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Active Citizens and Retirement Planning: Enlarging Freedom of Choice in the Course of Pension Reforms in Nordic Countries and Germany*)

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Abstract

One feature of recent pension reforms in OECD countries has been that more individual responsibility is transferred to employees and in particular to those approaching the end of their working life. Enlarged freedom of choice concerns the timing of retirement with corresponding consequences for the level of public pensions as well as the participation in supplementary pension schemes and subsequent decisions about investment of savings, take out of benefits etc. Within such changed framework individual retirement planning becomes more complex and risky. Starting from the question why the government is in the "pension business" at all, the paper explores the reasons (and the extent) of enlarging freedom of choice in four countries where major pension reforms have recently taken place (Finland, Germany, Sweden) or are entering the agenda (Norway). The risks of increased self-responsibility with regard to provision for old age are analyzed in general, and the concrete policy changes are evaluated comparatively in view of respective institutional legacies and current challenges and conflicts.

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1 Introduction

Some fifteen years ago an economist asked, “Why Is the Government in the Pension Business?” (Blinder 1988). This question may seem somewhat strange since public pensions amount to at least one half of aggregate retirement income in every OECD country and come to be by far and for long the largest item of total social expenditure. A re-start of the pension business from *tabula rasa* is thus unlikely, but it appears worthwhile spending a second thought on the rationales for state intervention in old-age security and, moreover, inquiring whether and to what extent one can observe a shift towards privatization and individual responsibility for one's retirement income when the reform of public pension schemes is progressing in almost all highly developed nations.

One can conceive of at least three factors pushing freedom of choice where, so far, the structure of the pension system had left the *average* employee with only limited scope for individual retirement planning beyond mandatory provision. First, the challenge to adjust national pension systems to a changed economic and demographic environment has strengthened the position of élites in politics, media and epistemic communities who are ideologically committed to increasing *freedom of choice* as a value in itself. They demand a reduced role of the state and collective solutions by which passive citizens are transformed into active consumers (see Bonoli et al. 2000: 115-8).[1] Second, it is conceivable that more individual choice will come about not so much as a result of the effective demand for *privatization*, but rather as an *inevitable concomitant* of partly shifting responsibility for protection to the individual after comprehensive, paternalistic state provision of pensions at present retirement age has been acknowledged as unsustainable in future. In this respect, the positive connotation of “choice” may be utilized to “sell” reforms to the public or to hide retrenchment effects. Finally, in all modern societies the ongoing process of individualization has largely diversified and “liquefied” life courses, life-styles and related preferences which, presumably, are less and less matched by standardized (or: “one-size-fits-all”) benefit packages in old age or by rigid retirement ages. Therefore, it is not unfounded to expect that more choice than hitherto amenable to employees is a response to *demands from “below”* when they want to see their capacity for agency increased.

Irrespective of whether the push for enlarged *freedom of choice* stems from citizens' immediate demand, is a by-product of reforms aiming at more efficiency and sustainability, or results from successful political work of market-liberals – or a combination of these three forces –, it is an issue that is definitely not confined to pension policy. In other sectors of welfare state activity enlarging freedom of choice is advancing as well. Corresponding demands for

[1] Gillion et al. (2000: 427) summarize the argument: “(S)ocial security overprotects individuals and removes their freedom of choice, on the basis that they are somehow incapable of making rational decisions as to what is best for them. It is argued that the state should withdraw to a position in which it provides a minimum level of protection and then creates and encourages an environment under which private arrangements can be made” (see also pp. 36-7, 455-6; Queisser 2001).

privatization and/or efforts to establish (internal) welfare markets and competition are to be found in public *care services* (health, children, frail elderly) and also in (higher) education – in particular, aiming at more efficient delivery, improved quality and lower public expenditure (Lundsgaard 2002; Blomqvist 2004). If implemented, more individual options very often imply (higher) user fees, (supplementary) private insurance and the like. Among *cash benefits*, however, it is only in the area of old-age pensions where a pronounced public-private mix has had a long tradition – albeit the weight of the different components has always varied between nations, and "private" usually meant constraints by state regulation, encouragement via tax expenditures involved in financing and, sometimes, government bailouts in case of pension funds collapsing.

Empirically and in comparative perspective, this paper deals with pension reforms in four countries – Finland, Germany, Norway and Sweden. Their respective pension systems have been very heavily biased in favor of public provision or, for the Finnish case, is characterized by comprehensive mandatory coverage and strict state regulation of private administration. While in Sweden the recent pension reform was carried out in one stroke, in Finland and Germany substantial changes came about as a result of a series of reform steps. In contrast, Norway has not yet begun to actually adjust its pension system to demographic aging. However, the recommendations of a pension reform commission already indicate the direction and central elements of legislative changes that might happen by the end of this decade. In the four countries in question, the policy changes or reform proposals indeed enlarge freedom of choice for employees and in particular for those approaching the end of their working life – although to a different degree.

Increasing the options for individual choice, however, has more than one dimension. It can relate to *ownership* when parts of an hitherto public system are privatized or a private component is added to the existing structure. In any case, individual property rights and not simply legislated "entitlements" are at issue. The different possibilities of private provision for old age may go along with a varying *range of choices*, e.g. regarding different portfolio compositions offered by pension funds one may choose from, various withdrawal options of accumulated savings (e.g. preservation age, lump sum *vs.* conversion into an annuity) or the amount of (annual) pension savings if there are limits for preferential tax treatment. Regarding retirement age, a rigid chronological boundary may contradict heterogeneous preferences for shaping an expected "third stage of life" after a truly work-free retirement had been universalized, was extended as longevity increased and hence gained a distinct meaning. In that respect, public pension schemes can offer almost as much choice as private alternatives and, in fact, *flexible retirement age* is no recent innovation (e.g. it has been in place in Germany since 1973, and in Sweden partial pensions were introduced in 1976), but existing options may be enlarged and entail different consequences for the "early"/"late" pensioner than before. If the "normal" retirement age is turned into a mere determinant of becoming entitled to unreduced benefits and individual deviations from it imply corresponding (actuarial) deductions or

supplements, retirement planning becomes more complex. For example, increased options would require additional savings to compensate for the permanent benefit deduction (in case of a preferred early exit from work) or demand a delayed entry into retirement if the return on private investments had proven less favorable than expected (as it obviously was the case in the U.S., see Eschtruth/Gemus 2002).

