The politics of pension privatisation and regulation
When the welfare state meets the regulatory state

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1 Introduction

Old-age pension policy is due to become an important area for analysing the transformation from the positivist - taxing and spending - state to the regulatory state (cf. Majone, 1997). Poverty alleviation and income maintenance for the elderly are at the core of the welfare state and a major source of its legitimisation. National political systems redistribute a substantial share of their gross-national product - between 8 and 15 per cent - to the old-age via taxation and pay-roll contributions. Due to demographic ageing and unemployment, however, public pension schemes are coming under increased pressures to increase taxes and contributions to maintain their protective functions while at the same time economic and financial internationalisation make it increasingly difficult to do so.

The neo-liberal state
This tension can play out in different ways. At one extreme one can hypothesise that rising economic constraints in combination with the dominance of the liberal ideology among elites will result into the retreat of the state. State-organised collective arrangements guaranteeing intergenerational and intragenerational redistribution will lose in importance. Citizens will have to rely increasingly on individual solutions for old-age income security. They will have to turn to intransparent and volatile financial markets. In fact, international (financial) organisations (e.g. IMF, World Bank), many economists, and liberal political forces advocate a more prominent role for private pensions. It is argued that private pensions, because they are typically funded, yield higher rates of return and are less vulnerable to unemployment, ageing and moral hazard (e.g. Chand and Jaeger, 1996; World Bank, 1994). The likelihood of such a scenario may increase, as there are very strong international financial interests in support of the retreat of the state, because new markets for the international financial service industry would develop worth many hundred, if not thousand of billions of dollars. The retreat of the state may be reinforced for the members of the European Union (EU), as the EU may have the capacity to liberalise the private pension market by negative integration but may lack the capacity for re-regulation for social policy purposes (cf. Scharpf, 1999).

The classical worlds of welfare
On the other extreme one can argue that welfare states will make an effort to keep accomplishing the major welfare functions of pension policy by traditional - positivist - means.
Old-age income security is important for the legitimisation of the nation state and the issue is sensitive in electoral terms. Therefore, the traditional defenders of the welfare state for the elderly, the social- and Christian democratic parties as well as the trade unions, will do their utmost best to defend the status quo. Rather than 'downward' convergence as in the first scenario, one can expect the existing diversity of “worlds of welfare” to persist (cf. Castles, 1993; Esping-Andersen, 1990).

One regulatory welfare state? Or several?
A third scenario is possible, however, that focus on the interaction of (international) forces of change and (domestic) defenders of the status quo. It might well be that forces of change are strong enough to erode the traditional solutions to old-age income security, hence to strengthen the private provision of pensions. At the same time, however, welfare advocates might be powerful enough to secure goals like broad coverage, security, solidarity, and (gender) equality by tightly regulating the private pension market. The positivist welfare state would become a regulatory welfare state.

While strict regulation might be a common feature of different states, there might still be diversity, because national specific political and economic institutions (e.g. corporatism) and policy legacies (existing welfare arrangements) inform and mediate the domestic and international political forces. However, common international pressures, supra-national regulation (EU) and cross-national regulatory learning might lead to a convergence towards a single (European) model.

Cross-national evidence documents that private (including occupational) pensions have indeed increased in importance in almost all welfare states though with different speed and to a different extent. This development is accompanied by efforts of regulating the private provision of pensions. Various types of regulation have been designed, supervised and enforced to ensure the viability and efficient operation of private pension markets as well as the accomplishment of social welfare goals. Examples are rules concerning the set up and access of private pensions; the relationship between public and private pensions, rules of conduct (competition, portfolio management, transparency, corporate governance); equal treatment of men and women, transportability of pension rights in cases of company or sector-based schemes, and guaranteed minimum returns in cases of defined contribution schemes.

Taking the three scenarios as theoretical and heuristic guideline, this paper seeks to provide for a preliminary analysis of the causes and courses of privatisation and regulatory
The long and winding road to pension privatization

2.1 Introduction to the different worlds of old-age pensions

It is common usage to make a distinction between three pillars, or three tiers, of old-age income security. The first pillar is made up of public pension schemes. These schemes are typically financed by taxes or social contributions (pay-roll taxes) on a pay-as-you-go (PAYG) basis. The second pillar consists of supplementary occupational pensions. Occupational pensions are part of the employment contract and are mostly funded. The third pillar is made up of individual voluntary pension savings (e.g. life insurances) which pay either a lump sum or annuities. These provisions are always funded. Some authors mention

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1 The paper is a first cut to a larger research project that seeks to analyse the trend towards the regulatory welfare state in the area of old-age income security from a historical and cross-national perspective. Some relevant regulatory issues will not be covered by this paper, among them, equal treatment of men and women, and the regulation of tax support to private schemes. Also, the paper does concentrate on private sector rather than public sector pensions, and on occupational pensions (2nd pillar) rather than individual savings (3rd pillar).

