the vast majority of workers, has been poor. The reasons for bad pensions management are manifold. Often pension systems have been politicised and abused to achieve short-term political aims. Many pension systems suffer from inherent design faults and badly conceived administrative procedures. In general, this has resulted in high administrative costs coupled with poor services (ILO, 1999, pp.8-9). The implication here is that poor management, rather than inherent pension scheme design, makes pension unattractive to workers who then withdraw to the informal sector.

PAYG Vs CR? Defined-Benefit Vs Defined-Contribution?

However, coverage and governance are issues affecting mostly developing economies. What story does the ILO tell about pension reform in industrialised countries? The basic, albeit implicit, message is: yes, ageing will create problems for defined-benefit public PAYG systems (p.21), but, no, that is no reason to scrap these tried-and-tested systems for private sector mandatory defined-contribution arrangements. Most of the problems commonly associated with public defined-benefit PAYG systems, the ILO contends, equally apply to private mandatory defined-contribution saving plans. Shifting to private defined-contribution mandatory savings plans will not solve the problem.

First, the alleged economic impact of public DB PAYG systems on labour markets and savings is subject to considerable uncertainty. "In most cases", the ILO (1999) argues,

"...theory yields ambiguous predictions concerning these effects, empirical studies have failed to resolve the issues and controversy remains. However, there is little support for large effects of retirement benefit programmes in either labour and capital markets" (p.12).

Moreover, studies suggest that even large cuts in pension benefits are likely to only bring about an increase of the actual retirement age by a couple of months (ILO, 1999, p.12). Research, the ILO concludes, does not provide any indication unfunded systems have any design-specific negative impacts on the economy.

Second, there is no reason to believe that mandatory defined-contribution schemes would not distort labour markets, savings and the retirement decision. Like traditional unfunded schemes, mandatory savings plans seek to change the behaviour of rational economic agents by coercion. Why, then, should patterns of evasive behaviour differ for any type of coercive pension plan, defined-benefit or defined-contribution, private or public, funded or unfunded? Any type of mandatory scheme "...will cause distortions, as individuals act to minimise the consequences of the programme that is undesired by them" (p.12). Further, if individuals are risk-averse, then private sector insurers will, if they are to attract customers, provide features that reduce risks to pensioners. However, these features, argues the ILO (1999), break the link between contributions and benefits creating all the distortions usually

ascribed to public DB PAYG plans (p.13). Indeed, many existing DC schemes contain these elements: these include guaranteed minimum benefits, rate of return guarantees, or benefits based on rates of return fixed by pension funds. Add to that the fact that private defined-contribution plans tend to have higher administration costs and are very vulnerable to capital market risks, and the World Bank reform proposals do not look as attractive.

Third, the management of mandatory DC savings plans is as much an issue as the management of unfunded schemes. If management is left to the private sector, government will have considerable regulation responsibilities. The opportunities for malfeasance, mismanagement, and private sector incompetence are, the ILO implies, practically limitless. In short, the ILO argues that placing responsibility

“...for managing the considerable sums of money in mandatory defined contribution pension accounts in the hands of private pension fund managers requires some mechanism to ensure that those funds are not stolen or otherwise misused” (p.7).

If individuals are responsible for managing their retirement income, then states have to ensure that workers are properly informed. Finally, if the state is in charge of managing mandatory DC savings plans, then policy actors should avoid the politicisation of pension funds. In either case, the ILO avers, capital markets will require careful regulation and governance.

How, then, does the ILO story assess the proposed shift from public DB PAYG systems to private DC mandatory saving schemes? Although the ILO concedes that such an assessment is a difficult and complicated task, they point out two issues. First, most commentators, the ILO maintains, use a perception of defined-contribution schemes that is “factually and analytically wrong” (p.22). In particular, would-be reformers seem to think that funded DC schemes provide a once-and-for-all solution to the fundamental problem of population ageing: the fact that more retirees depend on a smaller number of workers. In order to relieve the financial burdens of population ageing, the ILO continues, DC schemes will have to either reduce the benefits relative to income from work or increase the retirement age (or both). Yet, these are precisely the policy options open to PAYG DB systems: the fundamental problem of having to transfer more income across generations remains. In PAYG systems, policy-makers increase contributions to increase transfers; in funded DC schemes, pensioners must sell their assets to the working population. For a given level of benefits, the amounts the young transfer to the old is the same. Thus, the ILO concludes, whether a pension system is funded or unfunded makes little difference to the way it has to react to population ageing (either increasing contributions or reducing benefits). Stated differently, funded DC schemes face exactly the same problems as unfunded DB plans (ILO, 1999, pp.22-23).

Second, funded mandatory saving schemes conflict with fundamental principles of social security. First, recall that the ILO mandates that retirement income should be guaranteed and predictable. Whereas this is the case with traditional PAYG DB schemes¹⁷, benefits and annuities in funded DC schemes depend on variable market rates of return. Second, the ILO holds that retirement incomes should increase to take account of inflation: again, due to

¹⁷ Which, when looking at the developments of pension systems of the last decade or so, is blatantly untrue. Policy-makers regularly renege of pension promises by increasing the retirement age, fiddling with the pension formula, or changing the eligibility criteria.

market variability, indexing pensions is very difficult in the private sector. Third, the principle of democratic management, that is effective input of workers and employers into pension fund management, seems incompatible with the notion board-room sovereignty common in the private sector. In the absence of real voice, the ILO maintains, policy-makers should give workers the right to effective exit by providing a real choice of private sector pension management (ILO, 1999, pp.22-23).

2.3.3 The Heroes – The Policy Solutions

How, then, should policy-makers react? The first priority for policy-makers world-wide, the ILO maintains, should be to extend the coverage of old age social security and improve the governance of existing schemes.

What types pension systems should policy-makers in both the developing and the developed world institute? Given that different economies have very different characteristics and that these characteristics are subject to change, the ILO argues that pension systems need to be flexible and pluralistic: there is, the ILO avers, "...no one universal perfect retirement income scheme"(p.16). Different models and designs may be more appropriate for different places and at different times. Whatever the precise shape of the system, it must be able to achieve the objectives of pension systems: here, the ILO particularly stresses, poverty alleviation and the provision of low risk retirement benefits¹⁸). Whether the public or the private sector manage these systems will depend on

"...political philosophies towards individual and private sector responsibilities versus the role of government and views as to the relative governance capabilities of the private and public sectors" (ILO, 1999, p.16).

The best approach to a flexible and pluralistic system, the ILO (1999) maintains, is a multi-tiered system. Each tier features specific risk and redistributive characteristics. Although the number of tiers is less important than the specific function, the ILO suggests a four tier pension system. The bottom tier is responsible for poverty alleviation: here, means-tested benefits, financed from general revenues, ensure that pensioners will not fall into poverty. The second tier, the ILO continues, consists of a PAYG DB pension systems: this provides secure and predictable retirement income relatively insulated from market risks. The third tier, a mandatory defined contribution plan, provides security against demographic and political risks. The last tier, consisting of voluntary saving plans and other non-pension income, can provide extra income for those who can afford it without burdening pension systems (ILO, 1999, p.16).

This approach differs from the World Bank model in two important respects. First, the ILO model implies that policy-makers really cannot expect any benefits from leaving pension management solely to either the public or private sector. Both management systems have in-built advantages as well as their shortcomings: pension systems should be sufficiently flexible (or redundant) to be able to neutralise these weaknesses. Second, the four-tier model reveals the ILO's emphasis on the insurance function of pension systems. The four tiers provide a solid bulwark against all possible risks of ageing.

¹⁸ Note that the savings function finds no mention here.

2.3.4 In Sight of the Happy End – Pension Reform Pathways

Moving towards a multi-tiered system, the ILO argues, requires careful political management. The basis for any type of incisive reform is a basic political consensus; policy-makers will have to devise strategies for securing consensus across the policy spectrum. These strategies, the ILO maintains, will include the gradual phasing in of reforms and the provision of real options for workers (p. 16).

Most importantly, however, the ILO urges policy-makers to consult the policy actors (in this case employers and workers) at all stages of the process. This may involve a campaign of public education. Not only will the general public need to know about the pension issue, policy actors (such as parliamentarians) may also need to increase their level of knowledge and awareness about the impacts of ageing (ILO, 1999, p.17).

In sum, population ageing, while without a doubt a challenge to existing pension systems, is not the main pension issue. The real problem is that most of the world's workers have no type of old age security at all. Moreover, for those few that are covered, the administration and governance of pension schemes has left much room for improvement. Population ageing poses a fundamental problem for pension systems: how to finance the increase in transfers from a relatively small working population to a relatively large retired cohort. This problem is exactly the same for funded DC schemes and for unfunded DB schemes. What is more, there is no reason to believe that funded DC schemes will solve the problem in a more efficient and fair way. The solution, the ILO concludes, is to install flexible and pluralistic systems that can both adapt to changing socio-economic conditions and provide an adequate level of protection to retirees.

2.3.5 The European Commission Story: You're Barking Up the Wrong Tree

The European Commission takes a more holistic and systemic view of the pensions issue. In fact, the Commission understands the pension issue as only one element in the broader social challenge of ageing. The fact that European societies will be faced with an ever increasing number of elderly citizens, the Commission maintains, has repercussions beyond the pension debate. Policy-makers will have to confront the impacts of ageing on health care costs, on economic growth, and on social integration in general. Thinking about reforming pensions means thinking about ageing in terms of the entire socio-economic system.

2.3.6 The Setting – The Basic Assumptions

In order to meet the challenges of ageing, the Commission argues, European people will have to fundamentally change their behaviour and European societies will have to adapt to the changed age structure. This, the Commission implies, necessitates careful policy-making and public management. Poor policy co-ordination may lead to unnecessarily painful adjustment processes.

Although pension reform paths in each Member State will differ due to divergent socio-economic and socio-cultural conditions, the Commission outlines a number of general reform principles. First, pension reforms should aim to secure the broadest and most equitable

revenue base for public pension schemes. Second, pension systems should reflect "...a sustainable mix of mutually supporting pension pillars based on legislation, collective agreement and private contract" (European Commission, 1999, p.15): in this way, the state, social partners and individuals can share the responsibility for retirement income. Last, pension reforms should strengthen the intergenerational contract implicit in all forms of pension arrangements. In sum, pension reforms, the Commission holds, should strike a "...sound balance between long-term financial sustainability, intergenerational solidarity, and equity between and within generations" (p.15).

2.3.7 The Villains – The Policy Problems

The main problems of ageing, the Commission points out, are its adverse impacts on the labour market. As we have seen, ageing from the middle of the age pyramid will starve the labour market of new entrants. This implies, the Commission argues, that labour participation rates will increasingly depend on the activity patterns of older workers. What is more, in order to make up for the shortfall in labour force participation and in order to maintain an acceptable level of economic growth, the EU Member states will have to halve their unused employment capacities by 2015. This implies both reducing the high European rates of unemployment as well as reintegrating older workers into the workforce. The obstacles here, the Commission implies, emerge less from design features of pension system than from deep-seated socio-institutional practices towards elderly workers, the unemployed and women. For example, older workers tend to be concentrated in declining industries and command less valuable skills than younger workers. Training, the Commission maintains, so far concentrates on younger worker thus increasing the risk of labour market exclusion as their skill depreciate. Major factors for job creation and growth in the future, the Commission surmises, will be the employability of older workers, the rules and practices for adapting work-places, as well as promoting equal opportunities¹⁹.

Early retirement practices, common in Europe, exacerbate labour market problems. The Commission claims that the labour force participation of 60-64 year old males has fallen from 80% to about 30% in the last two decades. The trend to early retirement has also begun to erode labour force participation of males in their 50s (European Commission, 1999, p.12). Whereas the trend towards early retirement could indicate an increased preference for leisure as real incomes rise²⁰, the Commission points to survey findings in which 40% of early retirees see their retirement as involuntary (p.12). If this is the case, the Commission concludes, practices concerning early retirement require review. Many Member States, the Commission argues, have used the pension system as a labour market tool: the pension system helps ease out older worker while creating jobs for young labour market entrants. However, the Commission claims, the link between early retirement and job creation has been rather weak. Thus, given decreasing labour market participation, the Commission asks whether

¹⁹ Here, the Commission observes, increasing female labour market participation rates may help relieve the decline of the labour supply in general.

²⁰ Incidentally, the OECD (1998) argues that if the early retirement trend reflects a shift in preferences, then there is little policy can do.

- it makes sense for people to retire 8-10 earlier than their parents given increases in life expectancy and health
- access to training would change the retirement decision and early retirement practices?
- the option for gradual retirement would be attractive? (p.12)

The time, the Commission urges, to consider these questions is now. Current patterns and practices of early retirement will become unsustainable when the baby-boom generation withdraws from the labour market: not only will this lead to an excessive financial burden on existing pension systems, it will also lead to labour market scarcities and, thereby, a decline in economic growth (European Commission, 1999, p.12). What is more, losing the baby boom generation to the labour supply would represent a missed opportunity: the baby-boomers, one of the highly skilled and resourceful generation to date,

“...are thus ideally positioned to make the best use of the opportunities offered by gains in longevity. To squander their contribution through the continuation of current labour market practices would be very wasteful”(p.12).