The aim of this paper is to analyze the *extent* and *modes* of enlarging self-responsibility *viz.* freedom of choice in the four countries' recent pension reforms, the *reasons* why those changes became an issue at all in the reform process and the (potential) *outcomes* after they have been put into practice. Thus, no comprehensive "stories" of the respective reforms are told. Nor will there be a detailed presentation of the institutional development and features, but rather, the description of the policy process and the elements enacted is focused on the "choice issue".[2] It can be assumed that there have been comprehensible (not necessarily "good") reasons in the past for such a strong state involvement in providing retirement income which is slightly pushed back now. Therefore, the next part of the paper will recall arguments, mainly put forward by economists, concerning the justification of government intervention into the "pension business". These reflections emphasize a number of trade-offs between individualized arrangements and collective schemes aiming at financial security in old age – or: political decisions about the respective scope of social solidarity as opposed to individual responsibility. The arguments presented in section 2. also serve as a background when concrete policy changes and their potential risks are evaluated and compared (section 4.). Before, these changes relating to enlarged individual choice are dealt with in four case studies (section 3.). In that third section there will also be a retrospect on the critical junctures of the respective pension systems when during the *Golden Age* of post-WWII welfare capitalism political decisions about a more liberal or a more state-centered variant of pension provision were at stake. To a large extent, today's pension reform debate centers around whether and how to break with the path-establishing decisions of the late 1950s/early 1960s.

2 States and (Basic) Pensions: Why Are Governments Involved?

In contrast to incapacity for earning one's living due to sickness, disability or involuntary

[2] So called "third pillar pensions", which are *voluntary*, private and funded and intended to offer supplemental retirement income, are dealt with only insofar as their role within the national pension system as a whole has been changed politically (by altering the regulatory framework and/or corresponding tax codes) or because of individual savings behavior. — No special attention is paid to homeownership. It is a most important component of private asset accumulation and strongly influences economic well-being – not only in old age (see Ritakallio 2003; Frick/Grabka 2003). Taking into account this component of individual retirement planning would further complicate the comparative analysis and is thus left out. However, one should bear in mind the vastly different rates of homeownership which is highest in Norway (86 per cent) and lowest in Germany (43 per cent) while, in between, about two thirds of the Swedes and Finns live in owner-occupied housing.

unemployment, *old age* constitutes no social risk as such. As long as public pensions were confined to a few occupational categories (military personnel, civil servants and employees in certain state sectors – Ehmer 1990: Ch. 2), the bulk of wage-dependent laborers indeed “worked until death or disability” (Stearns 1975: 260). Invalidity was the main social problem, and in the title of Germany's pioneering legislation of 1889 (*Gesetz betreffend die Invaliditäts- und Altersversicherung*) insurance against this risk was consequently placed in front.[3] It was stipulated that without an extra proof of incapacity insured workers became eligible for pension benefits on reaching age 70 (later reduced to 65 years) which was synonymous with a generalized assumption of invalidity: workers of that age were regarded as completely incapable of working or presumed a remaining productivity too low to earn a living wage. They were called *Altersinvalide* (Wannagat 1965: 69), and not earlier than 1957 “old-age pensions” were created as a benefit category. Moreover, after a proxy for age-based disability had been institutionalized, in Germany and elsewhere, needy persons beyond pensionable age were no longer expected to take a job before being granted social assistance. Historically, economists' question about state involvement in the “pension business” could reasonably be raised only *after* the state, for humanitarian reasons, had taken over responsibility for preserving the dignity of old and thus *presumed invalid* citizens. Thereby, it created some notion of a legitimately work-free retirement, i.e. an irreversible exit from the labor market while potentially still employable according to medical criteria. When discussing the arguments about the extent of governments' engagement in providing pensions one has to bear in mind that “retirement age” is an invention of emerging public pension schemes.

2.1 Publicly Provided Minimum Pensions – Why and How

Any person who wants to terminate employment at a chosen age is free to put aside parts of her current earnings and to live on these savings during retirement. In this way, rational individuals smooth out consumption over their life-cycle. Intervention into that domain of self-reliance thus requires justification. Economists usually assume rational behavior but also acknowledge that, *voluntarily*, individuals do not behave as predicted by the well-known life-cycle model. They often fail to save enough: despite knowing that, after reaching a certain age, they can no longer work or find employment, future (consumption) needs are discounted as against present ones. When present selves and future selves are falling apart that way, such time-inconsistent behavior is called *myopia* (Thaler/Shefrin 1981; Kessler 1989: 80-2). There are social externalities arising from such lack of willpower since elderly people with insufficient resources will not be

[3] Of course, death of the breadwinner was a problem of similar relevance although the German public pension scheme provided no survivor benefits right from the beginning.

compelled to work until their dying day, but rather, for moral reasons, receive public support. Moreover, even "free riders" whose state of need results from *deliberate* "over-consumption" while at employable age can hardly be denied anti-poverty benefits out of taxpayers' money (Musgrave 1968). In order to counteract such *moral hazard* behavior, *protecting the prudent* (who make sufficient provisions for *their* old age) by forcing *all* adult members of society to take precautions for minimum security is therefore unanimously regarded as a legitimate justification for state intervention – including market-liberal hardliners, like von Hayek (1971: Ch. 19), who otherwise emphasize the welfare enhancing benefits of unconstrained individual choice.