2 'Social security' in the US sense

3 In a PAYG system pensions are paid from current contribution payments, predominantly out of domestic labour income. Each generation finances the pension income of the previous generation on the understanding that its own pensions will be financed by the next generation. This constitutes an implicit social contract

4 In the case of funded schemes employees (and employers) pay part of their (labour) income into a fund of financial assets. Retirement pensions are paid out of current capital income, originating from investment revenues (interests) and by selling assets
labour income as a fourth pillar of old-age income. House ownership is another source of financial security after retirement.

There are basically two types of pension arrangements (cf. Myles and Pierson, 2001). The Beveredgian countries have a basic pension system that provide flat rate benefits to all its citizens. Among these countries are Australia, Denmark, the Netherlands, Switzerland and the United Kingdom. The Bismarckian countries provide earnings related benefits on the basis of the working history; among them are Austria, Belgium, France, Germany, Italy, Spain and the United States. While the main goals of the Beveredgian schemes are national solidarity and the alleviation of extreme poverty among the elderly, the main goal of Bismarckian arrangements is income (and therewith status) maintenance. To be sure, there can be strong differences in levels of benefits within both systems. The Dutch basic pension scheme is more generous than the British one. The German system is more generous than the United States system. Generally, however, because of the flat rate character of the Beveredgian system, the system is less satisfactory for middle and higher income groups. The first pillar in these countries cannot guarantee the maintenance of their standard of living.

2.2 Beveredgian countries

The flat rate character of the basic pension scheme resulted in strong pressures of employees for supplementary pension schemes (cf. Esping-Andersen, 1990, 25-26; Myles and Pierson, 2001). In Denmark, the Netherlands and Sweden supplementary schemes were negotiated by trade unions and employer organisations for the whole sector (or even above sector-level as in Sweden), reflecting the corporatist policy style in these countries. In other countries occupational pensions were company based. In Switzerland, participation in an occupational pension scheme was made compulsory, while in the United Kingdom it is at the discretion of companies to offer occupational pension schemes. Due to different levels of the basic pension scheme and due to different regulations about the set-up and access of occupational pension schemes, the coverage rate varies between the Beveredgian countries (ranging between 60 and 100 per cent), but is usually higher than in the Bismarckian countries (see next section).

As occupational pensions are typically funded, the scheme benefits not only from contributions by employers and employees but also from returns of investments. Due to flourishing capital markets in the 2nd half of the 1990s, the value of pension funds increased

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5 In addition, some countries like Denmark, Switzerland and the United Kingdom introduced supplementary earnings-related state pension schemes, financed by PAYG. However, these schemes were too meagre to reduce the demand for additional occupational schemes.
considerably. Beveredgian countries benefited in particular from this development, because of the high coverage in these countries (see Table 1).

Table 1 Values of pension funds assets in selected European countries

<table>
<thead>
<tr>
<th></th>
<th>1992 Assets as %GDP</th>
<th>1997/8 Assets as %GDP</th>
<th>1997/8 Assets per capita $'000</th>
</tr>
</thead>
<tbody>
<tr>
<td>AUS</td>
<td>-</td>
<td>4</td>
<td>1.0</td>
</tr>
<tr>
<td>BEL</td>
<td>0.2 (1)</td>
<td>10</td>
<td>2.5</td>
</tr>
<tr>
<td>DEN</td>
<td>14.7</td>
<td>89</td>
<td>31.2</td>
</tr>
<tr>
<td>ESP</td>
<td>-</td>
<td>4</td>
<td>0.7</td>
</tr>
<tr>
<td>FIN</td>
<td>-</td>
<td>41</td>
<td>7.9</td>
</tr>
<tr>
<td>FRA</td>
<td>3 (2)</td>
<td>6</td>
<td>1.6</td>
</tr>
<tr>
<td>FRG</td>
<td>4.8</td>
<td>12</td>
<td>3.5</td>
</tr>
<tr>
<td>IRE</td>
<td>32.8 (1)</td>
<td>43</td>
<td>9.7</td>
</tr>
<tr>
<td>ITA</td>
<td>0.9 (1)</td>
<td>19</td>
<td>4.3</td>
</tr>
<tr>
<td>NET</td>
<td>45.9</td>
<td>141</td>
<td>35.5</td>
</tr>
<tr>
<td>NOR</td>
<td>3.5</td>
<td>24</td>
<td>8.9</td>
</tr>
<tr>
<td>POR</td>
<td>2.4 (1)</td>
<td>10</td>
<td>1.2</td>
</tr>
<tr>
<td>SWE</td>
<td>16 (2)</td>
<td>90</td>
<td>25.3</td>
</tr>
<tr>
<td>ZWI</td>
<td>51.9 (1)</td>
<td>105</td>
<td>40.3</td>
</tr>
<tr>
<td>UKM</td>
<td>52.2</td>
<td>86</td>
<td>21</td>
</tr>
</tbody>
</table>

(1) Include some publicly managed funds, (2) 1993, Davis referred to in (CPB, 1997).