2.3.8 The Heroes – The Policy Solutions

Concentrating on pension reform alone, the Commission argues, will not be enough to meet the challenges of ageing. Although pension reform is an important element in the overall ageing strategy, there is “...no design panacea, and adequate reforms take time and may themselves be painful” (European Commission, 1999, p.13). Thus, the Commission urges policy-makers to “move beyond the pension design debate”: no matter what pension system policy-makers adopt, transfers from old to young will have to increase substantially. Reducing the burden does not merely mean moving from an unfunded to a funded system. Rather, the Commission argues, it implies expanding the funding base in all directions: upward to include older workers and horizontally to include the unemployed and women. Thus, pension reforms “...are an important part of the necessary adjustments to ageing, but they will only be really effective when backed up by active ageing and higher employment rates in general” (European Commission, 1999, p.13)

What, then, is active ageing? In essence, active ageing means convincing people to work longer and providing flexible labour markets arrangements for gradual retirement. The former, the Commission (and, incidentally, the OECD (1998)) argues, involves providing access to training and new skills as well as work environments suited to older workers. The latter implies that pension schemes be adapted to permit part-time work. This, the Commission continues, will have to take place in close co-operation with the social partners in Member States. The Commission also foresees the need for collective agreements and policy that can bridge the gap between the actual and legal retirement age (p.13). However, policy, the Commission warns, will have to judiciously balance flexibility with the need for security in old age. Furthermore, increased female labour market participation, which could offset the fall in male participation rates, also requires the adjustment of pension contribution and benefit mechanisms.

This approach, which the Commission understands to be a more ‘productive’ approach to ageing than the pension design debate, will affect individual and collective retirement

behaviour. On the one hand, policy-makers will need to change union and employer practices. On the other hand, policy-makers will have to change individual behaviour. Here, however, the Commission maintains that individuals will change their retirement behaviour when presented with viable options (such as retraining, gradual retirement, or part-time work) (p.14). In the short run, the Commission concludes, policy-makers in the EU should aim for raising the actual retirement age by 2 years. The long-run goal, however, will be to equate actual retirement ages with legal retirement ages (p.14).

What does this mean for pensions? Here, the Commission, like the World Bank and the ILO, argues for a multi-pillar system. The Commission suggests that policy-makers expand the savings function of pension systems. In addition to desensitising public PAYG DB systems to demographic changes (by expanding the contributions base and strengthening the intergenerational contract), the Commission argues that reforms should introduce more funded elements: this would not only lead to more savings and a more diversified risk portfolio, it would also contribute to deepening European capital markets (p.15).

Yet despite the need for more advance funded element, the Commission also emphasises the redistributive function of pension systems. Pension systems in Europe must continue to guarantee a minimum income in old age. This is particularly important in terms of the gender aspects. Women typically live longer and participate less in the formal labour market. What is more, women are currently suffering from pension systems designed for single earner households (p.16). This, the Commission avers, calls for policy both in the fields of pensions and labour markets: equal opportunities in the labour market and pension reforms that take account of the gender issue, will alleviate the problem in the long-run. In the short-term, however, the Commission foresees a greater need for measures that compensate for existing inadequacies (p.15).

In sum²¹, the Commission story advocates a more holistic approach to ageing policy. Here, pension reform is an important element which, however, is only effective in conjunction with other policies. In particular, policy-makers will have to co-ordinate pension reform with policy initiatives in the labour market (to reduce unemployment) and in the socio-institutional management of ageing (changing behavioural patterns of institutional and individual policy actors). Active ageing and options for a gradual withdrawal from the labour market will play an important role in the future. In terms of actual pension reform, the Commission remains rather general: reforms should shift towards a multi-pillar system while ensuring secure minimal incomes in old age and creating a favourable environment for private sector pensions. Detailed prescriptions, the Commission avers, are meaningless: systems need to adapt to the national conditions of each Member State. The Commission, then, combines elements from both the World Bank (more private sector provision and capital deepening) as well as the ILO (the management of pension reform and security of pension income).

2.4 Conclusion

In the previous section we have seen how three international organisations define the pension issues. In essence, all three policy stories tell us about the impacts of ageing on our

²¹ Note that the Commission remains silent on reform paths: these are, one suspects, subsidiarity issues.

societies and suggest ways in which we can best respond to these challenges. The World Bank is worried about the effects of ageing on economic growth. Shrinking labour forces and growing numbers of retirees will have adverse effects on the functioning of markets. This, the World Bank contends, is exacerbated by distortionary and inefficient pension designs. The ILO, in turn, tells a different story. The fundamental problem is that most workers are not covered by old age social security and, for the few that are, these systems suffer from poor management. What is more, the structure of a particular pension system is not likely to make much difference to the impacts of ageing. Both funded and unfunded, defined-benefit or defined-contribution face similar challenges: how to transfer more income from a relatively small working cohort to a large retired population. The European Commission takes a more holistic approach. Pension reform, it maintains, is one element of an overall policy strategy concerned with ageing populations. The real problems here are socio-institutional practices and attitudes that marginalise older workers and thereby accelerate the decline in the labour supply: reform in pension systems necessitates reform in labour markets.

Although all three international organisations advocate multi-pillar pension systems, each story places a different emphasis on different pillars. If ageing is not to damage economic growth, the World Bank asserts, then the second pillar (mandatory DC savings plans) will have to provide the bulk of retirement income in the future: the emphasis here is on the savings function of pension systems. Conversely, the ILO claims that a radical shift to DC systems will not solve the ageing problem. On the contrary, any funded defined-benefit plan will feature all the distortionary effects of traditional PAYG systems, with the added disadvantage of exposing retirees to capital market and investment risks. Rather than retrenching tried-and-tested pension arrangements, the ILO urges policy-makers to expand and deepen systems in order to ensure that retirement income is secure: the emphasis here is on the security and redistribution aspects. Last, the Commission prefers not to think in terms of trade-offs. All three pensions objectives are important and interdependent: pensions systems should guarantee minimal pensions (redistribution), need to be secure (insurance), but also need to provide a favourable environment for investment (savings or capital deepening). These aims, the Commission avers, are not contradictory. However, they do depend on the judicious management and co-ordination of different policy measures in divergent policy fields.

The three discourses also tell us different things about who should manage pension systems. The World Bank, fundamentally suspicious of the public sector in general, advocates a radical shift away from public sector responsibility for pension systems. If securing savings and ensuring the smooth functioning of markets are the main objectives of pension reform, then pension systems are best managed by competitive private firms. In turn, the ILO, always looking out for workers' interests, is not sure that it can trust either government or the private sector: when it comes to managerial incompetence and the proclivity to fraud, the private sector, the ILO muses, is no better than any state bureaucracy. For that reason, pension systems need the democratic input and control from social partners. The Commission, however, insists that there is a pivotal role for the state. Pension reform will only be effective when implemented in concert with other policies: this, clearly, is a public task.

Last, the three different policy stories reveal different reform styles. Whereas the World Bank recommends a radical reform, the ILO and the Commission opt for more careful incremental approaches. Rather than sweeping away established systems and practices, as the World Bank rhetoric suggests, the ILO and the Commission prefer building on existing institutions. The three stories also disagree about who should conduct these reforms. The World Bank

argues that this is the responsibility of enterprising and responsible policy-makers: the public merely needs to be convinced by public information campaigns that this is a good idea. The ILO and the Commission, in turn, see pension reform as a process dominated by organised interests: pension reform, they maintain, needs the solid basis of tripartite or social partner consensus²².

Yet, for all the difference in rhetoric, all three pension reform proposals look very similar. All three opt for a move to a multi-tier or multi-pillar system²³. All three, albeit to differing degrees, acknowledge that there is a role for stronger private sector provision of retirement income. Most importantly, all three stories refer to the same types of policy levers: tighten early retirement restrictions here, expand coverage there, hike standard retirement ages, reduce benefits a bit, and increase contributions.

In sum, all three policy stories tell us plausible tales about pension reform. They highlight certain aspects and background others. They set up a problem and provide the solutions. In doing so, they provide coherent and normative frameworks for thinking and arguing about pension reform.

2.5 Uncertainty and Disagreement

Who are we to believe? The World Bank who suggests a radical departure from existing social insurance practices? The ILO who claims that expansion rather than retrenchment of pension systems is the key to solving the ageing problem? Or the Commission who tells us that overcoming the ageing challenge will involve careful policy management and co-ordination? Typically, (post) modern societies refer contentious policy issues to 'the experts'. Yet, both the basic variables as well as the economic impacts of ageing are subject to considerable uncertainty.

What, then, do 'the experts' have to say about ageing and pension systems²⁴?

2.5.1 Uncertainty of the Basic Variables

Although the broad trends and mechanisms of ageing are relatively intuitive, the devil, as so often, is in the detail. Experts disagree about the basic shape of the demographic, the economic, the and political dimensions of the pension issue. These dimensions, however, may have large impacts on pension systems. For example, in terms of human longevity,

²² Note that none of the stories foresees much of a role for public participation.

²³ This may mean one of two things. First, this could point to a 'hegemonic discourse'. This means that one form of thinking about pensions has become a paradigmatic entrance ticket for the debate as a whole: a 'hegemonic discourse', then, provides the most basic framing of the pension issue. Second, the similarity between different pension reform proposals could also indicate that there really are not all that many options open to policy-makers.

²⁴ The following will heavily draw from Landis MacKellar's (2000) excellent overview of the economics of ageing.

"...even slight underestimates of the number of people who will become eligible for benefits in the next century could mean huge unanticipated costs to taxpayers" (Roush, 1996, p.42).

The uncertainty begins with basic demographic variables. For instance, biomedical researchers are divided on the question of human longevity. While some sources in the US, particularly the US Pension Administration, believe there is a practical ceiling to human longevity at about 85, others are predicting that a child born today may reach the age 95 or even 100 with no theoretical upper limit (Roush, 1996, p.42).

Moreover, it is commonly assumed that health care needs increase over the age of 80. Yet, Abel-Smith (1993) points to a study that shows that "contrary to common belief, the costs of those who die aged 80 or over are about 80 percent of the costs for those who die aged 65 to 79" (p.261). The OECD Bulletin (1996/7) reports, however, that before the age of 80, the health differences across different age groups are not so marked. In fact, they argue that the health differences within a particular age group are "...usually more marked than across different age groups" (Hicks, 1996/7, p.19). Add to this that life-style changes will affect the health of the future aged and it becomes clear that these factors are very difficult to predict with any certainty.

Abel-Smith (1993) stresses the role of immigration: the developed countries' unfavourable age structure could be balanced by an influx of tax-paying immigrants. Once again, the direction of this variable is difficult to predict. On the one hand, streams of immigrants from developing countries to industrialised nations have been steadily increasing in the last two decades. On the other hand, immigration policies in the industrialised countries have become increasingly restrictive. The net effect of these two countervailing forces is hard to foresee. In sum, Martin Pfaff (1993) notes that "...demographers' forecasts of the 1950s erred by 100% and that the variability of inputs - fertility, mortality, and immigration - are mainly responsible for this variability" (p.302).

Precise long-run economic predictions needed for policy-making are equally difficult to obtain. Abel-Smith observes that the pension reform debate has fed on the decline of economic growth and the institutionalisation of structural unemployment evident in industrialised countries since the early 70s: "It was only when economic growth faltered that people began to write about the 'crisis' in the welfare and a period of modest retrenchment began" (Abel-Smith, 1993, p.265). A return to a tight labour market, he continues, would appease the present climate of crisis. However, whether the labour market will return to full-employment is difficult to foresee. Global markets are becoming increasingly interdependent which means that domestic economic performance may have little to do with domestic economic policy. For example, closer monetary and political union in the EU could have profound effects on the pension systems of its members. The UK House of Commons Social Security Committee (1996) is worried that, if the UK joins the EMU,

"...British taxpayers could be called upon to help finance the pay-as-you-go pension obligations of other EU members or suffer the consequences of being tied to interest rates on the single currency that were forced up by the market pressure of financing certain countries' inherited pension commitments" (p.iv).

The more complex and interdependent the markets become, the higher the uncertainties of key economic variables

In sum, the entire pension reform issue is surrounded by uncertainty: it is subject to so many 'imponderables' that social scientists are not able to "... predict the future with all its complex

and economic and political dimensions” (Abel-Smith, 1993, p.265). In effect, expert projections “...amount to no more than possible future scenarios. They are no more robust than the assumptions underlying them.” (Abel-Smith, 1993, p.260).

2.5.2 The Economic Impacts of Ageing? Well, it all Depends...

How have economists assessed the impact of ageing and pensions systems on the economy?