Fighting *moral hazard* and *myopia* not necessarily entails that a *public* savings scheme has to be erected. Compulsory private provision for minimum security in old age may be an alternative to a state basic pension. Still, there are a number of caveats. *First*, not all sick, unemployed or persons with no or very low earnings can afford to put aside the required minimum savings (or they would try to evade them), and the government has to bail them out as well as those unlucky who, despite state regulation on portfolio composition and on further terms of the contract, end up with inadequate savings because the assets in which they were invested performed poorly. At and after retirement more problems with a compulsory *private* savings scheme may arise.

Second, retirees face the risk of outliving their pension wealth – or, if risk averse, they spend down accumulated savings in a too cautious manner, thus forego consumption opportunities and leave behind unintended bequests. Therefore, some kind of insurance against longevity-related old-age poverty is recommendable (Blinder 1988: 18-23). A life *annuity* is such an insurance product that guarantees an stream of lifelong income. The market for this protection against the longevity risk is however prone to fail due to *asymmetric information*: prospective purchasers of an annuity regularly know better about their health status than the insurer. Annuities calculated on the basis of *average* further life expectancy are not actuarially fair to all individuals. Therefore, only those who expect to enjoying them for an above-average period will voluntarily convert their retirement wealth into an annuity while the others refrain from an unattractive purchase. Since insurers have to reckon with a disproportionate number of long-lived purchasers they will raise the price of annuities. It further limits the number of people for whom an annuity is an acceptable bargain and, hence, the spiral continues. An annuity mandate which precludes other withdrawal possibilities solves this *adverse selection* problem:[4] if "good" and "bad risks" are pooled that way, annuities may indeed be calculated on average life expectancy and thus offered at a lower price than before (Brown 2002: 165-8). Apart from constraining individual choice, compulsory annuitization of savings with uniform pricing that guarantees

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[4] Moreover, as "workers do not escape from moral hazard or myopia simply because of age" (St. John/Willmore 2001: 1299), an annuity mandate forestalls the possibility that, if accumulated savings are taken out as a lump sum at retirement age, they may be spent "unwisely" and people ultimately end up in need of public support.

lifetime minimum pensions redistributes *away* from lower-income people towards high-income individuals since the latter tend to live longer. Socioeconomic inequalities extending into differential mortality rates pose a problem of regressive redistribution for any public pension scheme as well – even if monthly benefits are calculated according to a progressive formula that privileges former low-wage earners (Garrett 1995).[5]

Third, the state of financial markets ("bear" or "bull" market) at the time of voluntary or mandated annuitization is crucial for the level of pension payments. It determines the value of savings designated for conversion into an annuity and, moreover, the current interest rate taken into account when calculating the annuity rate is decisive for the level of the periodic payment until the death of the annuitant. Hence, annuities in fact fluctuate tremendously (Blake 2003: 308-11; Burtless 2003: 387-94) and may possibly be much lower than expected – or even be too low to provide minimum security.

A *fourth* problem of a private minimum pension scheme relates to *inflation*. Instead of a level annuity it is possible to have it uprated according to an *assumed* rate of increase in consumer prices to be agreed upon in advance. In that case the initial annuity is (much) lower than without such an index link. However, unanticipated inflation is an *uninsurable risk* that can (completely) devaluate accumulated savings and current annuities (Bodie 1990). Only a public pension scheme that applies the pay-as-you-go (PAYG) principle of financing is suitable to cope with this contingency. Moreover, it can maintain minimum (and earnings-related) pensions as a fraction of average earnings when benefits are indexed to wages so that pensioners participate in economic growth (or decline) during retirement.

A *fifth* argument, relating to administrative costs, profits and bankruptcy, was already employed by both Bismarck (see Tennstedt 1995) and Beveridge (1942: 277-86). It encompasses the periods before and after retirement and adds further support for a "monopolistic" public solution to the poverty risk in old age: a publicly organized scheme has not to shoulder marketing costs or to earn profits that deliver a return on investment for private owners. Further lowering *transaction costs*, it can tap the economies of scale and standardization, thus operating at low administrative expenses and, different from private insurance, it is not exposed to the threat of economic failure. The latter aspect is particularly important for a retirement program because it has to bridge a very long time span and hence requires durability as well as flexibility.

Taken together, it is largely uncontested that there should be a state-run, somehow redistributive pension scheme that provides minimum security in old age, whereas less unanimity exists when it comes to the *mode of provision*, the *level* of benefits and how to *finance* them. In theory, a universal flat-rate basic pension scheme is superior to a means-tested minimum pension

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[5] This problem of heterogeneous mortality risks already arises prior to the payout phase. Contributions made by an individual who dies during working life become the "property" of the pension scheme (and are implicitly or explicitly redistributed to surviving participants) instead of being bequeathed to the decedent's family (as a lump sum or survivor pension).

in old age (although more costly) since the latter alternative sets a “savings trap”: either one provides for old age so extensively that complete independence from public benefits is given during retirement, or one refrains from saving at all and relies exclusively on the minimum pension instead. Since the first alternative is not amenable for most employees it would be unwise for them to build up assets in order to receive a current retirement income from these savings above given exempt amounts for obtaining the full means-tested benefit.[6] It is also for this reason why van Parijs/Schokkaert (2003: 250-1) argue in favor of an *unconditional* basic pension as high as is sustainable.[7] According to their egalitarian conception of social justice it should be financed out of redistributive taxation or income-related contributions paid by persons below pensionable age. Beveridge (1942: 141) who stands for the idea of universal basic security proposed a contributory scheme that grants benefits higher than the (tax-financed) means-tested minimum, because “otherwise the insured persons get nothing for their contributions”. His flat-rate logic of treating alike “the poorer man and the richer man” (Beveridge 1942: 108) excluded vertical redistribution *within* the scheme because the “poorer man” was compelled to pay the same amount of contributions. For low-wage earners it meant an excessive burden if benefits were to actually achieve a level of adequacy above the means-tested minimum (however, it was not Beveridge's intention to have benefits be exclusively financed out of contribution revenues).