With occupational pensions increasing in value and public pension schemes either maintained or retrenched, the share of occupational pensions income in overall pension income has increased in importance in the Beveredgian countries. According to World Bank projections the portion of average worker’s old-age benefit deriving from the occupational pillar will be about 50 per cent in countries like Denmark, the Netherlands, Switzerland and the United Kingdom. In order to shed some more light of the causes and mechanisms that resulted into this far reaching privatisation of welfare in these countries I will elaborate a bit more on the Dutch case.

The hidden privatisation of the Dutch welfare state for the elderly

The Dutch public welfare regime consists of a mix of earnings-related Bismarckian and universalistic Beveredgian elements. The Dutch public basic pension scheme (AOW) followed Beveredgian lines. It provides flat-rate benefits to all residents, retired or not, from age 65 on. Contributions are paid by employees. The amount is calculated as a percentage of personal income (17.9 per cent, ceiling: EURO 21,900 in 1999). The full benefit for a couple is 100 per cent of the net minimum wage (EURO 1,060 in 1999). Singles get 70 per cent
(EURO 740 in 1999). For full benefits, 50 years of residence are required. For each year less, the pension amount is reduced by 2 percentage points (CPB, 1997; Delsen, 2000; Kuné, 2000).

Initially, the flat rate pension did not provide enough benefits to ensure a decent standard of living. This was done to leave an incentive for supplementary pensions (Westerveld, 1995, 2). The basic pension was expanded in the two decades to come, however, regardless of whether the dominant Christian Democratic parties governed in coalition with the Labour party or the Liberal party (Roebroek, 1999, 163; Sinninghe Damsté, 1998, 14). This expansion resulted in a significant increase in the generosity of the basic pension scheme relative to regular wages. The purchasing power of the basic pension benefit quadrupled between 1957 and 1982 (Heuvel, 1988, 5-6). Still, despite this expansion, the flat rate of the Dutch basic pension had remained too low to allow for an acceptable income replacement especially for the middle and higher income groups. Accordingly, employees pressured for supplementary occupational pensions. In line with the Dutch corporatist tradition, the occupational pension provisions were negotiated between employer organisations and trade unions. Government regulations, enacted in 1947, stipulated that once a sector-wide occupational pension arrangement is agreed upon, it is compulsory for all companies of the sector to join. Company schemes are only permitted under certain conditions. This regulation aimed at preventing the distortion of competition (Kam and Nyples, 1995, 67). The compulsory character of the occupational pension scheme resulted in almost universal coverage for the employed population (cf. CPB, 1997, 240). Already in 1953, roughly two third of the relevant target group was covered by occupational pensions (Nelissen, 1994, 13). At present, the coverage rate lies at approximately 90 per cent (95 per cent of all male employed, 80 per cent of all female employed). Occupational pensions provide earnings-related benefits that have to be financed by funding. The system is a so-called defined benefit system. Contributions are calculated in order to achieve a 70 per cent replacement rate including the basic pension after 40 years (1,75 per cent per year). Contributions to pension funds and interest income from pension funds enjoy tax exemption. In general, employers contribute 50 per cent or more.

The public basic pension scheme was generous enough to nurture worries about cost control in the period after the golden age of the welfare state (from the mid 1970s on). It is important to note that the defined benefit of 70 per cent includes the basic pension scheme. It is this provision that enabled Dutch governments of all colours to pursue a gradual privatisation of the old-age income security pension scheme without significant electoral repercussions (Delsen, 1995, 119). As the basic pension scheme was linked to the minimum wage, a series of incremental and ‘technical’ retrenchment measures with regard to the
minimum wage translated directly into reduction in the benefit level of the basic pension scheme. Delsen calculates that the size of the basic public pension as a percentage of the average gross salary decreased by 25 per cent between 1980 and 1998 (Delsen, 2000, 151). For the participants in occupational funds, the AOW retrenchment did not matter in financial terms, because the defined target of 70 per cent (basic pension plus occupational pension) did not change. Relative losses in basic public pensions had to be compensated by the private occupational tier, which therefore increased in importance.

2.3 **Bismarckian countries**

In Bismarckian countries, it is up to individual firms to offer occupational pensions. Since state pensions are earnings-related and generally quite generous in countries like Germany, France, Italy, Belgium and Austria, the incentive to participate in occupational pensions has been quite low. However, due to their foundation on PAYG financing, these schemes are extremely vulnerable to demographic ageing and unemployment. To maintain benefit levels either contributions have to rise significantly or state subsidies would have to increase. In an internationalised economic and financial environment both options are becoming increasingly infeasible. In contrast to the Netherlands, the Bismarckian countries had not the possibility to gradually shift the responsibility for old-age income security to the private (occupational) pillar without serious electoral repercussions. Still, some Bismarckian countries have recently started to join the Beveredgian countries on their path towards more private pensions. Germany is one of them.