Labour Markets

Recall that pensions contributions are pay-roll taxes that may distort labour markets. The effects of these payroll tax on employment rates are, however, ambiguous. Standard economic wisdom, which the World Bank applies aggressively and the OECD more carefully, tells us that the impact of payroll taxes depends on the degree of flexibility in labour markets and the elasticity of labour supply to the real wage. MacKellar (2000) argues that in

“...a world of immobile labour and mobile capital, it is fair to assume that the long-run incidence of social security payroll taxes is entirely on labour. Therefore, in a flexible labour market, high payroll taxes will lead to lower net wages and unemployment and firms’ labour unit costs will be unaffected “ (p.22)

In other words, employers can pass the tax on to workers in the form of lower real wages. If the labour supply is highly elastic to changes in the real wage, workers will withdraw their labour from the market. However, in countries with well developed formal sectors, evidence suggests that the elasticity of labour supply to the real wage is close to zero (MacKellar, 2000, p.22)²⁵.

What happens when labour markets are not flexible? If wages are sticky downwards, theory tells us, employers will not be able offload the costs of pension contributions to workers. Consequently, employers reduce their demand for labour as pensions contributions increase unit labour costs. High-skilled workers in a strong bargaining position will benefit from higher wages, whereas low skilled workers will become unemployed (MacKellar, 2000, p.22). Much of the political debate about socio-economic changes in Europe revolves around this insight. The argument, usually couched in terms of international competitiveness, asserts that the combination of generous European social programmes and inflexible labour markets has led to a “...witch’s brew of high costs, low price competitiveness, and structural unemployment” (MacKellar, 2000, p.22).

Yet, in terms of economic theory, it is not pensions contributions *per se* that affect labour demand. Rather, the question is whether pensions contributions increase the real net wage. The answer to this question, again, is ambiguous: much depends on the precise institutional nature of labour market inefficiencies, i.e. on the socio-political constellations of the state, labour unions, and employer’s representatives. Alesina and Perrotti (1997) find that pensions contributions only increase unit labour costs when union power is at a medium level: when union power is weak, employers meet little resistance when setting wages; when union

²⁵ To be fair, the World Bank repeatedly points out that escape to the informal sector is a marginal problem in affluent northern countries.

power is very strong, meaning that unions are equal social partners in the political dialogue, payroll taxes lead to lower net real wages. Moreover, as MacKellar elegantly argues, the problems are inherent to labour markets, not inherent to pension systems: existing labour market distortions lead to reduced labour demand as a *reaction to pay-roll taxes*, it is not the pay-roll taxes that produce labour market distortions²⁶.

Labour Market Participation

What influences the retirement decision? Public PAYG systems that distort individual choice by inefficient and unfair pay-offs to politically influential groups, shouts the World Bank. Wrong! interjects the ILO. If workers want to retire early, they probably have good reasons: it is the lack of democratic management and poor working conditions that lead to early retirement. Be that as it may, the Commission surmises, but taking a systemic view will reveal that fundamental, yet inappropriate, socio-institutional and individual practices are responsible for early withdrawal from the labour market.

In terms of the retirement decision, economic expertise provides reasonably clear indications. If we assume workers are rational economic agents, what factors affect 'the retirement decision'? In general terms, (rational) workers will consider life expectancy, income, and the availability of pension and health insurance, when thinking about retirement (MacKellar, 2000, p.4). Whereas increases in life-expectancy would motivate an individual to work longer, high real incomes as well as the ready access to appropriate health and pension insurance would suggest early retirement.

Why, then, do workers retire early? As we have seen, life expectancy is on the rise: rational economic agents should prefer to work longer rather than retire early. That leaves two alternative explanations: either people retire early because, as real incomes rise, they prefer leisure to work or the structure of pension systems has skewed the retirement decision in favour of early retirement. If the former is the case, the OECD maintains, then policy can do very little short of drastically cutting income for early retirement (p.42). If the latter is the case, then policy can and, by implication, should affect the 'retirement decision'.

How does the structure of pensions systems (public or private) affect the 'retirement decision'? The OECD (1998) lists a number of potential influences on the decision to exit the labour force. First, standard, i.e. legal, eligibility ages²⁷ will probably have little influence on the actual retirement rate. The OECD argues that raising the standard age of retirement (at 65 for males and 60 for females in most European countries) will not raise the actual retirement age in the same way. There is, the OECD avers, "...a strong desire to take advantage of any mechanism permitting early retirement, but not vice versa, as shown by the fact that actual retirement ages have fallen during the period when the standard age has remained stable" (p.44).

Second, minimal eligibility ages²⁸, however, are likely to have a strong impact. Many pension systems, the OECD points out, have in-built mechanisms that allow access to pension

²⁶ This assumes that withdrawal to the informal sector is not an option, which, given the structure of European labour markets, is a fairly plausible assumption.

²⁷ This is the legally mandated age at which workers can retire. Although there is some variation, most countries set the standard retirement age at about 60 for females and 65 for males.

²⁸ This differs from the standard retirement age. It is the minimal age at which a worker becomes eligible for pension. Often, this relates to a minimal number of contribution years.

benefits after a certain amount of contributing years or at a certain age (below the standard age). Although the precise modalities vary²⁹, these arrangements provide for fairly generous benefits before the legal retirement age. The European Commission (1999) points out that

“...there is a strong correspondence between the age at which retirement benefits are available departure from the labour force. In many cases, pension systems have provided generous retirement benefits at relatively young ages” (p.36).

Third, the OECD contends, perhaps somewhat surprisingly, that benefit levels will probably have little impact on the retirement decision. The rationale here is essentially empirical. Although replacement rates have risen and retirement ages fallen in the OECD as a whole, there are notable exceptions. One such exception is France, where replacement rates have hardly increased yet retirement ages have plummeted. The other is Japan, where replacement rates has increased sharply, yet retirement rates have hardly decreased (OECD, 1998, p.45).

Fourth, rules governing pension accrual rates will, according to the OECD, have a large impact on early retirement. The way in which an individual pension rights accumulate often acts as an disincentive to remain in the labour force. In many systems, workers do not accrue any further pension rights after a specified period of contribution. As MacKellar (2000), points out (referring to occupational pensions), the result “...is to reduce the net wage to a fraction of the nominal wage....Not surprisingly, many workers choose to leave the firm” (p.5).

Additionally, structures and practices of both public social protection provisions and private occupational pensions have encouraged early retirement. In the public sector, the use of unemployment insurance and disability pensions as labour market tools, that is as means to ease older workers out of the labour market, accounts for a considerable part of European early retirement figures (OECD, 1998, pp.47-49; MacKellar, 2000, p.5). In the private sector, occupational pensions may set retirement ages at or below the legal retirement age, with reductions for early retirement that are not actuarially neutral (OECD, 1998, p.46).

In sum, the institutional set up and rules that govern pension systems have encouraged early retirement in Europe. The OECD concludes that

“...employees desire to retire earlier than the standard retirement age...has to some extent been transformed into reality at possibly high cost to society as a whole by developments that are in principle susceptible to policy” (p.43).

Note, however, that these features are common to both public sector and private pension arrangements.

Savings

The issue of savings, that is whether or not specific types of pensions systems discourage savings, is particularly thorny and complicated.

²⁹ Some countries, e.g. Germany, actuarially reduce benefits for each year of early retirement, other have no such reductions.

Recall that the World Bank suggests that societies with an older age structure will save less. This effect is then exacerbated by public PAYG systems that fail to accumulate capital reserves. Both the evidence and the theory of this line of thinking are, however, questionable. In terms of empirical evidence of whether pensions systems (particular public PAYG systems) discourage savings, even the World Bank admits that the jury is still out (World Bank, 1994, p.125). Some researchers argue that public PAYG pension system enable the first generation of the scheme to consume without saving. Others look at the empirical data and find no conclusive evidence either way (Magnussen, 1994). Understanding whether public PAYG pension systems inversely affect the national savings rate is hobbled by two fundamental uncertainties. First, it is difficult to establish, let alone research, the counterfactual (i.e. what would have happened if there had been no PAYG system) (World Bank, 1994, p.126). Second, even if the evidence were conclusive, MacKellar (2000) argues, it "...may not tell us very much about the impacts of moving from an existing PAYG-financed system to a CR-financed one" (p.12).

Further, despite World Bank assertions, two circumstances militate against the unambiguously positive effect of mandatory savings plans on national savings rates. First, given that most countries already operate large public PAYG plans, any change to CR-financed schemes would require a transition period: policy-makers need to find ways to finance pensioners' claims under the old PAYG system while compelling workers to contribute to the new system. None of the available options are attractive. Policy-makers could simply let the young cohort finance two pensions: their own via mandatory savings schemes and those of the retired generation via PAYG pension contributions. Alternatively, the state could finance the transition by increased government debt: yet, deficit financing simply replaces the obligation to serve interest payments with the obligation to support current pensioners (OECD, 1998; MacKellar, 2000). Financing the transition by increasing taxation provides another option. Here, however, policy-makers would run into evasive and distortionary patterns of behaviour. Last, states can cut public spending to finance the transition and maintain an adequate level of savings (OECD, 1998, p.5; MacKellar, 2000, p.12); recent political experience of budget cuts in Europe, however, shows that containing government spending is at least as difficult a process as pension reform itself.

Second, MacKellar (2000) is doubtful about the efficacy of both mandatory savings plans and incentives to save (such as tax breaks). Disney (1996) argues that, if forced to pay into a mandatory pension plan, households may find ways to dissave in other areas of their budgets (i.e. by increasing borrowing). Again, the empirical evidence is mixed (MacKellar, 2000, p.3). Tax exemptions used to encourage savings also pull in two directions. On the one hand, tax exemptions produce substitution effects, meaning that current consumption becomes more expensive leading to increased savings, and income effects, meaning that after tax income increases and leads to higher consumption. The relative sizes of the effects will determine whether households will save more or consume more³⁰. In any case, the state will save less, since it loses the tax on capital gains. In order, then, to make savings plans effective, policy-makers will have to

- establish mandatory savings schemes,

³⁰ MacKellar points out that if there is a ceiling on tax-deductible retirement income, high income households will definitely save less if the ceiling is below what these households would have been saving anyway (see p. 13).

- prohibit borrowing against pension assets,
- tax capital gains on retirement savings (p.13).

But are savings necessarily so crucial to economic growth? MacKellar (2000) does not seem to think so. A reduced level of savings will affect economic growth if it leads to declining investments. While the change in the age structure may have an impact on the composition of investment, it does not necessarily have to depress the level investment. Slower labour force growth, MacKellar asserts, will however inevitably lead to reduced investment demand. This, in turn, implies that societies can support a given per capita path of output growth with less investment. Since societies need to invest less to sustain the same rate of output growth, ageing presents societies with a “golden opportunity” to maintain levels of consumption with less savings (MacKellar, 2000, p.10).

In sum, there is little conclusive evidence that public pension systems reduce national savings and, conversely, that mandatory or voluntary funded schemes would promote savings. Evasive behaviour of rational individuals equally applies to mandatory savings plans as it does to public PAYG systems³¹: if policy-makers cannot expect to elicit more savings from households, then, it would seem, they will have to provide the savings, in the form of public expenditure cuts, themselves. What is clear is that an older society

“...will inevitably have lower savings than a younger one, because the ratio of consumers to producers is higher. This will be equally true whether the pension system is PAYG- or CR-financed, whether it is defined-benefit or defined-contribution, whether it is public or private” (MacKellar, 2000, p.15).

Fiscal Balance

Economists largely agree that ageing will increase pressures on the public purse (OECD, 1998, pp.28-35; MacKellar, 2000, p.15). Although the OECD concedes that fiscal impacts of ageing are difficult to assess (due to the fundamental uncertainties in forecasting demographic and economic trends mentioned above), the accumulated pension entitlements of the baby-boom generation are likely to strain fiscal balances once this cohort retires (p.30). If policy-makers choose to finance public PAYG pension deficits by budgetary means, the OECD, like the World Bank, fears that

“...such a policy could seriously compromise economic efficiency and dynamism if cuts were to be concentrated in areas such as education, research and development, and infrastructure” (p.34).

Add to this expected steep increases in health care costs (OECD, 1998, p.13) and we are left with the picture of a dire fiscal squeeze beginning about 2010.

Yet, MacKellar (2000) reminds us that the point about what he calls ‘doom-and-gloom’ fiscal predictions is that “they will never come to pass” (p.9). In the past, he continues, policy-makers have broken pension promises: there is no reason to believe they will do otherwise

³¹ The World Bank argument that workers will perceive contributions to mandatory savings schemes as a price (for which they purchase a good) rather than a tax (that disappears into thin air) is rather thin. What is more, it presupposes that rational economic agents share the same enthusiasm for and trust in private sector firms, a dubious assumption at best.

in the future. This means that states will act (by reforming pensions systems, reforming health sectors, cutting public spending, etc.) before it comes to 'fiscal melt-down'³²

In sum, 'expert' opinion, like the policy stories themselves, is divided on both the basic variables and the economic impacts of ageing. However, there is general agreement that, *modo grosso*, ageing will burden public finances and that current pension arrangements (both public and private) have probably encouraged early retirement. The precise shape and form of these effects, however, is unclear. In terms of labour market distortions and savings, neither economic theory nor empirical evidence unambiguously points one way or the other: the size and direction of the impacts will depend on the precise set-up of the economy. What is more, while economists seem to agree that an ageing society will save less, they disagree about how much the decline in savings will be, what can be done about the problem, or, indeed, whether it is a problem at all.