When arguing in favor of basic security, at the same time, Beveridge (1942: 6-7) demanded a clear boundary for state involvement:

> (It) should not stifle incentive, opportunity, responsibility; in establishing a national minimum, it should leave room and encouragement for voluntary action by each individual to provide more than that minimum for himself and his family.

And in a later chapter Beveridge (1942: 121) defended the unequal outcomes inevitably produced by “voluntary action”:

> The actual incomes and by consequence the normal standards of expenditure of different sections of the population differ greatly. Making provision for these higher standards is primarily the function of the individual, that is to say, it is a matter of free choice and

[6] See e.g. World Bank 1994: 239-44; Rødseth 2004: 357-62. In Scandinavian countries, during the lengthy political process of transforming income-tested national pensions into universal, unconditional flat-rate benefits, the detrimental effects of the assistance model on the growth of voluntary retirement provision and the length of working life were recurrently emphasized, and it was an issue raised by bourgeois parties since the middle classes in particular gained most from the abolition of income testing (Salminen 1993: 163-299; Baldwin 1990: 113-4, 134-43). The savings disincentive is, of course, dependent on the withdrawal rate by which additional retirement income above a threshold amount is taxed away.

[7] In contrast, the World Bank (1994: 242) pleads for a “modest” level, just enough to attain the poverty alleviation goal and which should be paid for the first time at an age “high enough so that it is a good proxy for the inability to work for the majority of people.”

voluntary insurance.

Apart from financing, the closest realization of Beveridge's concept may be found in New Zealand where the government runs a universal, tax-financed, flat-rate pension scheme and nothing else. There are not even tax subsidies intended for encouraging voluntary provision for retirement because they are assumed to disproportionately favor the better off and hardly effect an increase in private or national saving (St. John/Willmore 2001; World Bank 1994: 203, 247).[8] The New Zealand model may be defended because it combines reliable poverty prevention and a maximum scope for undistorted freedom of choice to additionally provide for retirement. So do St. John/Willmore (2001: 1299): “Why should society care whether a worker has the means to consume well above the subsistence level during retirement?” Among real-world pension systems, New Zealand nevertheless remained an exception. Obviously, such a principled model is inherently unstable – it either degenerates into a scheme whose insufficient benefits have to be topped up with means-tested ones (like in the U.K.), or it is supplemented with a mandatory earnings-related pillar (as it happened in Scandinavian countries – see below –, Canada, Switzerland or Australia), whereas public schemes of the social-insurance type that somehow blend (individual) equity and (social) adequacy functions encountered little political pressure for fundamental change (Teles 2000; Hinrichs 2000). This leads to the question why, *beyond providing basic security*, governments have usually become involved in the “business” of earnings-related pensions.

2.2 Wage-replacing Pensions: Rationales for Government Provision

While in Beveridge's liberal conception of a universal welfare state a *compulsory earnings-related pension scheme* was ruled out, the World Bank (1994), likewise propagating liberal values, includes a mandatory second pillar in its recipe for a sustainable, just and transparent pension system. It refers to “shortsighted individuals” and, in a paternalistic manner, argues for a *mandatory* employment-related pillar that “requires people to save when they are young so that they will have *adequate income* when they are old” (World Bank 1994: 201, 244; my italics, K.H.). However, it wants to see this pillar of forced savings to be *decentralized*, *privately managed*, albeit publicly *regulated*, fully *funded* and *non-redistributive* (World Bank 1994: 238).[9] Such notion of a wage-replacing pension scheme, designated to prevent a drastic fall

[8] Arguing from an ethical standpoint, van Parijs/Schokkaert (2003: 255) also approve supplementary private pension arrangements that do not involve tax advantages, but priority should be given to safeguard minimum pensions at the highest sustainable level.

[9] The paternalistic justifications for a mandatory employment-related pillar do not really fit with the overall ideological thrust of the World Bank's approach. Obviously, it considers developing capital markets and increasing national saving to be equally relevant goals (World Bank 1994: 208-13 or 229-31).

in the standard of living after retirement, differs from reality in most traditional OECD countries where it is public, pay-as-you-go (with buffer funds of varying size) and to some extent redistributive. The question of the merits and disadvantages of an either pre-funded or PAYG based pension scheme is not relevant here, but rather, whether – beyond *myopia* and *paternalism* pure and simple – further arguments can be brought to bear which justify public provision of earnings-related pensions.

Individuals may indeed wish to smooth consumption over the life-cycle, and even if they do not act on mistaken preferences (myopia, procrastination), but rather are considered to exhibit perfect foresight, there is still legitimacy for publicly provided pensions *above* a social minimum due to uncertainty they face. Within a volatile economic environment, it is an extremely complicated task to manage saving and investment decisions comprising long time spans – from starting to earn an income until the expected labor market withdrawal – so that eventually a pension materializes which corresponds to the preferred (or accustomed) standard of living *and* to have this consumption level effectively protected over the whole retirement period (Pechman et al. 1968: 60-3). In addition to always present investment risks, "wrong" decisions about pensions cannot be corrected easily, and they are becoming even less reparable the closer one approaches to retirement. Moreover, despite sufficient telescopic faculty there are a number of unforeseeable life events which impede continuous and sufficient provision for old age (unemployment, divorce, disability etc.). By and large, individuals can be assumed to be aware of the difficulties to make informed decisions and of the contingencies during the life course, and they should also know about their weakness of will. As a consequence, risk aversion is enhanced and, while at employable age, they possibly prefer to have the responsibility for supplementary pensions being transferred to the state – either completely or for a large part of the desired retirement income that will replace earnings. If such *self-paternalistic* motives for mandatory coverage are met by a public scheme, the consequences of familiar market failures (adverse selection and unanticipated inflation – see above) are ruled out as well. Still, the paternalistic argument in favor of earnings-related pensions is not without problems:

> Hard evidence that the majority of people would prefer less liberty is always likely to be hard to come by and, even then, the infringement of the freedom of those who prefer to organize their own finances must be taken into account (Agulnik 2000: 49; see also Diamond 1977: 281-2; Blinder 1988: 28-31).