**Germany: The significance of a marginal reform**

In comparative welfare state research, Germany is often treated as the proto-type of the Bismarckian welfare state. The earnings-related public retirement insurance ‘Gesetzliche Rentenversicherung’ has been the corner stone of old-age income security for more than a hundred years. It is financed by pay-roll taxes (employers 9,75 employees 9,75, ceiling EURO 52,000, 1999). State subsidies compensate for the cost of benefits not covered by contributions. In 1999, the share of state subsidies of the overall public pension budget was

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6 As the minimum wage was linked to the contractual wage development in the private sector, incidental wage increases were not included in the adjustment process. Moreover in most years of the 1980s and the early 1990s, the minimum wage development was decoupled from the general wage development. The minimum wage (and by extension the basic pension benefits were either frozen or adjusted at a rate below the level of wage development (Green-Pedersen, 2000, 90-92; Visser and Hemerijck, 1997, 141-8).
26.5 per cent, or DM 104.4 billion (Konrad and Wagner, 2000, 3). Pension benefits are calculated to achieve some 70 per cent of the average net income of the insured population for the average worker (standard pension). To achieve this level, however, contributions have to be paid for 45 years.

The scheme was generous enough to guarantee a decent standard of living after retirement for the long term employed. As a matter of fact, more than 80 per cent of the income of households headed by a person 65 years or older is provided by this scheme (Börsch-Supan, 2000). Accordingly, only half of the current work force is covered by occupational pensions, and these pension supplements do not contribute as significantly to individual pension income as in the Netherlands. It is characteristic for the German politics of pension reform, that up to the 1990s all major reforms (1957, 1972, 1989/1992) have been adopted by a broad parliamentary majority (Alber, 1998; Nullmeier and Rüb, 1993; Schmähl, 1993). The two major parties, Social Democratic Party and Christian Democratic party, are equally strong defender of the welfare state for the elderly. Up to the mid 1990s, both major parties were - at least officially - of the opinion that the public pension scheme would provide sufficient benefits for the future retirees (a standard pension of 70 per cent) and that it would be is financially sustainable.

In the mid-1990s this general view started to change however. Problem pressure increased, dominantly for domestic reasons: high unemployment did not vanish, the effective retirement age was low, reunification had put serious strains on public finances and the demographic challenge became more prominent on the political agenda. In the situation of a rising need for reform, the political competition between the Social Democratic Party and the Christian Democratic Party increased. In 1997, a Christian Democratic-led government enacted the 1999 pension reform act that included a demographic factor aimed at reducing benefit levels from 70 to 64 per cent (standard pension) in 2030. This reform act was the first significant policy change regarding old-age pensions that was not supported by the major opposition party in parliament (Alber, 1998, 24; CPB, 1997, 249; Meyer, 1998).

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7 This subsidy is a substantial amount of money absorbing roughly one quarter of the German federal budget.
8 Data from the Luxembourg Income Studies show for the early to mid-1990s that some 75 per cent of Dutch pensioner households received occupational pension income, and that private pensions made up almost 40 per cent of the recipient household income. In Germany less than 20 per cent received occupational pension benefits. These benefits contributed on average less than 20 per cent to the household income (Behrendt, 2000, 14).
9 To be sure, there had been some retrenchment of the public pension scheme from the mid-1970s on. As in the Netherlands retrenchment was done by incremental, ad hoc, relative invisible, “technical” measures. This retrenchment was, however, primarily concerned with reducing the expansionary effects of earlier reforms that have not yet materialised. In other words, retrenchment was significant in the sense that without the measures, the standard pension would rise from 70 per cent to 90 per cent. From the view of the electorate, however, this was a rather hypothetical situation (Alber, 1998, 24)
federal election campaign, the Social Democratic Party therefore strongly objected the benefit reductions implied by the 1999 reform act. Accordingly, when the Social Democratic Party won the election, the benefit reduction element was suspended for two years, and a new law announced that has been heavily debated since then.

The current proposal of the new government, a coalition between the Social Democrats and the Green party - is also geared towards retrenchment, however. The standard pension will also be 64 per cent in 2030. Most importantly, however, for the first time in German history, the structural deficiency of the PAYG system - its vulnerability to demographic ageing and inactivity - has persuaded a major government party to propose a partial transition to funding. In addition to their public pension contributions, employees are asked to make additional contributions to private saving plans. Note that these additional savings have to be made by the employees without a contribution of the employers. This deviation from the principle of ‘equal contributions’ confirms the willingness of the government to reduce company costs in order to increase the competitive position of business in the world market.

Initially, it was planned to make additional savings compulsory (see next section). The recent bill leaves it to the discretion of the employees. Yet, the reform will provide for a strong incentive for employees to save up to 4 per cent of their gross salary (see for more details the next section).