³² MacKellar is rather scathing about the argument, that fiscal doom-and gloom predictions serve a political function in that they create an awareness (albeit an exaggerated one) of the shape and size of the issue. In particular, he claims that this argument "...is precisely how the Club of Rome modellers defended their silly simulations. The excuse was thin then, and it's still thin" (p.9). Our suspicion, however, is that it is precisely this types of policy knowledge that drives reforms.

3 **Why is Pension Reform so Difficult? Approaches to the Political Economy of Pension Reform**

After having discussed the economics of pension reform, let us now turn our attention to the politics of old age pensions. In the following, we will look at several representative approaches from political science that aim to answer one question: why is pension reform so difficult?

The approaches fall into one of two broad categories: those theories that analyse how the interplay of divergent interests leads to policy and those that attempt to understand how ideas structure policy-processes. Not unlike policy stories, each approach focuses on a specific aspect of policy-making and the policy process.

3.1 **Decisions, Interest and Pension Reform**

Conventional political sciences usually conceptualise policy decisions in terms of interests. The way political scientists commonly think about interests is borrowed from microeconomics: political interests of policy actors, be they individual politicians or organised interest groups, corresponds to the rational preferences of the economic agents. Policy decisions are the outcome of rational preference maximisation: policy actors attempt to maximise their interests by transforming their programmes into policy decisions. Policy outcomes, in turn, are explained in terms of the those interest-maximising strategies that led to a particular decision. Within this approach, we can identify three broad churches: power theories, Public Choice, and political approaches.

3.1.1 **Power Theories**

Power theories see policy decisions as a function of political power. Decisions, so the argument goes, result from discrete exercises of political power in order to secure a particular end: in other words, power is used to realise interests.

Whether such uses of political power are legitimate or illegitimate, functional or dysfunctional depends on one's theoretical approach and political bent. Elitists (Hunter, 1953; Mills, 1956) argue that political power is exclusively used to secure the interests of a small ruling elite. Similarly, Marxists and Neo-Marxists (Poulanzas, 1973; Miliband, 1977) contend that policy outcomes reflect the political dominance of the ruling-class. „Not true!“, interject the pluralists (Dahl, 1961; Polsby, 1981): policy decisions, in pluralist polities at least, emerge from a fair competitive process between the divergent and decentralised interests. Last, corporatist theorists (Schmitter and Lehbruch, 1979; Ebbinghaus and Hassel, 2000) argue that policy-making depends on a delicate tripartite balance of power (between state, employers, and workers). Policy in general and pension reform in particular emerges from a bargaining process between these three institutional actors. Whether the process is conflictual or consensual will depend on the structure and interdependence of different issue areas and policy networks as well as the relative institutional autonomy of these actors (Ebbinghaus and Hassel, 2000)

The driving force in power approaches is the idea of interests. They provide the motivation and direction for legitimate or illegitimate uses of power. Thus, pension reform is difficult because either the reform is incompatible with elite/ class interests or it simply failed to generate sufficient agreement in the market place of interests.

Power approaches go some way in explaining the pension reform experiences in some OECD countries. In Austria, for example, the proposal to harmonise pension systems, which would quite drastically cut civil servant's pension benefits, has been vehemently opposed by the powerful Austrian public sector union (GÖD). Likewise in Germany: the opposition Social Democrats threatened to block the proposed pension reform in the German Upper House which caused the demise of the reform. Again, one could plausibly argue, as the SPD did, that the proposed reforms were not in their interest and they exercised (in this case legitimate) power to hinder the reform.

However, power explanations suffer from oversimplification. First, it is difficult to unambiguously ascribe interests to organisations and institutions. Organisations, particularly governments, are complex networks which often pursue many different objectives and aims. Since interests are not always clear, one would have to rely on stated interests or revealed preferences, which often may serve as mere justification. For example, the German Social Democrats issued a 80 page document outlining their opposition to the proposed reforms. Commentators in Germany and abroad, however, suspected the hard-line stance of the opposition had more to do with the impending general elections than the Social Democrat commitment to social justice.

Second, power explanations, particularly of Elitist or Marxist approaches, do very badly when power is not being exercised (at least not overtly). In the USA, pension reform debate is presently deadlocked after the responsible commission presented their report outlining three reform strategies. Power theories, one could argue, would predict that the option chosen will be the one that maximises interests of the elite, the ruling class, or the plural pressure groups. Yet, in the US, the situation is at a standstill.

Third, power explanations are inherently deterministic and cannot account for change in perceived interests. Here, politics is a zero-sum game where those that exercise political power invariably win at the cost of those over whom power is exercised. This, however, neglects what Paul Sabatier and Hank Jenkins-Smith (1987) refer to as 'policy-oriented learning'. Interests can change over time as different groups engage in policy debate and deliberation: For example, Martin Rein and Donald Schön (1994) show how the state's interests and preferences concerning early retirement in Germany changed in the post-war period. Whereas the German government tacitly supported the abuse of the pension system as a personnel policy tool for the private sector for nearly two decades, the present German government is attempting (somewhat unsuccessfully) to re-allocate labour market costs to the private sector.

3.1.2 Public Choice

The Public Choice school of thought is a very powerful theory of decision-making. Rooted in neo-classical economic theory, Public Choice analysis draws its persuasive force from its provocative and intuitively plausible basic assumptions. Challenging the common myth that public officials are selfless servants of the citizenry, Public Choice theorists contend that public officials are self-serving, motivated, indeed like any rational economic agent, by self-

interest (Downs, 1967; Niskanen, 1973). In order to maximise their interests, such as larger budgets or bigger offices (Niskanen, 1973), bureaucrats and politicians promise the electorate higher public spending in return for votes (the so-called 'vote-motive'). Further, in order to retain power, politicians will cut deals and provide side-payments. The net result is wasteful, ever-increasing public budgets.

The upshot of the Public Choice argument is that analysing politics is no different from understanding economics. The same laws that determine the behaviour of firms in the market place affect behaviour of officials in public institutions. Just as price distortions lead to inefficiencies in the private sector, the distortions of market forces in the public sector leads to inefficient and wasteful public spending.

Here, pension reform is difficult for two reasons. On the one hand, public PAYG pension schemes, argues Richard Disney (1996), call for policy action guided by long-term economic considerations. These, however, are, by the very nature of representative democracy, sacrificed in the pursuit of short-term political interests, such as, classically, re-election. Politicians will offer side-payments (such as the extension of pension rights to women rearing children proposed in both Germany and Austria) and increased benefits in order to secure short-term political objectives. On the other hand, voters, equally driven by self-interest, will either seek to secure the benefits gained (in the case of the older generations) or will try to offset present high taxes by demanding increases in pension benefits. The result is an ever-increasing spiral of unsustainable public expenditure on the pension system. The older generations collude in an attempt to outvote younger workers. At the same time, politicians, fully aware of the electoral ramifications of an ageing society, pander to the whims of well-organised and politically influential age cohorts. Political conditions such as these, contend Public Choice theorists, make pension reform (meaning a move to funded pension systems) very difficult indeed.

While there does seem to be impressionistic evidence to support the Public Choice analysis (the sinking of the British Basic Pensions Plus Scheme in 1997, for example), the larger picture is more complex. First, rather than the inexorable rise of pension benefits Public Choice analysis predicts, reforms currently under consideration in OECD countries strive to reduce the level of pension benefits by tightening the relationship between what individuals contribute to the scheme and what individuals receive when they retire.

Second, a random survey conducted by the NOP Research Group Ltd³³ on the issue of pension reform in the UK, shows that there is little evidence of voter collusion. In general, the proposal that private pensions take the place of public pension provisions was rejected by a very clear majority of the respondents (68%)³⁴. According to the Public Choice analysis, one would expect older and middle-aged respondents to be more likely to reject a proposal introducing private pensions. Yet sorting the responses by age shows that there is a remarkable similarity across different groups: 69% of 18-24 year olds reject the idea of private pensions, compared 72% of 35-54 year olds and 63% of the 55+ age group. Political affiliation, rather than age, is more significant in this context: 33% of Conservative voters

³³ NOP weekly omnibus survey, May 1996, N=1567

³⁴ The exact wording of the question is: "Britain spends more than 90 billion pounds a year on social security. Do you think, in general, that private pensions and insurance schemes should take the place of state provisions?"

favour private pensions whereas the figure for Labour and Liberal Democrat voters is 17% and 22% respectively.

Third, if Public Choice assumptions about the inherent short-term outlook of politics were correct, or even roughly accurate, we are still left with the mystery of why some governments are concerned with the long-run financial, social and economic viability of the pension system. For example, the Swedish reforms have totally remodelled the pension edifice. The introduction of notional accounts has transformed the public defined-benefit PAYG scheme into a contributions-defined system with notional accounts thus binding benefits closer to contributions (Palmer, 1997).

Countries of Eastern Europe, most notably Latvia and Poland, are instituting similar long-term reforms: the difference is that in Latvia and Poland the share of contributions flowing to the second fully-funded tier are higher than in Sweden (6% and 9% respectively) (Palmer, 1997). It would seem that the narrow self-interest and short-term outlook that dictates political behaviour in the median voter models has been overcome in these countries. The question, that Public Choice theories cannot answer, is why?

Last, and most importantly, the Public Choice approach seriously overstates the role of the voter in pension reform processes. Voters do not dictate the political agenda in advanced capitalist societies. In most OECD countries, particularly in countries such as the Austria and Germany but also in the USA and the UK, the pension reform process has been isolated from public scrutiny, let alone broad civic involvement. The pension reform policy-process, far from being the fragile policy process volatile to the self-interested whims of politicians and voters alike, has proved itself considerably immune as well as somewhat ignorant of public opinion. In Austria and Germany, the pension reform process is dominated by experts and functionaries: pension reform deliberation takes place at ministerial and even prime ministerial level, the negotiating partners are high ranking functionaries of organised interest groups (such as the labour unions) and both parties are serviced by a host of technical experts such as economists, actuaries, demographers and statisticians. The input from the voter is, at best, remote and the homage paid to public opinion by politicians and functionaries is little more than a ritual nod to the altar of democracy.

3.1.3 Political Approaches

Political approaches to decision-making stipulate that policy-making in democratic policies follows its own, peculiar logic. Decisions emerge from a complex process of adjustment and re-adjustment as policies are fine-tuned in order to reach some form of agreement among competing policy actors. Policy-making, argues Charles Lindblom (1958; 1979), is a delicate walk through the mine-field of diverging interests. Since resources in the policy process are scarce and human capabilities for information processing are inherently limited, policy-makers do not have the time or capability to 'rationally' explore every available option.

Instead, policy-makers limit their analysis of policy options to solutions that are familiar. They proceed by successive limited comparisons meaning only policies that differ incrementally from the status quo as well as incrementally from each other are considered. Lindblom calls this process 'disjointed incrementalism': analysis is incremental because it is limited to options that are known and it is disjointed because there is no central co-ordinating authority in the policy process overseeing different analytical efforts.

Political change proceeds through a succession of small, incremental changes. Incremental policy-making thus involves a high degree of trial and error as well as political adjustment. Policy problems are rarely solved once-and-for-all so that policy-makers return to problems cyclically, adjusting policy to the new situation at hand (Parsons, 1995, p.287). Similarly, policy-makers adjust to the different actors in the policy process (a process called 'partisan mutual adjustment'). Thus, the test of a good policy is whether it can achieve agreement among policy actors rather than whether it can fulfil predetermined objectives. (Parsons, 1995, p.287)

In an incremental policy process pension reform is difficult for at least three reasons:

- i) In order to be successful, pension reforms must gain the support of the plurality of policy actors in the political system
- ii) The pension reform process is a dynamic, iterative process: it is impossible to find a definitive solution to the pension issue
- iii) Pension reform can only proceed in small incremental steps.

When looking at the reforms either currently being implemented or under discussion, it would appear as if the incrementalist model provides an accurate description of the pension reform efforts in the OECD. In general, OECD governments are not boldly sweeping away existing public pension structures in favour of private or other forms of pension provision. Rather, each country is responding to the problem of an ageing society by adjusting or adding to the existing institutions.

Some governments move further away from the status quo than others. Different pension reform efforts, then, are situated on a continuum where the starting point is the status quo: Figure 1 (see Annex 4) illustrates how different pension reforms could be characterised.

At the more cautious end of the continuum are Germany and Austria: they represent the 'simple incrementalist' model. The governments of both countries have decided to reform the pension system without major adjustments in the existing institutions; in fact, the reform proposals of both countries explicitly emphasise their commitment to their existing social insurance schemes (SPÖ, 1997; Bundesausschuß der CDU Deutschlands, 1997).

In 1997, the Austrian government opted for policy alternatives that close to the status quo. Like Germany at the time, the governing coalition planned to change to pension calculation formula. Moreover, and more controversially, the Austrian government intended to begin the harmonisation of pension systems: in the future, civil servants' pensions will be calculated in the same way as worker's pensions³⁵. Predictably, at least in terms of the incrementalist model, it is precisely this element that is slowed the reform process: the civil servants' union blocked efforts at shifting from the status quo. In similar fashion to Germany, the Austrian pension reform experience has been a trial and error process: the 1997 reform was the second recent attempt at reforming the system after an earlier attempt had lead to the fall of the ruling coalition.