Instead of compulsory (public) arrangements for wage-replacing pensions, restricting state intervention to tax relief for contributions made on behalf of supplementary pensions would spur spreading but leave substantial choice with the individual employee. However, the arguments presented in the preceding paragraph were not dismissed by this liberal solution and, due to voluntary participation, no universal coverage can be expected, but rather a take-up biased towards high-wage earners so that income inequality in old age possibly increases to an

intolerably high degree. In fact, unequal provision with earnings-related pensions gave rise to demands for universal coverage in countries that only offered flat-rate pensions so far (see also section 3.).

Aside from the above infringement argument, there are further reasons for state intervention over and above minimum security in old age. Public pensions bearing some relationship to lifetime earnings have to be funded out of compulsory, earmarked contributions. Compared to taxes, the *willingness to pay* should be higher if these contributions offer an equivalent return and are thus perceived as an adequate "price" for future benefits, granted without any test of income and/or wealth (Agulnik 2000: 50-2). This feature makes such an earnings-related scheme superior to those which merely provide universal, flat-rate benefits or means-tested pensions since there are low or no returns at all for former high-income earners *viz.* (prudent) taxpayers. Moreover, a contributory scheme that regularly provides benefits *above* the social minimum reduces the number of elderly who are dependent on means-tested transfers. It thus helps to avoid the problem of raising (more) unpopular taxes in order to support poor elderly, since the potentially poor are now expected earn entitlements above the minimum level themselves. However, the willingness-to-pay argument holds as long as there is *confidence* in the security of future benefits: contribution-based claims will be honored eventually. Attaining long-term financial sustainability has thus played an important role in recent public pension reforms.

Regardless of whether there is a mandated privately managed pillar of employment-related pensions (as proposed by the World Bank) or a social-insurance-type public scheme, it can hardly live up to the heterogeneity of preferences among the covered workforce. Deviations from the desired package may imply efficiency losses emanating from a too high rate of contributions and, related, ratio of wage replacement[10], an individually inadequate minimum (or standard) age of retirement etc. Dissatisfaction with certain stipulations will reduce the willingness to pay or entail other distortions (e.g. work disincentives).

Those "distortions" can assumed to be minimal if there is a strict link between contributions and pension benefits as it is regularly the case with mandatory saving plans corresponding to the defined-contribution (DC) type (World Bank 1994: 214). A *political* rationale for a public earnings-related pension scheme is that *social* insurance benefits not necessarily represent actuarially fair returns, but rather allow some *intra*generational redistribution in favor of low lifetime earners while the image of "equivalence" may still be maintained. Such "backdoor" income redistribution that satisfies risk aversive persons' desire for

[10] The World Bank (1994: 75, 293-5) recommends a replacement rate of 60 percent of gross average lifetime earnings. — When the standard *replacement level* is politically fixed a trade-off arises: if for a sizable fraction of employees it is set too low, paternalism is not going far enough to meet their security needs. In contrast, an overly high provision crowds out private pensions, possibly preferred by those who want more variation in either choice of policy or quantities purchased or who desire a different spread of risks in the public/private mix (Queisser 2001: 22-3).

income equalization is effected via benefit formulae which lead to replacement ratios that vary inversely with previous (lifetime) earnings. Sacrificing strict individual equity for the sake of socially adequate benefits is politically advantageous compared to raising taxes for the same purpose as public resistance against contributions is assumed to be lower, particularly if notions of "equivalence" nevertheless prevail (Diamond 1977: 278-9; Agulnik 2000: 50). However, limits of utilizing a pension scheme as a risk-sharing device within generations may be encountered when high-wage earners perceive a too low return on their contributions.

A final reason for pay-as-you-go based public pension schemes is that they can effect *inter*generational redistribution, thereby relating benefits not to the length or amount of previous contribution payments, but rather to the earnings history of the retiree.[11] During the maturing phase a "double payment problem" – still somehow supporting the earlier generation (of parents) while, at the same time, saving for one's own retirement – may be avoided whereas the merits of the justifications mentioned above (paternalism, willingness to pay and intragenerational redistribution) can already be reaped. These "windfalls" transferred to the first generation of beneficiaries are dragged along as an implicit debt of the scheme (and inhibit an easy transition to an advance-funded one).

However, this feature makes such a program of intergenerational risk sharing susceptible to demographic shifts:[12] population aging either necessitates lower benefits or higher contribution rates. Both alternatives negatively affect the willingness to pay. This interrelation can be turned into an argument why governments should *not at all* be in the business of providing PAYG pensions or, at least, should reduce its involvement in favor of private provision. Advance-funded private plans offer real property rights but are exposed to (financial) *market* risks. Conversely, public schemes always face *political* risks and can hardly be insulated from *rule instability* (Lindbeck 1994; Diamond 1997). A shift towards greater diversification of the different risks would increase social acceptance of its single components *and* the pension system as a whole. The counter-argument says that a strengthened individualized component was not going to make the system politically less vulnerable since policy risks equally exist for private pensions (Heclo

[11] There are two more reasons for state involvement in the pension business which need not to be discussed here in detail. First, the state may intervene for macroeconomic purposes when it mandates (or encourages) employment-related pensions as a vehicle to attain wage restraint and/or to increase the national savings rate (e.g. this was the case in Australia – Hinrichs 2001). Second, beside its role as provider and regulator of pensions, the state also acts as an employer. When granting pensions to its personnel, it pursues similar goals as private enterprises albeit preventing corruption by offering first-class security should be of more importance in the public sector.

[12] Advance-funded pension schemes are not immune from those shifts either. Decreased post-retirement mortality rates imply lower annuities or demand higher contributions during working life instead. Furthermore, if cohorts approaching retirements are followed by smaller ones of employable age (as a result of lower fertility) more older people will sell their assets ("dissave") than there are younger people who want to save for their retirement. A substantial liquidation of retirement wealth may imply a lower pension in *real terms* than the older cohorts expected beforehand (see Gillion et al. 2000: 273-83 for the argument in detail).