The adoption of the reform is complicated because in contrast to changes in the parameters of the public pension schemes, a tax supported partial privatisation of old-age income security needs the assent of the Upper House of the Legislature, the Bundesrat. The Bundesrat represent the governments of the German states.\textsuperscript{10} Neither of the two major political parties has a majority in the upper chamber. The states with a coalition of both major parties can tip the balance towards acceptance or rejection. By the time of writing this paper, the Government proposals have been adopted by the Bundestag, rejected by the Bundesrat, and are now under discussion in the joined Conciliation Committee. It is quite likely that the reform will be adopted as both major parties are very close to each other, and the government has still some room for bargain.

This reform will be a major step towards funding. The reduction in benefit levels of the public pension scheme and the state aid for private savings will nurture private pension plans.

\textsuperscript{10} It is estimated that by 2008 the government supports the choice of additional private savings by annually 20 billion German marks. More than half of it has to be paid by the states and the municipalities. If insured persons engage in voluntary saving, they will either benefit from a fixed yearly state allowance (dependent on number of children) or from tax deductions, depending on what is more favourable for them.
This process will be reinforced by the emerging political consensus that the public pension system will not guarantee sufficient income maintenance for future retirees.

3 The different worlds of private pension regulation

3.1 Introduction

Old-age income security can involve a number of serious regulatory issues [cf. \(\text{OECD, 1999}; \text{OECD, n.y.}; \text{Queisser, 1998}\). Some general aspects relating to the set up and access of occupational pensions have already been discussed. Occupational pension schemes can be sector-based (e.g. Denmark, The Netherlands), or company-based (e.g. Germany, United Kingdom); they can be mandatory (e.g. Switzerland), quasi-mandatory (e.g. Denmark, Netherlands) or voluntary (e.g. Germany, United Kingdom).

A number of regulatory issues are related to the type of benefit. In defined benefit schemes (DB), the sponsor of the scheme (usually the company) makes a promise to provide beneficiaries with a certain level of benefits upon retirement. Contributions are calculated accordingly. The risk lies with the sponsor. In defined contribution schemes (DC), the future benefits depend on contributions and the performance of the pension fund. Most schemes in most OECD countries are DB schemes. Denmark is one of the few advanced welfare states where DC schemes are in the majority. The scope of regulation is wider in DB schemes than in DC schemes. As a certain benefit level is promised regulators have to ensure adequate funding. Yet, the appropriate method and the determination of the ‘right’ contributions and valuation of assets and liabilities of pension plans are controversial. Another important problem that speaks more directly to the internationalised economic environment is portability of defined benefit rights, between different schemes, when a worker transfers from one company to another. In DC plans workers are immediately owners of the accrued benefit rights and funds can relatively easily be transferred. Portability is more difficult in DB schemes, because if many workers leave a company and are entitled to all contributions made by themselves or on their behalf, funded DB schemes which usually rely on risk pooling can have problems of underfunding. Moreover, in DB schemes the risk that the plan sponsor default on its promises might need to be insured against. Since no such promises are made in DC schemes, insurance is irrelevant. There are, however, usually safeguards against fraud or mismanagement of funds in DC schemes. Another regulatory topic is transparency and disclosure of information to pension plans. This is of general importance, but particularly in
mandatory DC schemes with individual accounts, i.e. in schemes where the contributors have to choose the scheme themselves and have to bear the risks of under-performance of funds.

The investment and management of pension funds can be guided either by the so-called prudent man (or prudent person) rule or by the more ‘draconian’ asset restriction approach. According to the prudent-man rule, the supervision authorities do not restrict pension funds investment policy *a priori*. It is assumed that money is invested “for the sole benefit of the beneficiaries” and that investments are made with “the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar such matter would use in the conduct of an enterprise of a like character and with like aims” (Davis, 1995). The prudent man rule is applied in English-speaking countries (Australia, Canada, Ireland, United States, the United Kingdom) and the Netherlands. The rule is mostly used to regulate DB plans where the risk that the target is not reached lies with the plan sponsor. For DC plans, particularly when they are mandatory, a more ‘draconian’ approach is commonly applied in order to safeguard the interests of the beneficiaries. Pension supervisors issue investment regulation specifying the financial instruments that are authorised for investments (e.g. shares, bonds, and loans), and minimum or maximum quotas for the share of certain kind of assets in the overall portfolio. An import reason for maximum quotas is to safeguard the assets through diversification. One reason for a minimum quota can be to help national governments to finance their debts (i.e. minimum quota for investing in state bonds). Other regulatory issues involve the type of benefit (annuities and/or lump sum), the guarantee of a minimum profitability in cases of DC, and the regulation of fees charged to workers for pension management services.\footnote{This is especially important for individualised schemes, where fees can absorb a substantial part of the contributions paid (up to 25 per cent).}

In the remainder of the section, regulatory issues in the Netherlands and Germany will be explored in more detail. Partly due there different policy legacy (Beveridge vs. Bismarckian), these countries present two divergent worlds of the regulatory welfare state of the elderly: The Netherlands has a sector-based, almost universal, funded, defined benefit scheme which is subject to prudent-man regulation. Germany has traditionally fragmented and selective company based schemes, predominately unfunded. It is currently patched up with a voluntary, funded, optionally company-based, defined contribution scheme that is heavily regulated.
The Netherlands: or how to regulate surpluses?