³⁵ At present, civil servants' pension benefits are 80% of the last salary. In contrast, workers under the ASVG system receive benefits based on the best 15 (or 20, should the reform be approved) years of earning.

Currently, a new and controversial Austrian government is attempting to radically reform the pension systems (albeit not as radically as the World Bank would suggest). Most of the reforms aim at drastically reducing early retirement. In a political system accustomed to incremental corporatist policy-making, policy actors have not taken favourably to either style or content of the pension reform. Employers organisations and unions alike have announced that they will resist the reforms. At the time of writing, the pension reform process is deadlocked (Der Standard 2000, May 5th, p.1).

The evidence in favour of an incrementalist explanation of OECD pension reform processes, however, is ambiguous. When reviewing the pension reforms that have passed the decision-making stage of the policy-process, it would appear that, with the exception of Britain, it is precisely those reforms that suggest a more radical move away from the status quo that have been adopted. In particular, Sweden, Latvia, Poland, and Hungary (not to mention the Latin American countries) have, as we have mentioned above, already passed legislation that, if implemented, will considerably change the structure of existing pension edifices.

What is more, Lindblom's approach describes decision-making in pluralist polities with many and diffuse centres of power. However, the most incremental pension reforms are taking place in countries that are not particularly pluralist. Both the German and Austrian policy process is strongly corporatist, with an emphasis on expert knowledge and a highly exclusionary decision-making process. In contrast, more pluralist systems, such as the USA, Canada and the UK, are not exhibiting characteristic signs of incremental policy-making. It is precisely in the US and the UK that the more radical departures from the existing public PAYG system are being seriously considered.

3.2 Ideas and Pension Reform: Intractable Policy Controversies, Policy Oriented Learning and Garbage Cans

Although interest-based approaches go some way in explaining why pension reform is so difficult, they leave many questions unanswered. In particular, they fail to address the central question: why does pension reform lead to such a vehement clash of interests? In order to answer this question, we have to explain how interests are formed and how they can be mobilised.

3.2.1 Pension Reform as an "Intractable Policy Controversy"

Martin Rein and Donald Schön (1994) set out to understand why issues such as pension reform are particularly contentious, politically divisive, and stubbornly resistant to resolution. Rein and Schön differentiate between policy disagreements and policy controversies. Policy disagreements "refer to disputes in which the parties to contention are able to resolve the questions at the heart of their disputes by examining the facts of the situation" (Rein and Schön, 1994, p.3). These types of disputes are amenable to resolution by recourse to arguments based on facts and evidence. Policy controversies, in turn, "...are immune to resolution by appeal to the facts" and "...tend to be intractable, enduring, and seldom finally resolved" (Rein and Schön, 1994, p. 4).

In policy controversies, facts and evidence become a resource in the rhetorical struggle for legitimacy. Parties to such a controversy use “different strategies of selective attention”: they differ on the data they accept as evidence, what facts are relevant, and even what is to count as a fact. Even if the parties in a policy controversy focus on the same set of facts, they interpret the facts differently. Thus, Rein and Schön define intractable policy controversies as situations where

“...two or more parties contend with one another over the definition of a problematic situation and vie for control of the policy-making process. Their struggles over the naming and framing of a policy situation are symbolic contests over social meaning of an issue domain, where meaning implies not only what is at issue but what is to be done” (p. 29).

The source of intractable policy controversies are clashes of conflicting ideas, or ideologies, which Rein and Schön call ‘frames’. Although they do not provide a concrete definition, frames are sets of ideas that serve as referential systems with which policy actors define policy problems. Frames give policy-actors the conceptual tools to interpret political events, facts, and scientific evidence. They emerge from, argue Rein and Schön, the institutions and organisations of the policy process.

These frames cannot be reduced to interests because “... it is the frames held by the actors that determine what they see as *being* in their interests and, therefore, what interests they perceive as conflicting” (Rein and Schön, 1994, p.29, original italics). What is more, frames cannot be falsified: Rein and Schön observe that “...if *objective* means frame-neutral, there are no objective observers” (Rein and Schön, 1994, p.30, original italics).

Pension reform, then, is difficult for two reasons³⁶. On the one hand, the pension issue is an intractable policy controversy that will not be resolved with recourse to facts and evidence. The parties to the dispute hold different sets of ideas with which they interpret the pension reform issue. The debate is less about finding a long-term solution to the problem of ageing in advanced capitalist societies than about accruing legitimacy for a particular way of viewing the world. On the other hand, because sponsors of different frames attempt realise their world-views by appropriating the pension issue, a policy dialectic develops in which the meaning and significance of the pension system is in constant flux and transformation.

Although Rein and Schön’s frame approach is more inclusive than decisional theories discussed above, some question remain open. First the differentiation between policy disagreement and policy controversy is arbitrary and somewhat unconvincing. The difference is not one of kind but one of degree: at a certain level of generality, all policy debates are policy controversies. Policy disagreements open to facts and evidence usually are smaller segments of a larger policy debate. For example, all parties in the pension debate will agree that populations in the OECD are ageing and that, if some form of action is not taken, public PAYG pension systems will face grave financial difficulties in the middle of the next century. However, the shape and form of policy action is hotly disputed. Does this make the pension reform issue a complicated policy disagreement or a policy controversy? Furthermore, compare the pension reform issue to, say, the debate about genetically modified foodstuffs.

³⁶ Rein and Schön actually apply their frame analysis to the German debate about early retirement. They show how, over a time-span of forty years, the interplay of different institutional frames has defined and redefined the basic telos of the German pension system.

Here the scientific uncertainties are so large that even the basic data on, for example, releases of genetically modified organisms are contested by different policy actors (Levidow *et al.*, 1996). Another example is the global climate change conversation: although the figures relating to the probable increases in mean global temperature from Intergovernmental Panel on Climate Change are being treated as facts by the mainstream of the policy actors, these figures are still disputed by many different parties to the controversy (Meyer, 1994).

This leads to another related difficulty in Rein and Schön's approach. Given the differences across policy areas, do policy controversies differ in severity? Are some policy controversies slightly intractable (such as the pension debate) and are others, such as the GCC debate, highly intractable? A cursory glance at different policy areas appears to give credence to the notion that policy controversies differ in severity. What, one wonders, makes one policy controversy more severe than another? Unfortunately Rein and Schön leave us in the dark.

Further, the relationship between institutions and the emergence of frames is unclear. Rein and Schön allude to the institutional origins of policy frames but leave it at that. This is unfortunate because it leaves frames dangling in mid-air with no grounding in social relations. Moreover, it becomes wholly unclear how frames can help construct political metaphors that enable the mobilisation of power. In short, there is no explicit treatment of political power, metaphorical, symbolic or otherwise, in the approach. Where, then, do frames draw their authority?

The lack of political power in the model points to another weakness in the frame approach. Rein and Schön do not have a structural dimension in their explanation of policy controversies. The specific structure of the policy process in particular and the polity in general, that is how political power is channelled and managed, surely affects the manner in which a policy controversy arises, is carried out and, most importantly, is resolved. One major implication of the frame approach for our purpose is that pension reform is conditional on some form of rapprochement between conflicting frames. Yet, although Rein and Schön offer models of cross-frame dialogue and reframing based on the one hand on abstract concepts such as Kuhnian paradigmatic shift and Habermas' ideal speech situation and on the other hand on practical approaches of mediated negotiation, institutionalism and Hirschmann's 'bias for hope', it is somewhat unclear how they suggest that the gulf between different frames be bridged³⁷. Furthermore, they make no explicit reference to the structures that provide the institutional framework in which a reframing of different position could take place.

When reviewing different pension reform efforts in Europe, the institutional differences between polities are at least as important as the different competing frames in the respective pension issue controversies (Ebbinghaus and Hassel, 2000). In Germany and Austria, the corporatist structure of the policy-making process with its emphasis on consensual policy-making is conducive to deadlocks if an intractable policy controversy arises: indeed, this seems to be the case in the present pension reforms. Rather than cross-frame dialogue, there is mutual retrenchment which is articulated and exacerbated by the structure of the policy process. In the UK, however, the peculiar parliamentary structure has enabled a de facto one-party rule: one could quite plausibly argue that the Conservative Party, had they not lost the general election, would have implemented the Basic Pension Plus Scheme

³⁷ For a more detailed discussion, see Rein and Schön 1994, Chpt 3.

paying scant attention to opposition opinion. Although there is clearly a frame conflict, on the one side the individual responsibility frame of the Conservatives, on the other the stakeholder frame of the Labour Party, the reforms would have been carried on the strength of parliamentary clout. Furthermore, Sweden, Latvia, Poland and Hungary are in the process of major reform to their pension systems. Undoubtedly, there is a frame conflict in the former East Bloc countries between free-market frames and frames that are of a more socialist flavour. Yet, these reforms have passed the decision-making stage.

This is not say that frame conflict is not an crucial factor in what makes pension reform so difficult and that we can reduce explanations to different institutional structures. It does mean, however, that Rein and Schön have ignored the relationship between institutional structures and cognitive frames. Hence, they cannot explain how political power affects the pension debate.

3.2.2 Policy-Oriented Learning: Sabatier and Advocacy Coalitions

Why is it that sponsors of different policy frames cannot communicate across the boundaries of the frames? As we have seen, Rein and Schön neglect the effects structural features of a policy sphere may have on the quality of communication in this policy area.

One theorist who has closely examined this relationship is Paul Sabatier (1987). His Advocacy Coalition Framework approach attempts to understand the role of knowledge in long-term policy change. Sabatier is particularly interested in the long-term enlightening function of technical knowledge: in short, Sabatier asks how policy actors learn.

Ideas affect the policy-making processes, maintains Sabatier, in terms of so-called “policy belief systems”. All policy, Sabatier avers, is based, either implicitly or explicitly, on some form of theory specifying how to achieve the objectives outlined in the policy. The theories, in turn, are grounded in policy belief systems. These policy belief systems operate like ideologies: they set value priorities, they structure perceptions of causal relationships, they mould perception of states of the world, and, they affect how an individual policy-maker views the efficacy of different policy tools. Some parts of the policy belief systems, Sabatier continues, are more susceptible to change than others: “deep core beliefs” (fundamental norms based on ontological axioms) change very glacially if at all; “policy-core beliefs” (fundamental policy positions) change slowly but are open to negotiation an persuasion; “secondary beliefs”, however, can change rapidly.

How, then, does policy change? Apart from what Sabatier refers to as external changes³⁸ and “dynamic system events”³⁹, “policy-oriented learning” brings about long-term policy changes. These long-term impacts of technical knowledge on policy belief systems are “... relatively enduring alterations of thought or behavioural intentions that result from experience

³⁸ Meaning attributes of policy issues, the distribution of resources across policy subsystems, or the transformation of underlying cultural values and social structure.

³⁹ Meaning change in the broader political landscape. This includes not only general socio-economic conditions and technological change but also changed in the system’s governing coalition.

and are concerned with the attainment (or revision) of policy objectives" (Sabatier and Jenkins-Smith, 1987, p. 19).

When does learning in a policy subsystem take place? Sabatier and Jenkins-Smith outline three conditions that are conducive to policy oriented learning. First, the level of conflict between advocacy coalitions within a policy subsystem needs to be at an intermediate level. At a high level of conflict, policy actors perceive the outcome of the dispute as central affirming core policy beliefs: the political stakes are high. Consequently, as rival arguments become more of a threat to the policy core, policy actor's willingness to engage in constructive debate declines. Analysis becomes more of a political resource than a means to settle a disputed policy question. Learning under these conditions is difficult: in the extreme, Sabatier and Jenkins-Smith maintain, policy debate becomes a 'dialogue of the deaf'.

If, however, core values rest on a complex set of secondary elements, the level of conflict about a particular question is likely to be moderate. The outcome of the debate is not seen as crucial to legitimating core beliefs, so consequently some flexibility in questioning one's own assumptions is permissible: learning can take place. Thus, the advocacy coalition framework, unlike Rein and Schön's approach, specifies different levels of policy controversies: policy debates involving deep core or policy core beliefs will develop into what Schön and Rein call intractable policy controversies. If, however, debate is focused on secondary elements, there still may be a policy controversy (because debate ultimately driven by core beliefs) but some degree of learning and rapprochement takes place.

Second, Sabatier and Jenkins-Smith assert that learning in a policy subsystem is promoted if the issue under consideration is analytically tractable. This assumes that analysis and science itself is a mutual search for what is to count as truth. The more practitioners and analysts can agree on what is to count as a valid fact, the easier learning across and within different advocacy coalitions will be. The higher scientific uncertainties and the more complex the issue area, the more policy actors will fall back on socio-ideological world-views to interpret political life: there is, in short, less common ground on which an informed policy debate can take place. Policy debate then becomes a show-down based on core values which, as mentioned earlier, cannot be resolved by recourse to empirical evidence.