1998; Gillion et al. 2000: 429) when the regulatory framework (e.g. restrictions on funds' portfolio composition) or tax rules (regarding savings, pension fund earnings and benefits) are changed significantly.

The analysis of pension reforms in three Nordic countries and in Germany will show to what extent the arguments about state intervention or abstention actually played a role in the policymaking process. The main rationales in favor of state involvement which have been presented in this section are summarized in *Figure 1*.

Figure 1: *Summary of main arguments for state involvement in pension policy*

Degree of state intervention	**Economic/political rationale**
mandatory individual provision: ⇓	• fighting myopia and moral hazard
mandatory annuitization: ⇓	• insurance against longevity • removing adverse selection
mandatory public scheme: ⇓	• security: insurance against unanticipated inflation • participation: indexing benefits according to economic growth (possible) • efficiency: low transaction costs
public earnings-related scheme:	• predictability: complexity of individual retirement planning reduced • redistribution: socially adequate benefits for lifetime low-wage earners

3. Pension Reform and Individual Choice: Four Case Studies

As a mass phenomenon, real *retirement*, meaning an expanding, work-free, but not poverty-stricken third stage of the life course, happened not earlier than during the 1950s in most Western nations when statutory pensions replaced an adequate portion of previous earnings and not just alleviated poverty. In Germany and Sweden, it was the result of far-reaching pension reforms, enacted in 1957 and 1959 respectively. The Swedish decision paved the way for subsequent and broadly similar policy changes in Finland (1961) and Norway (1966). Everywhere, these reforms meant a strong role of public pensions in replacing earnings

after retirement, and up to the 1990s incremental policy change has nowhere touched upon this paradigm. The development was clearly path-dependent. Beginning in the mid-1990s, substantial pension reforms occurred in Finland, Sweden and Germany which, at least in the two latter countries, meant a paradigm shift and a more pronounced turning to the so called "multi-pillar approach" in retirement income provision.

3.1 Germany

3.1.1 The 1957 Reform: Status Maintenance and the Birth of the One-Pillar Approach

Until 1957, central traits of the German public pension scheme which are assumed to be generically "Bismarckian" – the equivalence principle and status maintenance in particular – were merely embrionic. Benefits were linked to preceding contribution payments right from the beginning, but elements of basic security still played a role after World War II. Nevertheless, average pensions were low and, conceptually being part of a "multi-pillar approach", meant to simply *add* to other sources securing livelihood in old age, like private provision, family support, (reduced) earnings from continued work or occupational pensions. Correspondingly, poverty rates were high, particularly among former blue-collar workers and their survivors if they relied on public pensions alone. The reform of 1957 had an immediate impact on the economic well-being of all current retirees when, within a PAYG framework, benefits were increased by nearly 70 per cent, and the hitherto static scheme was turned into an inherently dynamic one: individual, lifetime earnings in relation to average earnings determined the initial benefit level, and annually upgrading pensions according to gross wage growth made retirees participating in economic progress. As a result, after a full occupational career (*and* all through retirement) the new scheme was going to provide true replacement of lifetime (not: last) earnings of about 70 per cent – even for employees with wages up roughly 1.8 times the average.

During the reform debate the *Deutsche Bundesbank*, the financial service industry, the employers and, within the government itself, the Ministers of Finance and Economic Affairs strongly opposed pay-as-you-go financing, a high replacement level and the quasi-automatic indexing of benefits because they feared higher inflation rates, decreased private (and national) saving and long-run financial unsustainability of the scheme. Moreover, they criticized extended mandatory coverage as well as too little individual choice and responsibility, and instead demanded a much leaner, preferably needs-based public scheme to be supplemented by occupational pensions and private provision. After the Social Democrats had presented a reform bill first (that, in large parts, was identical with the final legislation), Chancellor Adenauer who correctly recognized the electoral significance of the pension issue prevailed over the opponents

with only minor concessions (Hockerts 1980; Hinrichs 2004).

Despite much rhetoric about a “three-pillar model”, the 1957 reform actually meant the “birth” of a state-paternalist *one-pillar approach* in Germany because the relatively high level of public benefits impeded *occupational pensions* from prospering. In a tight labor market mainly larger firms strategically employed them to recruit, motivate and chain workers. In the private sector, occupational pensions hardly became an issue in collective bargaining so that coverage remained low. Like additional, voluntary *private provision* for old age (financial assets or home equity) of some significance they were largely confined to the more prosperous parts of the work force, additionally enjoying some tax privileges for their savings. Therefore, still about 80 per cent of total retirement income stems from unfunded public sources (when the civil servants' pensions are included – Deutscher Bundestag 2002, pp. 317-21).

After 1957 for white-collar workers with earnings higher than the contribution assessment ceiling still some choice remained until 1968: they could *opt out* of the statutory scheme completely and “go private”. Traditionally, the self-employed were not regarded as being in need of social security. The expansionary reform of 1972, however, offered them the opportunity to *opt in* on extremely favorable terms by paying low retroactive contributions (Baldwin 1990: 281-3).[13] In 1972, also flexible retirement for insured with an employment record of at least 35 years was introduced: they could start drawing their pension at age 63 (if seriously handicapped, already at age 60). There were no (actuarial) adjustments for prolonged benefit receipt. Merely, fewer years of covered employment meant lower entitlements.[14] When full employment came to an abrupt end in 1974 in combination with further pathways into premature retirement (disability pensions, old-age pensions due to unemployment starting at age 60) the frequent utilization of the flexible retirement option contributed to the decline in labor force participation after age 55 and, correspondingly, to a lower factual retirement age.