Dutch occupational pensions are usually sector-wide schemes, negotiated and administered by trade unions and employer organisations. The schemes are backed by a 1947 law that not only made collective agreements compulsory but also stipulated that assets backing occupational pension obligations must be held outside the sponsoring firm by independent pension funds. The reason for this was that retirees should not be dependent on the fate of their company. The choice for pension funds rather than book reserves as in Germany (see next sub-section) turned out to be financially very beneficial in times of flourishing capital market, especially as portfolio managers were not heavily restricted in their investment decisions. As noted above, the value of pension fund assets increased dramatically in the 1990s. Traditionally pension funds base their calculations on a yield of capital of 4 per cent. From 1995 to 1999 the yield of the average pension fund was 10 per cent, which increased the value of assets immensely. Sector wide schemes have a current value of approximately 800 billion guilders and company schemes of approximately 200 billion guilders. Currently half of the portfolio of pension funds is invested in stocks, more than 60 per cent of the portfolio is invested outside the Netherlands. Because of the flourishing stock markets, return on investments rather than contributions of employers and employees nurture the pension funds. In 1999 for instance, the ratio was 8 to 1 (NRC 17.02.01). There are currently some cases where companies do not have to pay any contributions to occupational pensions. Other pension funds even pay money back to their sponsoring companies.

The current wealth of pension funds lead to ‘problems’, however, that sound rather strange from the perspective of continental Bismarckian country. As the system is a defined benefit system, it not a priori clear who should benefit from the surpluses. Employees and especially ex-workers and retirees do usually not benefit from these surpluses. This has caused some political conflict, especially as in some cases the adjustment of occupational pension benefits lacked behind the development of inflation or wages. In other words, retirees became poorer in relative terms despite wealthy pension funds. Elderly organisations therefore lobbied for higher occupational pensions. This protest has ebbed away as the last year (2000) was a rather bad year for the pension funds. On average, they did not achieve the 4 per cent capital yield target. The more general question remained however: who should be
in control of the pension fund. Should solely trade unions and employee organisations administer it? Or should the retirees and other ex-employed should have a say as well?\textsuperscript{12}

3.2 Germany: on the road towards tightly regulated funded schemes

Germany and other Bismarckian countries are far away from the kind of regulatory controversies experienced in the Netherlands. As stated above, the earnings related German public pensions scheme was generous enough to secure a decent standard of living after retirement for the long-term employed. Occupational pensions are therefore not so important, they are a voluntary social benefit provided by the employers. In 1990, 97 per cent of all expenditure for these schemes is paid by employers and only 3 per cent by the employees (Schmaehl 1997: 102). Employers provide these schemes for reasons of personnel policy. They are a means to bind the core work force. Therefore vesting periods are quite high, 10 years, and the portability of benefits is seriously restricted.

The system of occupational pension systems is quite fragmented: There are four different types (Ebbinghaus 2000, Queisser 2000, Schmaehl and Boehm 1994, Schmaehl 1997):

(1) The most important are the so-called direct commitments (53% of all company schemes, 75% of all participants in occupational pension schemes). Pensions are provided directly by the employers financed by book reserves, a commitment by the employers to pay pensions out of reserves. Book reserves are reinsured against bankruptcy. The scheme is solely administered by the employers;

(2) Pension funds are legally independent institutions in the form of mutual insurance associations, financed through contributions to which employees can bear a part;

(3) Another legally independent type of scheme is the support fund. They are mostly registered associations financed only by the employer and capital yields. The employers solely administer them;

(4) Direct insurance constitutes the fourth type. The employer being the police holder takes out individual or group insurance for the employee. Financing is based either on lump sum payments or on regular contributions by the employer; the employee can contribute or raise the total contribution on his or her own (contributions by earnings conversion).

\textsuperscript{12} In 1998, Trade Unions and Employer Association united in the Foundation of Labour have concluded a Covenant with an elderly organisation (CSO), which included the right to establish advisory councils made up of employees and retired persons. The elderly organisation were unhappy with the results, and demand legislation to impose more far reaching participation for the retirees in the decision making of pension funds (NRC 17.02.01). As the absolute and relative number of elderly increases as does their degree of political mobilisation, a serious issue for the politics of pension regulation is about to arise.
Note, that the majority of schemes are based on book reserves, hence they are not funded (cf. Ebbinghaus, forth.). Book reserves became prominent because the tax system provided an incentive for them. They are in effect a cheap source of financing for the company (CPB, 1997, 241). Especially in the years of reconstruction, German companies were keen to use these schemes as an instrument of internal financing (Schmähl, 1997, 110).