Last, the presence of a professional analytical forum in the policy subsystem is conducive to policy oriented learning. This implies that policy debate takes place within the institutional and ideational confines of a closed network: the less policy actors can question the fundamental values of what is to count as a fact or not, the less an issue will become a dialogue of the deaf.

The Advocacy Coalition Framework offers a sophisticated tool box to analyse the pension reform issue in Europe. Pension reform may be difficult because the structure of policy subsystems in which debate takes place does not allow for policy oriented learning. The debate has become a discussion about first principles and deep core beliefs.

A cursory glance at the policy subsystems dealing with pension reform appears to support Sabatier's thesis. Although the pension issue is analytically tractable, or at least not as intractable as, say, global climate change or bio-technologies, the lack of professionalised fora as well as the high level of conflict surrounding pension reform have made policy oriented learning very difficult. Pension reform, although undoubtedly an activity of elites in the political system, is not the exclusive domain of particular group of professionals. In fact, the professionals analysing pension reform, mostly economists, political scientists and

actuaries, arrive at very different conclusions. Whereas economists, in general, point to the 'fundamental flaws' of PAYG schemes and are more likely to conclude that pension systems are in crisis (Mitchell and Quinn, 1995; Kotlikoff, 1996; Shoven and Schreiber, 1996; Rürup, 1997), political scientists show a tendency to downplay the financial aspects of the pension issue and focus on the social repercussions of dismantling the welfare state (Esping-Andersen, 1991; Kingson and William, 1996). Actuaries, in turn, stress that, for all the problems facing pension systems, there are still sufficient funds to cover payments in the medium-term and that a crisis is not immanent (Jones, 1996). Thus, differing theoretical frameworks give rise to contending interpretations of the pension issue.

3.2.3 Garbage Cans and Policy Streams

Whereas the approaches discussed so far have either stressed the role of policy-processes (Public Choice, Incrementalism) or the importance of ideas (Frame Analysis, Advocacy Coalition Framework), this section will look at how social structures and ideas interact to make the pension reform issue an intractable policy controversy. In particular, we will look at how social and ideological structures rank ideas in the policy process: in short, how the pension reform agenda is affected by specific structures of the welfare state.

Garbage Cans

In their 'garbage can' model of organisational behaviour, Michael Cohen, James March, and Johan Olsen (1973) outline decision-making in uncertain and complex policy situations. The model depicts decision-making in 'organised anarchies' where there are problematic organisational preferences, the technology to realise these preferences is unclear and where participation in the organisation is fluid. In organised anarchies, decision-making is not a linear process: policy problems are neither clearly defined nor can the organisation neatly dispense with them. Rather, argue Cohen et al., the garbage can process features four relatively independent streams: problems, solutions, participants and choice opportunities. As a result, organised anarchies are

"...a collection of choices looking for problems, issues and feelings looking for decision situations in which they may be aired, solutions looking for issues to which they may be the answer, and decision-makers looking for work" (Cohen *et al.*, 1973, p.2).

The manner in which the four independent streams are coupled and how policy problems are handled, argue Cohen, March and Olsen, depends on the structure of the organisation: the institutional structure channels both the attention of policy-makers and couples the different streams. Policy problems and solutions are dumped into a garbage can and, depending on the shape and form of the garbage can, participants will seize upon the decision opportunities to couple solutions to policy problems

The garbage can model provides a good characterisation of the pension reform process in Europe. As we have seen in preceding section, the preferences of the different policy actors are problematic and ill-defined: in Germany, as Rein and Schön skilfully point out, industry, central government and local government use the pension system to fulfil different goals. In the US, the debate has come to a standstill after the Congressional committee has reported back with three very different policy solutions: policy-makers' collective preferences are not sufficiently defined to facilitate a clear policy choice. Furthermore, the technology in the pension debate is highly disputed: the abortive pension reform attempt in the UK most

clearly shows the rift between policy-makers that see privatisation as the technology to secure long-term financial stability of the pension system and policy-makers that prefer to rely on existing public PAYG systems. Harriet Harman, MP pointed to the flaws in the Basic Pension Plus Scheme when she observed that

“...we [the Labour Party] think it’s costly, it’s very risky; it gives nothing to today’s pensioners and it puts all your pensions in private pensions basket, which is just too risky“ (Penman, *The Scotsman* April 25 1997:8)

Further, the participation in the pension debate is highly fluid: politicians at all levels, civil servants, and a host of analysts drift in and out of the debate. In Austria, the pension reform debate has provoked comments from most politicians at all levels.

Pension reform may be difficult because the pension reform process is structured in terms of the garbage can model. The process may not follow a rational process of problem recognition, policy formulation and policy implementation. Cohen, March and Olsen suggest that policy-making is more complex due to the institutional structures of the pension policy process. The way solutions are coupled to the pension problem may depend less on the actual problem at hand rather than the institutional backdrop that provides decision opportunities.

Policy Streams

Kingdon (1984) has developed the Garbage Can model further. He sets out to understand why certain policy issues rise to the top of the agenda when they do. Unlike Cohen, March and Olsen, Kingdon draws a line between participants and processes: participants in the policy process not only include politicians, advisors, civil servants but also journalists, researchers and interest group representatives. Kingdon understands processes, in turn, as three independent streams that flow through the policy process: a problem stream, a policy stream and a politics stream.

The problem stream consists of competing problem definitions. Kingdon identifies three mechanisms with which policy problems are brought to the attention of policy-makers: indicators, events and feedback. Change in indicators, such as GDP, the level of unemployment, population statistics, not only draw attention to a particular problem as it develops, these forms of data construct a particular image of a emerging policy problem. Events, such as catastrophes or personal experiences, serve to focus policy-makers’ attention to societal conditions. Last, feedback on the performance of existing policy alerts policy-makers to unanticipated implementation problems.

The second stream Kingdon outlines is the policy stream. Policy solutions, Kingdon argues, float about in a primeval soup consisting of policy communities and policy networks. Some policy solutions, Kingdon continues, will rise to the surface of the primeval soup while others remain at the bottom. The upshot of the argument is that the manner in which policy solutions rise to the top of the agenda may follow a different, far more complex logic than conventional theories of the policy process assume. Rather than simply providing solutions to policy problems, different policies compete in an evolutionary process for survival and supremacy. Policy solutions, Kingdon argues, may not even be bound to specific problems. For example, in the pension debate, the libertarian Adam Smith Institute in Britain and the Cato Institute in the US have called for the ‘wholesale’ privatisation of the pension system (Duncan, 1997, p.6; Cato, 1996, pp. 8-11). This should come as no surprise: the preferred

solution of these institutes to any policy problem is a greater involvement of the private sector. Thus policy solutions may be loosely related to the actual policy problem at hand

The third policy process Kingdon describes is the political stream. The political stream determines the status of a particular issue. Its components are the national mood, the constellation of organised political forces, the make-up of government, and the drive for consensus-building (bandwaggoning, bargaining, etc.) The political stream operates quite differently from the other two process streams: it is only with the co-ordination of this stream that problems are coupled to policies and thus reach the political agenda.

Thus, Kingdon contends, a policy issue can only reach the political agenda when all three process streams converge at a single point. This means that a policy issue becomes pressing when the political circumstances are right: Kingdon speaks of the opening of a launch-window. When all three streams converge at a point, an opportunity to couple a policy problem with a preferred solution arises. This window is open for a limited time only: national mood may change, the issue may 'go off the boil', the issue may be superseded by another event.

Pension reform, then, may be so difficult because the policy process is inherently complex and anarchic. The solution to policy problems such as the pension issue may have less in common with a rational utility maximisation or muddling-through. Kingdon suggests the rise of a particular idea is related to the complex confluence of the three process streams and that the opening of a policy or problem window is fairly independent of the substantial content of a particular policy or problem.

The Evidence

The policy stream argument is an attractive tool for explaining the pension reform experience in the OECD. Not only are different problem definitions of the pension issue evident. Linnerooth and Ney (1997) have shown that there are a plethora of possible policy solutions that float around in the political system. Moreover, the failures of the German and British pension reform efforts are, in terms of Kingdon's approach, efforts that were launched 'at the wrong time'. In the UK, the Basic Pension Plus Scheme was launched when the political window was firmly closed. The pension issue had been coupled to a quasi-privatisation solution that, although it had served the Conservatives in the past, was, in the eyes of the public, becoming a dogmatic and worn Thatcherite response to a emotionally laden and symbolic policy issue. Likewise in Germany, the political constellation, the organised political forces and, most importantly, the consensus-building elements of the political stream were out of kilter for the *Rentenreform 1999* to be able to remain at the top of the political agenda.

By the same token, we can use Kingdon's approach to understand why such sweeping reforms have been instituted in Eastern Europe, in particular in Latvia, Poland and Hungary. These countries are in the process of transition from command to market economies: socio-economic hardship and severe fiscal malaise are accompanying these countries on their way. The indicators for Poland, Latvia and Hungary all point in the same direction: the existing pension systems are utterly unsustainable in the medium and long term. This has focused policy-makers' attention on the pension problems and in the general national mood of change, more structural reform proposals found a hearing in the political process. What is more, the disillusionment with socialist economic management has undermined the legitimacy of conservative critics. Thus, both political and problem launch windows have

opened in formerly East Bloc countries and have facilitates the coupling of fairly wide-reaching reform to the pension issue.

Kingdon offers an insightful approach to explaining how policy processes rank problems and policy solutions. What is more, Kingdon shows that rapprochement in intractable policy controversies is possible, if certain structural conditions are met.

4 Summary

The following report has provided an overview of the three central research areas of the PEN-REF project.

In Section 1, the report briefly outlines the major issues associated with ageing and pension reform. This included outlining the objectives of pension systems and the different types of institutional arrangements in place for achieving them. After briefly reviewing the fundamental demographic challenges to existing pension systems, the report recounts three representative policy stories about pension reform from international organisations. The policy stories, which are narrative devices for framing policy issues, each provide a different analysis of the pension policy problem and suggest divergent policy responses to the challenge of population ageing. The report then goes on to evaluate what ‘the experts’ have to say about population ageing and pension reform in the light of the policy stories. Although there is some agreement about very broad developments, expert opinion is as divided on the details of pension reform and the impacts of ageing as is policy discourse: the uncertainties surrounding both the basic variables of ageing and the economics of pensions (theoretical and empirical) are considerable.

Section 2 then reviewed different approaches in political science and the policy sciences that could enlighten policy-makers as to why pension reform is so difficult. The approaches fall into two categories: interest-based theories and discursive approaches. Whereas the former explains pension reform in terms of the interaction of institutional and individual interests, the latter focuses on the way ideas and ideologies set pension reform agendas. While all theories provide an insight into pension reform, no approaches in either category provides a wholly satisfactory account of why pension reform is so difficult.

5 Appendices

The research in the PEN-REF project falls into two broad phases. The first phase (WP2) will look at pension reform processes across Europe. The final product will be a report comparing different reform experiences. Here, the PEN-REF consortium will use a three-pronged methodological strategy involving a survey of country-specific literature, a country specific media analysis, and expert interviews. Appendix A contains the interview guidelines as well as the questionnaire.

The second phase will consist of testing whether focus groups can contribute to the pension reform policy process. In Appendix B, we briefly outline some of the options for setting up focus groups.

In Appendix C, we list the research questions emerging from the Inception Report

Appendix D contains Figure 1: the Pension Reform Continuum

5.1 Appendix A: Expert Interviews

5.1.1 Interviewer Guidelines

The following provides some general guidelines for conducting the PEN-REF expert interviews. Since the level of experience with qualitative interviewing in the group differs, I will probably be telling some of you things that you already know. I would, then, kindly ask those of you who are familiar with the technique of quality depth interviewing to bear with me.

5.1.1.1 General

The expert interviews for the PEN-REF project are semi-structured qualitative depth interviews. This means that although you have a questionnaire you can use as a guide, the structure of the interview is more or less open.

The idea of these interviews is not primarily to gather information about pension reform, but to understand the attitudes and belief-systems that motivate policy-makers. In order to understand these belief-systems, we have to go into 'depth'. This means that we want the respondents to talk, explain, and expound as much as possible.

The trick here is to avoid asking any questions that would engender a 'yes or no' answer. Rather, we want to get the respondent to open up, speak freely and **make value judgements**. We can then latch onto these value judgements and ask the respondent to provide an explanation, that is, provide reasons, for why they think, feel, or believe that way.

When interviewing in the past, I have found it rather useful to remember these basic ground rules:

- 1) **Nothing is obvious:** When respondents make statements or judgements that sound obvious or common sense, *always* make sure to have respondents explain what they mean.

If, for example, a respondent claims that "...it is perfectly clear that the current contributions-based pension system disadvantages women"

While we may **agree** for many reasons, this does not mean that we **know** why the respondent thinks pensions systems treat women unfairly. The respondent could be referring to any number of specific reasons why this may be the case (such as unequal treatment on the labour market, differential educational standards, the fact that women spend more time child-rearing, differential wage structures, and so forth). In these cases, **always** probe (see below).

Another example would be a respondent claiming that "the policy conflict was solved in the traditional Austrian style, you know what I mean" (this is, by the way, a real quotation).