3.1.2 The 2001 Reform: A Paradigmatic Change

After 1977 numerous small adjustments and three larger reform packages (legislated in 1989, 1996 and 1997) aimed at containing public pension expenditures and further rises of the contribution rate. They created difficulties for low-wage workers with discontinuous or short employment careers to attain an adequate pension level, but not until the late 1990s the principle

[13] In 1938, self-employed artisans were made compulsory members of the blue-collar scheme, and farmers are included in a special scheme since 1957. Civil servants (nearly 6 per cent of all gainfully employed) are provided for through a uniform, tax-financed program without own contributions.

[14] Since 1957 female workers with 10 years of covered employment after age 40 were eligible to retire already at age 60 without having their pensions reduced. Meanwhile, this pathway into retirement has completely phased out.

of *wage replacement* was called into question. A stable target replacement rate of 70 per cent of net wages was still a cornerstone of the reform of 1989 which was a first and comparatively early attempt to cope with imminent population aging. It stipulated that all pathways into early exit from work will phase out (this development was accelerated in later reforms), but *flexible retirement* beginning at age 63 (after 2012: 62) at earliest is still possible. However, if claimed before age 65 the pension is permanently reduced by 0.3 per cent per month. Such rate is budgetary neutral for the pension scheme but still offers an incentive to retire early (Clemens 2004). Additional choice was granted in the 1989 legislation when *partial pensions* were introduced: any old-age pension may be drawn as one third, one half or two thirds of the full amount and be combined with limited earnings which again increase subsequent entitlements. However, the take-up rate of this type of pension was disappointingly low,[15] whereas in Sweden gradual retirement was very popular as long as the replacement rate for older part-time pensioners/workers had been quite generous (Wadensjö 1996).

Immediately after coming into office in 1998, the Red-Green government suspended the "demographic factor" which was a central element of the pension reform legislated by its predecessor in 1997. It was roughly similar to the longevity-related conversion factor within the new Swedish pension system and designed for containing the contribution rate as further life expectancy at age 65 was integrated into the formula that determines the initial benefit level as well as the annual adjustment. As a result, the target replacement ratio would have fallen from 70 to 64 per cent, but already in June 1999 the government came forward with a reform proposal that would have led to an even lower replacement ratio. Inspired by the Swedish example, the plan included a *mandatory* contribution of 2.5 per cent of earnings to private pension plans. Due to vehement all-round protests (*Zwangsrente*) that element was dropped after one week, but as a tax-subsidized vehicle to *voluntarily* compensate for lower public benefits the so called *Riester-Rente* became the cornerstone of the reform package which finally passed in May 2001.

The 2001 reform clearly represents a path departure or *paradigm shift* for two reasons. First, it was stipulated that the contribution rate *must not* exceed 20 per cent until 2020 and 22 per cent until 2030. This provision replaces the principle of a "fixed relative position" which had been institutionalized in the 1989 legislation with that of a "fixed contribution rate" (Myles

[15] Partly in reaction to the poor utilization of partial pension, but foremost due to the almost "exploding" and costly inflow into old-age pensions after one year of unemployment during the early 1990s, in 1996 it was decided to discontinue the latter pathway into retirement at age 60 and to replace it with a program of "elderly part-time work" (*Altersteilzeit*) which is limited until end of 2009. The minimum eligibility age is 55 years, and if older workers halve their working hours they are entitled to 70 per cent of former net wages and contributions paid to the pension scheme on the basis of 90 per cent of former gross earnings. It is not required that older workers really work "part-time" until becoming entitled to an old-age pension. They may continue working full-time for the first half of the agreed period and work zero hours for the second half. Most participants opt for the full/zero hours variant and claim their pension at age 60 or later with corresponding reductions (for details see Hinrichs 1998: 20, n. 15).

2002: 140-5, referring to Musgrave). It makes the benefit level the dependent variable with demographic and labor market development, the statutory retirement age and the share of expenditures funded out of general taxation working as intervening variables. The upper limits on the contribution rate were confirmed in recent legislation (2004) when, in order to attain these targets in view of earlier overly optimistic assumptions, the benefit (adjustment) formula was again changed, now including the contributor/pensioner-ratio as a correction factor. As a result, the standard replacement ratio for new and current pensioners will decline by about 17 per cent until 2030 (which roughly doubles the decrease the former Christian-Liberal coalition aimed at in their reform of 1997). The message sent out by the government in 2001 (and constantly repeated since) was that public pensions alone will *no longer* provide adequate *wage replacement*.

Second, when institutionalizing voluntary private pensions (*Riester-Rente*) as a component of future retirement income the Red-Green government has not only made up for the "forgotten" compensation in the 1997 reform of its predecessor. Moreover, the extension towards *retirement income policy* has irrevocably shifted the German pension system towards a multi-pillar approach again after it had been tantamount to *public pension policy* and a one-pillar approach since 1957. The *Riester-Rente* started in 2002. Contributions to certified savings plans, gradually increasing to 4 per cent of gross earnings in 2008, benefit from direct subsidies or tax privileges with a bias in favor of families raising children and high-income earners.

The *Riester-Rente* opens up freedom of choice to a large extent, namely, whether to participate at all (although strongly encouraged) and with regard to a variety of private pension products. So far, employees have not embraced the *Riester-Rente* enthusiastically. After 18 months the take-up rate has remained low (about 12 per cent - Dünn/Fasshauer 2003). One has to take into account, however, that there is also the option to benefit from corresponding tax privileges when it is provided as an occupational pension. Converting parts of the salary (up to 4 per cent right from the start in 2002) into savings to single-employer plans or those set up by industry-wide collective agreements can be advantageous due to cost efficiency[16] and lower demands on employees' "financial literacy". Understandably, occupational pension coverage in the private sector has steeply increased between December 2001 and March 2003 – by 10 percentage points, so that about 57 per cent of employees insured with the public pension scheme were covered (Infratest 2003: 8). Before, it was on the decline for about 25 years. Within the new architecture of the German pension system, occupational pensions will change their character: up to now they were first of all an instrument of personnel management (see above) and *supplemented* (sufficient) first-pillar pensions. This function (and employers' financial responsibility) will fade in importance as against a new role, namely to become a

[16] This type of occupational pension resembles the "401(k) plans" in the United States (see e.g. Springstead and Wilson 2000).

genuine element of social policy, providing status maintenance for a substantially larger share of employees when public pension benefits alone will no longer perform that role.