The four different types of occupational pensions evolved gradually over time and were not comprehensively regulated before 1974. The 1974 law stipulated minimum rights in case of employment termination, introduced rules to protect beneficiaries in case of bankruptcy and introduced periodical benefit review. In comparison to other countries, especially Beveredgian countries, however, the law was only meant to regulate but not to support occupational pension schemes (Ebbinghaus, 2000, 22).

The current pension reform, however, will provide a major support for private pensions, occupational (2nd pillar) and individual (3rd pillar) alike. As stated above, it for the first time in the history of Germany that both major parties are suggesting that the public scheme will not secure the same level of pension benefits as in the past, and that private pensions are necessary as supplements. Which regulatory alternatives where chosen and why?

The Social-democratic-led government discussed various regulatory options. As in the case of the debate about the future level of public benefits (see previous chapter) the discussion was characterised by very intense party competition. In addition, the financial service industry was involved with heavy lobbying for a regulatory framework that would benefit their specific products. It is worth noting that preliminary evidence suggest, that German based (multi-national) companies were more actively participating than large multi-nationals from abroad. This might have to do with the fact that the German market for insurance and similar products is still a domestic market (Schmidt, 2001). In addition to the financial service industry, also consumer protection associations became involved.

Initially (June 1999), the Minister of Labour proposed that employees should - in addition to their pension contributions - save 2.5 per cent of their gross wage - up to a ceiling. Private providers of pension products should guarantee a yearly capital yield of 3 per cent. The private saving should be compulsory but supported by the tax system. There were good reasons to make saving compulsory, in particular to prevent myopic behaviors decisions and moral hazard (Bovenberg and Linden, 1997). However, the popular press and the Christian-democratic party heavily criticised the compulsory character (‘Zwangsrente’) of the saving.

13 If individuals are myopic they may make insufficient savings for retirement. Moral hazard may lead to low savings in order to exploit means tested social assistance provided by the state.
The public turned against the proposal and the Minister had to withdraw it a couple of months later (Der Spiegel 30.9.1999). A voluntary, heavily tax supported, saving scheme had to be chosen to secure a broad parliamentary majority. Especially the Christian democratic opposition party was in favour of strong tax support.

From the very beginning, the government had individual rather than company-based or even sector-wide occupational pension schemes in mind. As has been the case in the past, the German hands off labour-relation approach has prevented the sector-wide schemes that are common in the Netherlands or Denmark. The German government stuck to the tradition of non-intervention “into the employer prerogative” with regard to occupational pensions (Ebbinghaus, 2000, 30). It was only due to the pressure of the trade union and Social democratic backbenchers that the government introduced at least the choice for employees to either make savings individually or within the company (mainly be converting wage into pension entitlements). Trade unions are in favour of strengthening occupational pensions in order to increase their role in companies. The government decision to allow for tax supported savings in occupational schemes, has already resulted in heavy lobbying of trade union representatives by the financial service industry. This development is a nice example for the changing politics of welfare.

The tax supported schemes function according to the defined contribution principle. Given (a) the individual character of choices, (b) the importance of these savings for income maintenance in times of public pension retrenchment, and (c) the generous tax support, the provision of the product is highly regulated. Only those products that provide for annuities (monthly payment of a constant or increasing sum of money until dead) and that guarantee as minimum return the nominal value of the contributions made (or in other words a capital yield of at least 0 per cent), will be supported. Insured persons have to be regularly informed about their entitlements and the administrative costs involved. A regulatory authority (probably the Federal Insurance Authority) will certify the schemes that comply with these rules.

With regard to individual solutions, the above mentioned conditions can be most easily satisfied by private retirement insurances. Investment funds and banks will also provide products, however, which are geared towards these conditions. With regard to company-based solutions, direct insurances, support funds, and pension funds are supported. Note that the

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14 The German solution is also in sharp contrast to the recent corporatist solutions Italy and Sweden, which have introduced national wide negotiated occupational pension schemes (cf. Ebbinghaus, 2000, 30).

15 In addition, providers have to declare whether and how they consider social, ecological and cultural aspects in their investment policies. They do not need to consider them, but they have to make a statement about that. This
reform confines tax support to the funded types of occupational pensions. Direct commitments based on book reserves are not supported. This choice has to be understood against the background of an internationalised economic and financial environment. Book reserves may have had advantages during the time of reconstruction and in under-developed financial markets. However, book reserves are not only vulnerable to the companies’ performance and do not allow the risk to be diversified across various firms and countries. Investing pension savings in mature, existing firms runs also the risk of an inefficient allocation in the European capital markets, which will become increasingly integrated within EMU (CPB, 1997, 248-9). In addition, companies with too much unfunded pension liabilities (book reserves) might have problems to issue corporate debt. “Experts argue that if Germany want to issue corporate debt, borrowers will demand disclosure of full pension fund liabilities. This will not made pretty reading (in cases of book reserves, M.H) and may add to the pressure on companies to move to a funded basis” (FT 21.05.1999).