While the researcher probably can pretty well guess what the respondent may mean (a typically corporatist style, a style of policy-making based on consensus and co-optation, etc.), there is absolutely no way the researcher can actually know what the respondent means without further explanation.

- 2) **Do not try to read the mind of respondents:** There is no way to know in advance what a respondent will think of a particular question. We have no means of knowing whether any particular question will annoy, anger, bore, or irritate a respondent. We also cannot predict whether they will find the question irrelevant. The easiest way to find out, however, is to ask the question. Further, it is very interesting to have the respondent explain why a particular question is annoying and irrelevant.
- 3) **Profess ignorance:** In order to obtain depth information, it is crucial to let respondents formulate their thoughts while they speak. This is most easily done by letting respondents explain concepts, principles, systems, etc. It is completely immaterial whether or not you know perfectly well what the respondent is explaining to you or, for that matter, whether you know better.
- 4) **Maximise the amount of respondent talk, minimise your own:** the idea is to get the respondent to speak openly, rather than to answer a set of questions. If the respondent is giving you one-liners, there is a problem. I have found the easiest way to get people to talk is to be quiet myself (for those of you who know me, you can imagine how difficult that is for me).
- 5) **Some respondents are impossible:** However, there are times where respondents simply refuse to co-operate no matter how hard one tries. In that case, make sure to ask all the questions so that we can get at least a minimum of information.

5.1.1.2 The Aims

The research aims of the interviews are the following:

- to understand the policy processes that give rise to pension reform,
- to find out about elite discourses concerning pension reform,
- to understand the role these different pension discourses play in the pension policy process.

5.1.1.3 The Interview Guide

The interview guide is divided into five parts:

- A. Warm-Up
- B. The Pension Policy Community and the Pension Policy Process
- C. The Pension Problem

D. The Development of the Pension Issue

E. The Current Pension Reform Debate

As you can see from the lay-out, I have highlighted certain parts of the text. The different styles mean the following:

1. Text in ***bold italics*** indicates explanatory text you may want to read out to the respondent. This text is purely optional but may come in useful for those of you who have not conducted many interviews before.
2. Text in **underlined bold** signifies section headings which are mainly for our orientation. You do not have to read them out to the respondent. If, however, you feel it is useful for whatever reason, please feel free to integrate the headings into the interview.
3. Text in **bold** marks the questions that you should read to the respondents. For those of you who have little experience with interviewing, I would suggest you stick to both the wording and the order of the questions for the first couple of interviews. After that, you will get a feeling for how the questions need to be modified or adapted.
4. Text in *italics* are so-called prompts. These are issue or items that should not be read out as part of the question but should be covered in one form or another. If respondents refer to these items on their own, there is no need to mention them. If they do not, you can 'prompt' them by mentioning the particular item. For example, if a respondent in question B1 (institutional actors) mentions a list of actors that do not contain, say, private sector actors, you would ask: "What about private sector actors?". You may find that respondents mention issues that are not on the list of prompts. In this case, please add them for future interviews and inform the consortium.
5. Text in **UNDERLINED CAPS** signifies so-called 'probes'. A probe is a question that asks the respondent to enlarge, specify, expound, explain, define, or augment a particular statement. The quality of an interview crucially depends on the degree to which an interviewer probe the respondent. As a rule, any statement of opinion and value judgement should be subject to a probe. What is more, if respondents use jargon or technical terms, these should also be subject to probes (e.g.: when you say "second pillar", what do you mean?). The probes in the interview guide are **by no means exhaustive**. Rather, they represent the absolute minimum amount of probes that arise from the questions. By the way, I have found that the best probe is an attentive 'yes' or 'uh-huh'.

5.1.1.4 Definitions

Some members of the PEN-REF consortium have suggested that we should provide respondents with definitions for key terms (such as 'reform' or 'technical changes'). I must admit that I am rather reluctant to provide these definitions for the following reasons.

First, we ourselves have not drafted social scientifically sound definitions for these terms and categories. These categorisations are solely heuristic devices that have not been rigorously defined, let alone empirically validated. As heuristic devices, however, they are rather useful in structuring our thought.

Second, although we need devices to structure our thought, I would feel very uncomfortable about using these heuristics to structure the thought of our respondents. A major part of this exercise is to find out what respondents define a 'reform', an 'irrefutable fact', a 'technical change', a 'radical switch in policy' and so forth. Only then can we properly reflect on our categories.

Third, as you will see, we have revised the interview guides in such a manner that it should not give rise to definitional issues.

5.1.2 The Interview Guide (Questionnaire)

OPTIONAL INTRO: Thank you very much for agreeing to help us with our research. The PEN-REF project is an international research endeavour of seven European research organisations. The project is funded by European Commission in terms of the Fifth Framework Programme. Our research, which covers six European countries, aims to understand the policy processes and the policy debates related to public pension reform in Europe.

I would like to take this opportunity to point out that all your responses will be treated with the strictest of confidence. None of your responses will be directly attributed to either you or your institution.

A. Warm-Up

1) What policy-areas do you deal with or are you responsible for?

2) How did you get to be in this position?

- *academic/professional background*
- *career path*

B. The Pension Policy Community and the Pension Policy Process

1) Who are the main policy actors responsible for formulating and implementing pensions policy?

- *state actors (ministries, civil servants, executive agencies, etc.)*
- *political actors (ministers, advisers, spokespersons of political parties)*
- *interest representation and NGOs (trade unions, employer's associations, specialised interest groups, etc.)*
- *private sector actors (insurance companies, banks, firms, etc.)*
- *research actors (universities, think-tanks, research organisations, etc.)*

2) What do these actors have in common and what makes them different from one another?

- *commitment to common/divergent policy goals*
- *commitment to common/divergent political programmes*
- *commitment to common/ divergent paradigms*
- *professional affiliations*
- *institutional affiliations*
- *political affiliations/ political patronage*
- *resource dependencies*

3) With what institutions and policy actors do you most frequently co-operate when formulating pension policy?

4) In what ways has the community of institutional actors concerned with pension issues changed in the past 10-15 years?

- *changes in personnel in existing institutions*
- *new institutions have joined the community / old institutions have left the community*
- *balance of power within the policy community*
- *more or less public exposure*

5) In terms of policy-making, have these changes been for the better?

- PROBE: FOR WHAT REASONS

6) In general, how does the pension policy agenda get set?

- *process*
- *participants*
- *policy-making level*

7) Do you think the process of pensions policy formulation is different from policy-making in other fields?

- PROBE: IN WHAT WAYS IS IT DIFFERENT

C. The Pension Problem:

1) What are the current and future challenges facing public pension systems in Europe?

- *population ageing the changing nature of employment and the labour market*
- *new labour market participants (e.g. women)*
- *equity issues (intergenerational, gender, etc.)*
- *efficiency issues*
- PROBE: WHAT ELSE?

2) What are the current and future challenges facing public pension systems in [insert country]?

- *population ageing*
- *the changing nature of employment and the labour market*
- *new labour market participants (e.g. women)*
- *equity issues (intergenerational, gender, etc.)*
- *efficiency issues*
- PROBE: WHAT ELSE?

3) Do you think public pension systems will be able to face up to these challenges?

- PROBE: FOR WHAT REASONS?

4) In what areas, if any, do you think the current pension system is unfair?

- PROBE: FOR WHAT REASONS? FOR WHOM IS IT UNFAIR?

5) In what areas, if any, do you think the current pension system is inefficient?

- PROBE: FOR WHAT REASONS? FOR WHOM IS IT UNFAIR?

D. The Development of the Pension Policy Issue

OPTIONAL TEXT: I would now like to talk a little bit about the way the pension policy issue has developed in [insert country] in the past 10-15 years. We are particularly interested in the way different institutional players interact, whether in a consensual or conflictual manner, to produce pensions policy.

1) What issues have dominated the policy debate on pensions in [insert country] over the past 10-15 years?

- *expert/ technocratic level (independent and civil service experts)*
- *political level (politicians and interest representation)*

- *public/ media*
- 2) **What have been the points of broad consensus and what have been the points of conflict among the community of institutional actors?**
- 3) **To what extent was there a public debate?**
 - *degree of interest mobilisation*
 - *the role of the media*
 - *openness of the debate*
- 4) **How different, if at all, was the public/ media debate from the debate among the institutional actors?**
- 5) **To what type of changes in the public pension system, if any, did these debates lead?**
 - *statutory changes to the public pension systems*
 - *incremental changes Vs radical changes*
 - *changes in the expert/ public perceptions of pension systems*
- 6) **What was the objective of these changes? Were these objectives adequate?**
 - PROBE: FOR WHAT REASONS WERE THE OBJECTIVES ADEQUATE/ INADEQUATE?
- 7) **Did the changes or reforms fulfil their objectives?**
 - PROBE: FOR WHAT REASONS?
- 8) **Who, if anyone, opposed these changes?**
 - PROBE: FOR WHAT REASONS?
- 9) **How were the conflicts solved?**
 - *by compromise*
 - *by ignoring conflict*
 - *by learning*

E. The Current Pension Reform Debate

- 1) **What are the pension reform proposals currently on the political agenda?**

- 2) **What are the objectives of these reforms?**
- 3) **In what ways do these reforms address the challenges facing public pensions systems?**
 - PROBE: IN WHAT WAYS?
- 4) **What triggered these reforms?**
- 5) **How have these pension reform proposals come about?**
 - *type of actors involved*
 - *level of policy-making*
- 6) **Is this process adequate?**
 - PROBE: FOR WHAT REASONS IS THIS PROCESS ADEQUATE/ INADEQUATE?
- 7) **To what extent have the present reform proposals given rise to policy conflict?**
- 8) **In your opinion, how will this conflict be dealt with?**
 - PROBE: FOR WHAT REASONS?
- 9) **Compared to previous pension reforms or pension reform debates, in what ways is the present pension debate different?**
 - PROBE: FOR WHAT REASONS IS THE PRESENT DEBATE DIFFERENT?
- 8) **How likely, do you think, is it for the current policy debate to lead to concrete changes in the public pension system?**
 - PROBE: FOR WHAT REASONS IS IT LIKELY/ UNLIKELY

Thank and Close

5.2 Appendix B: Options and Alternatives in “Focus Group” Research

The PEN-REF project has promised to explore the utility of “focus group” discussions as a public consultation format. The present review of systematic consultation formats will outline some of the choices available to researchers and policy makers. Note that the PEN-REF group will study these choices and make research decisions in their October 2000 meeting, when baseline country reports will have become available.

5.2.1 Major Dimensions in Organising Public Consultation

A number of typologies exist to describe and categorise techniques for public participation and consultation. In the area of technological risk, in which much development of these techniques has taken place, outstanding references are : English *et al.* (1993); Renn *et al.* (1995); as well as Stern and Fineberg (1996).

Within the PEN-REF programme, three major dimensions have been laid down to organise thinking about choosing a consultation format. These are:

- i. Output
- ii. Scale
- iii. Process.

These dimensions are bi-polar, that is, each dimension may be represented as a continuum, at either end of which two opposing options lie. Organisers of consultation, it is suggested, should choose a position on each of the three continua. The opposed options forming each end point are discussed in the following. PEN-REF positions are sketched.

5.2.1.1 Output

Output reflects the objectives sought in organising consultation. Two opposed types of output are seen: *data in response to demand*, and, *decision*. That is, in one type of public consultation, the objective pursued is to gather data on a question that interests the persons or institutions organising the consultation. In this way, the participants in the consultation are essentially responding to an information demand. The information they provide (opinion, attitude, preferences, social representations, etc.) can be used by the organisers in coming to a decision at another time or place. Participants are not empowered to make effective decisions.

In contrast, another type of public consultation is organised in order to produce a decision in real time. In this format, also called *deliberation*, participants are empowered by the organising institution (to a greater or lesser extent).

5.2.1.2 Scale

Scale refers to the number of persons consulted. A secondary dimension is whether participants are consulted as individuals or as a group. Note that a large or small number of individuals may be consulted (as in a national survey, or, a focussed group discussion bringing together 8 persons who may or may not know each other). Large or small numbers of groups, i.e. persons bound by some common project, may also be consulted. Frequently, when the input of large numbers of groups is desired, the actual consultation may take place by gathering designated representatives of the groups.

Note that both output and scale will have significance for *sampling*, i.e. choosing the persons who will participate in the consultation. Generally individuals or groups will be recruited on the hypothesis that they are representative in some significant way of the larger population likely to be affected by the decision under discussion.

Scale and output also have important influence upon deciding the *format* to be chosen for the effective consultation, e.g. whether participants will be physically grouped in a room for discussion, consulted via telephone or post, interviewed singly, etc.

5.2.1.3 Process

A final important distinction resides in the process, or elicitation pathway chosen by the organisers of consultation. That term refers to whether consultation is carried out in a "top-down" or "bottom-up" manner. In the first case, the organisers of consultation impose to some extent a set of questions to which participants are expected to respond. This corresponds to a so-called "closed" response format. In contrast, with an "open ended" or "bottom-up" pathway, organisers lay out preliminary information or a first set of decision options, and then invite and observe the process of analysis and choice that takes place among those consulted.