More generally speaking, the stimulation of pension funds is an explicit strategy to strengthen the German capital market. The government estimates the market size for these products at some 70 to 100 billion German marks annually (SZ 2.2.2001).

Another recent change in private pension regulation can be related to the increased (international) labour mobility. The new law, reduces the period for vesting rights from 10 to 5 year and facilitates the portability of pension entitlements.\textsuperscript{16}

\section{Comparison and conclusion: Old-age pensions in an internationalized environment}

\subsection{Towards the privatization of old-age pensions}
There have been deeply embedded differences between welfare state regimes in general and old income security arrangement in particular in advanced industrialised democracies. Diversity does persist. However, with regard to the size of the public-private mix there is a clear trend towards more private and less public provision of old-age income security. It seems somehow ironical that those countries that already had a comparatively small share of public pensions have moved faster and to a greater extent towards more private solutions (e.g. UK). While countries with very generous public schemes moved later and to a smaller extent, if at all.

\footnotesize provision obviously reflects the influence of the Green Party, the coalition partner of the Social democrats in government.
The move towards more private pensions in the 1980s was motivated by rather short-term consideration of controlling the public budget (e.g. The Netherlands). Due to the political sensitivity of old-age income issues it was only in the 1990s, that the long-term challenge of demographic ageing was really taken up by policy makers. Economic internationalisation and the integration of financial markets seriously constrain the options policy makers have to cope with demographic ageing. Increasing taxes or social contributions harms the competition position of the domestic industry. Increasing debts are likely to be punished by the international capital market. The retrenchment of public pensions and the promotion of private solutions are increasingly chosen as ways out of the dilemma. As the German case demonstrates for the Bismarckian countries, the additional costs caused by demographic ageing have to be paid by employees rather than employers.

It can be argued that even in traditional welfare states as Germany, the reform is only a first step to a much larger privatisation of old-age income security. As citizens turn increasingly to private solutions, solidarity for collective arrangements may erode further. This process might accelerate in those Bismarckian countries that are members of the European Monetary Union, (e.g. Germany, Italy, and France). As the March 2001 Council meeting in Stockholm documents, EMU members that are in a comparatively better position like the Netherlands have already joined forces with the European Commission to pressure these countries to reform the public pension systems. It is argued that without radical reforms, demographic ageing will force these countries into higher public debts, which will exceed the Maastricht criteria and will make a common monetary policy increasingly difficult. The resulting inflation would in turn hollow out the pension funds that play such a prominent role in Beveredgian countries, as capital funding is vulnerable to inflation. To be sure public pension reform is a domestic affair, direct European Union competencies are lacking. It is rather unlikely that outside pressure as such will make a difference to domestic politics. It can become important, however, when this pledge is taken up by domestic policy makers in favour of reforms, arguing that reforms are forced by the European Union. Reform-oriented governments will probably use the opportunity to share the blame for cutting public pensions with “Brussels”.

16 Besides, these latter changes and the trend toward pension funds rather than book reserves, points towards trend away from the Rhineland model of welfare capitalism. It increases the reliance on the international capital market and reduces the incentives to invest in the own human capital (cf. Ebbinghaus, 2000, 30).
17 Or by the ascendance to the neo-liberal ideology (e.g. Thatcher in Britain).
The regulation of private pensions

The reduction of public pension entitlements increased the importance of private (inclusive occupational) pensions. The privatisation of welfare does not mean, however, that individuals are exposed to unregulated market forces. There is a trend towards a regulatory welfare state for the elderly. As in the case of public pension there are large differences between countries in the nature, scope and extent of regulation. There is not one regulatory welfare state for the elderly but several. While some country choose sector or even nation-wide negotiated schemes, other rely on company-based schemes. There are defined benefit schemes as well as defined contribution schemes; prudent-man regulation contrasts with a more restrictive approach.

Despite the large diversity of pension regulations, there are however some trends towards convergence. Due to economic and financial internationalisation the importance of unfunded occupational pensions decline. Due to increased labour mobility, vesting periods for benefit claims are reduced and the portability of benefits has is facilitated.

Apart from this rather anonymous market pressures there are also attempts of supranational regulations that may foster convergence. The Commission has proposed a directive that aims at promoting the free movement of capital and services in the area of pension funds: national rules that oblige pension funds to invest in national bonds have to be relaxed, more room for investing in stocks has to be created. Consumer protection figures rather low in this proposal. Not surprisingly, this proposal is supported by countries, such as the Netherlands, that have large, internationally operating, pension funds, as well as the financial service industry. Countries with more restrictive portfolio regulations are opposed to the directive, in particular some southern European countries.

5 References