A top-down process is easier for organisers to control and may be more economical, since a framework for understanding input exists a priori, and thus relatively lesser effort will be required to report the consultation findings. In contrast, bottom-up consultation may be more likely to lead to unanticipated findings and calls for both a more onerous system of recording and more intensive post hoc analysis.

Unless skilfully handled by a facilitator respectful of participants' expression, closed consultation may produce demotivation or mistrust in participants. They may feel that they are being "railroaded" into choices, or that opinions that are not their own are being recorded and will feed into a thereby corrupt decision process. A skilled facilitator is also needed in an open-ended process, to ensure that all participants have the opportunity to express themselves and that the discussion remains, despite its freedom, centred upon the task.

5.2.1.4 Choices for Consultation Format

Researchers or policy makers who wish to organise public consultation must thus choose a format by selecting among the options described above in a manner coherent with their project and their powers. Theoretically any set of options may be associated to produce a

consultation format, e.g. (decision + large scale + top down process; this might correspond to a binding referendum) or (response to demand + small scale + bottom up process; this might correspond to an in-depth field study of a population confronted by a certain environmental problem, or, to a brainstorming session grouping a set of ex-patients asked for suggestions on improving customer relations at a hospital). While the main constraints in choice should be, again, organisers' project and powers, the secondary constraint will probably be economic, as different formats require different levels of resources for preparing and conducting the consultation, and for reporting or acting upon findings.

PEN-REF decisions on the *output* dimension will be constrained, notably, by the fact that the planned consultation serves a double purpose, of both demonstration and data collection. PEN-REF seeks a format to explore the feasibility and the utility of citizen input to decision making in pension reform. The PEN-REF consultation is thus a simulation of deliberation or citizen decision-making (a simulation, because the groups consulted will not be empowered to contribute directly to some national pension reform currently in progress). At the same time, group output will be analysed and reported as interesting to pension reformers. Thus, the PEN-REF groups will combine aspects of each output option.

As for *scale*, PEN-REF objectives and a priori budget limitations may be served by consultation in each participating country of (most probably) two groups of about eight individuals, each group meeting for a series of five discussion sessions. Across those five sessions, to serve the PEN-REF objectives, the top-down and bottom-up *process* options will be explored.

5.2.2 Examples of Commonly Used Consultation Formats

To inform policy makers, some further examples may be given of public participation and consultation formats combining different options among those laid out above.

5.2.2.1 Techniques for Information Output

5.2.2.1.1 Small Scale Consultations

Focus Groups

Focused group discussions, or "focus groups", are small-scale consultations of individuals chosen and grouped together for the purpose. Generally 6-10 participants are chosen more or less at random from targeted populations (that is, it is assumed the persons will be sufficiently representative of a broad class of persons whose opinions and preferences are of interest to the organisers). The group population is thus theoretically homogeneous; sampling does not seek to pit in discussion persons likely to have very conflicting points of view.

This technique was developed in a marketing context, and in such a setting is often conducted in a predominantly "top-down" manner. That is, generally the organisers of the focus group research require precise responses to an information demand, and guide the discussion with a set of questions. Typical uses of such research have tested response to a

new commercial product, or, verified understanding and impact of written text (divergent examples of verified text might be: advertising copy or medicine warning labels).

Focused group discussions may also be conducted in a less rigid manner. While the interviewer has a set of questions or research themes that must be covered, participants are given more latitude and time to discuss the themes in their own terms. This is the format favoured by social researchers.

Focus groups are seen to be a low-cost manner of eliciting opinion, and are increasingly used by policy makers to gain a better understanding of points of view lying outside their institution. However, caution must be used in basing decisions upon information gathered in this manner, since the technique does not deliver a statistically representative portrait of viewpoints among the larger population. In contrast to a questionnaire survey, in which a theoretically representative data set may be obtained, however, focus groups deliver much qualitative information: if a bottom-up process is chosen, organisers can learn much about the ways persons think and talk about a given issue, and perhaps adjust their own thinking and vocabulary to better embrace a non-specialist point of view.

Policy Dialogues

Policy dialogues may be seen as a version of focused group discussion. However, rather than delegating the task to an interviewer provided with a set of questions, institutional organisers participate directly in discussing the issue that interests them with the group gathered for this purpose. Policy dialogues may be used in a potentially conflictive setting as a means of dispute resolution. Although no formal decisions are taken in the group, policy makers may gain insight into stakeholder viewpoints, and the dialogue serve as a foundation for policy development.

5.2.2.1.2 Large Scale Consultations

Surveys

This format asks randomly selected citizens to reply to a defined set of questions. Paper and pencil questionnaires may be personally presented or sent by mail to participants, or an interview may take place face-to-face or by telephone. A relatively large number of participants are chosen (usually on socio-demographic criteria: age, education, income, profession of head of household and so forth) to produce a sample statistically representative of the population of interest to the organisers. In this way it can be expected that the opinions gathered match or predict the opinions in the population at large. However, the need to standardise and streamline questions and response modes, so as to obtain strictly comparable responses, usually signifies that a reduced range of meaning is explored. This feature may limit the utility of the consultation: organisers may omit meanings that are of real significance for certain subpopulations. The closed character of the consultation may also lessen participant or population confidence in the meaningfulness of the results.

Public Hearings or Public Meetings

Hearings are consultations mandated by law, whereas public meetings are not required but are implemented by choice by policy makers. The goal is to gather information on stakeholder viewpoints that may enlighten decision makers in their policy reflections; generally no obligation to respect this input is undertaken. Participants in hearings have some pre-existing strong interest in the issue under discussion; representatives or individuals may be called to participate by organisers or may be self-selected, but they are not randomly recruited. Hearings or meetings are relatively easy to organise and can allow participants to respond to issues in a "bottom up" process (thereby requiring intensive analysis of recorded input). This technique is useful for collecting conflicting viewpoints; participants are heard sequentially and there is no need or aim for dialogue. As a policy building tool, hearings may attract stakeholder criticism as they very often are scheduled quite late in a decision process, and usually engage no guarantees for respect of citizen input; they thus may appear to be purely pro forma rather than a real contribution to the building and weighting of policy options.

Deliberative Polling and Consensus Conferencing

Deliberative polling aims to learn what persons in the general public might choose or prefer if they ever gave a lot of thought to some current issue, and thereby sets up an organised process to simulate such opinion formation. Two main phases are organised. In the first phase, a questionnaire mail survey is addressed to some thousands of individuals making up a representative national sample, in order to scope out opinion tendencies on the issue investigated. In the second phase, individuals are asked, often by public advertising, to come forward and devote some number of hours to considering information provided by organisers. At various intervals participants are asked to express their choices or preferences and the overall results are fed back or communicated to them, thereby influencing the subsequent course of the deliberation process. Because a large number of individuals are involved, it is thought by organisers that the opinions and preferences expressed are sufficiently representative of an informed opinion that might be developed by other members of the general public who would go through such an analytic process. Deliberative polling has recently been used to gather opinion on e.g. "the future of the royalty" in the UK, and organisers displayed the deliberation process and results on live television.

Consensus conferencing sets up a much more intensive process of study and deliberation. It is not a very large-scale endeavour, grouping only about 15-25 individuals from the public, but the pool of potential self-selecting participants is very large. Again through national advertising, volunteers are recruited to devote a significant amount of their free time (for instance, several weekends away from their families in a group work setting) to analysing an issue. They consider information that is provided by organisers or requested by the conference members themselves; they may analyse written documents or hear experts or other persons with light to shed on the topic. This technique obviously requires a significant investment in logistics and in personnel to assist the conference members. The output is a report in which the conference participants express their considered views on the issue at stake. Consensus conferences are generally requested by high ranking or central authority on topics of controversy or national interest (e.g., radioactive waste management options; regulation of genetically modified foodstuffs, etc.). While authority plans to rely upon and refer to the consensus report as indicative of informed public choice, no decision power is

conferred upon participants. It is not known to what degree non-participant members of the public adopt the conference outcome as an enlightened opinion of their peers.

5.2.2.2 Techniques for Decision

5.2.2.2.1 Small Scale Consultations

Citizen Task Forces

Persons with some special knowledge or representing some interest of the community may be appointed to a temporary task force, organised to consider in depth some issue on which decision is required. The group meets a number of times, often in the company of organising entity representatives, to consider information and formulate recommendations. A technical advisor may be provided, the task force can sometimes commission information gathering needed for their deliberation, and communications are facilitated with decision-makers within the organising institution. Often a consensus-based decision rule is applied in task force deliberations, meaning that recommendations must enjoy the approval of all group members; to arrive at this result, participants must make efforts to find common ground, compromise or innovative solutions.

As effective participation in such a task force is often dependent upon a high educational level and familiarity with group deliberation and decision making, task forces may sometimes be insufficiently representative of the affected publics, and indeed may be recruited primarily among persons already mandated for decision in their community or involved in some capacity with the issue discussed.

Regulatory Negotiation

In this type of deliberation, representatives of interested and affected parties work together with regulating government agency personnel to draft proposed rules. Participants are mandated by the group they represent, or are chosen because of some recognised expertise. Participants need negotiation skills. The function of such negotiation is to fine-tune regulation before its application, so as to avoid legal or other challenge, and to improve its responsiveness to the needs of affected parties. A shortcoming of such an approach is that unrepresented parties may challenge the process as unfair. Another undesirable outcome may be that the group achieves agreement while overlooking some domain or series of data, resulting in an unwise choice of options.

Citizens' Juries and Citizens' Panels

The term citizen's jury reflects the fact that participants are recruited by lottery to serve their community by taking part in deliberations, much as citizens must perform regular jury duty under some systems of court justice. This format has been successfully used in situations where a planning decision will affect a geographically situated population: for instance, it has been applied to designate precise sites for waste management installations. The organising institution, or delegate staff, propose some number of decision options among which the jury must choose. These options could be developed beforehand by the institution alone, or with the input of other consultative techniques as described above. (Citizens' *panels* are similar to

juries, except that they are indeed charged with developing options before deciding upon one.)

The jury hears witnesses who present positive or negative features of the options considered. Jury members are free to pose the questions they wish and therefore this method is appropriate for accommodating citizens' particular concerns; the random nature of the sample is thought to guarantee representivity and encourage acquiescence of non-voting members of the community. Generally the decision method imposed is that of majority vote. However, in order to refine the decision and allow it to reflect aspects of minority opinion, complementary systematic techniques may be introduced. For instance, the jury could formally work out a criterion list and analyse options in light of those criteria. Such a complementary analysis could highlight e.g. impacts calling for compensation.

Both citizens' juries and panels rely for success upon a clear legal commitment by the organising entity to respect the decision outcome. As the citizens' decision is meant to be binding, it is important for legitimacy that the random selection of participants be above question, that the deliberation be conducted in a transparent manner, and that participants involve themselves seriously in their task.

5.2.2.2 Large Scale Consultations

Referenda

For reasons of cost, the only very large scale public decision format is that of the vote. While this method enjoys a high level of perceived legitimacy, often complex decisions must be reduced to their simplest binary form to be proposed to the vote. Recent experience in Europe has shown the difficulty of organising and ensuring public education on the issues proposed to referenda. However, such a vote is often called for by stakeholders in highly contentious situations, with the justification that setting up such a procedure can be an efficient way of attracting citizens' attention to the issue at hand and in allowing citizens to collect information about the different positions taken by public figures.

5.3 **Appendix C: Questions for the PEN-REF Project**

Over the course of the project, the PEN-REF consortium will address the following questions.

Concerning policy discourses, the following questions emerge from the Inception Report:

- 1) Where do the differences in policy stories originate?
- 2) Where do the differences in 'expert' opinion originate?
- 3) How are 'expert' discourses institutionally and ideationally related to policy stories?
- 4) Do international policy stories differ from national policy stories?
- 5) How do the policy stories affect international and national pension reform agendas?
 - i) how do ideas disseminate through policy networks?
 - ii) how do national policy-makers use international policy discourses?
 - iii) in what ways do national policy-makers adapt and reinterpret international policy stories?
 - iv) how insulated, in terms of ideas and discourses, are national policy arenas from international or other national policy platforms?
- 6) How do 'local' experts related to international policy discourse on the one hand and national policy stories, on the other?
- 7) How do ideas and discourses at international level affect the citizen?

Concerning the political economy of pension reform, the Inception report raises the following questions:

- 1) To what extent do these theories help us understand pension reform processes in Europe?
- 2) Is there a 'magic bullet' theory that subsumes all pension reform processes or do we need to be methodologically pluralist?
- 3) How do pension reform agendas actually get set? What are the driving factors?
- 4) What do actual pension reform processes tell us about these different approaches?

Concerning focus groups, the PEN-REF project will address the following questions:

- 1) Which combination of output, scale, and process options are most appropriate to the double objective of PEN-REF consultations, i.e. both gathering information on citizen views and simulating citizen policy deliberations?
- 2) Which combination of options might be best recommended to policy makers who desire citizen input to the pension reform process?
- 3) What justifications and arguments may be offered in defence of citizen consultation to policy makers who are not convinced?

5.4 **Appendix D: The Pension Reform Continuum**



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