The shift towards the private/occupational pillars in the retirement income mix will continue, particularly, since the latest attempt (in 2004) to attain financial sustainability of the public scheme imply that in future more retirees will end up with benefits close to or even below the level provided by the special means-tested minimum scheme for pensioners which was introduced in 2001. It might be questionable whether exactly those (low-wage or discontinuously employed) workers who need supplementary pensions most will actually participate in corresponding pension saving plans. However, as a result of sweeping changes in the taxation of pensions, financial latitude will be enlarged due to a gradual tax exemption of contributions to public and private pension schemes up to a limit (while accruing pensions are taxed upon receipt). These changes render rational deliberation between alternative vehicles for retirement income even more complicated (Schnabel 2004).

It remains to be answered why it was exactly a government led by Social Democrats that carried out the paradigm shift and inserted private pensions into an emerging multi-pillar system. The first part of the answer relates to demographic aging which makes *all* retirement schemes more expensive. Within the political discourse during the 1990s an interpretative pattern developed and solidified that demographic aging must not lead to (substantially) higher contributions to the public scheme due to the detrimental effects on employment and an inequitable outcome in intergenerational perspective. So framing the aging issue, enlarged individual responsibility appeared as sheer necessity (see Marschallek 2003). On part of the public, after recurrent policy adjustments and still uncertain prospects regarding security in old age, by the end of the 1990s public pension policy had lost its *credibility* and the institution as such had used up *plausibility*. Simply turning again well-known “adjustment screws” and afterwards declaring “less” as more “secure” would have been absolutely pointless for restoring confidence. Likewise, asking higher contributions to a *collective* security scheme from the insured was hardly suitable for promoting expectations of reliability after this originally risk-compensating institution was perceived as risky in itself. By providing the opportunity to put subsidized savings into pension plans which offer true *property rights* (and a sense of *ownership* instead of insecure “entitlements”) and *freedom of choice* the government could even hope to gain reputation. It thus enabled current employees to take an intertemporal (or: *diachronic*) perspective insofar as they pursued an “investment strategy” which demands to (additionally) sacrifice consumption now for not being worse off (than the present generation of pensioners) later when a declining replacement ratio of public pensions is offset by a parallel increase of the *Riester-Rente*.

The second part of the answer relates to a modernized Social Democracy that now places *self-responsibility* and *efficiency* on equal footing with its traditional triad of principles: freedom (emancipation), solidarity and social justice. Individualistic solutions to securing a sufficient

level of pensions in view of *individualization* as a societal “mega-trend” clearly match the new credo. Purely collectivist solutions were discarded, as can be shown from numerous quotations of leading Social Democrats in Germany, e.g. when citizens are asked to say farewell to the desire for a welfare state that, in paternalistic manner, relieves them of individual responsibility to take care for their life and to provide against risks (e.g. Behler 1999; Müntefering 2001; Friedrich-Ebert-Stiftung 2004). However, *within* the party the frame shift about the respective role of the market and the state was not universally accepted. In 2001 as well as before the final vote on the 2004 reform package, some (symbolic) concessions to the “traditionalists” had to be made in order to attain a majority in parliament.

“Side-payments” were also made to the opposition parties, particularly to the Christian Democrats (e.g. improved survivor pensions or generous subsidies to families saving for the *Riester-Rente*) in 2001 although no inter-party consensus was attained. As there was no principled dissent about private pensions as such, freedom of choice as a value in itself played no role in the parliamentary debates either. The conflict between the political parties centered around the degree of regulating the *Riester-Rente* (“too bureaucratic” versus not enough protection of pension savers).

3.2. Sweden

3.2.1 The 1959 Decision: Universal Public Income Maintenance

Unlike Germany, the Swedish pension system started from a “national pension” model (adopted in 1913), but not earlier than 1948, flat-rate pensions became truly universal and granted without any test of income. In Norway, the citizenship model was realized in 1957, whereas in Finland a national pension combining an income-tested component on top of a modest universal, flat-rate benefit remained in place until 1985. The three Scandinavian countries had in common a very unequal coverage of white- and blue-collar workers with earning-related pensions provided by their employers. The political conflict about how to universalize access to earnings-related pensions developed into one of the fiercest in Sweden during the whole 20th century. The subsequent adoption of pension schemes aiming at wage replacement in Finland and Norway happened in much more peaceful manner.[17]

Social equality attained by the citizenship model of flat-rate pensions had a trade-off, namely, *economic inequality* in old age as the social classes had different opportunities to

[17] The respective sections on the introduction of earnings-related pensions in Sweden, Finland and Norway rely heavily on Salminen's (1993) excellent compilation of numerous national sources for a comparative analysis. Other detailed accounts on the Swedish case used here are Heclo (1974: 232-53), Esping-Andersen (1985: 108-9, 160-5) and Baldwin (1990: 212-23).

voluntarily save for retirement or to become covered by contractual occupational pensions (Salminen 1993: 204-5; Baldwin 1990: 222). By the mid-1950s, far more than half of Swedish white-collar workers could expect a contractual, employment-related pension (and all civil servants anyway) whereas those arrangements were less widespread among blue-collar workers (Salminen 1993: 217). It was the starting-point for the blue-collar worker union (LO) to demand equity which should be established by a mandatory earnings-related public scheme. The Social Democrats somewhat reluctantly adopted the LO demand while the bourgeois parties strongly opposed it and pleaded for the Beveridge model (see section 2.) instead — either a higher basic pension plus voluntary individual provision (Center Party) or topping up the people's pension with decentralized arrangements of occupational pensions negotiated between the social partners (Conservatives and Liberals, in line with employers' associations). The conflict between the two political blocs was not only about the statutory/voluntary issue, but rather, the central controversy was about the accumulating funds in a state-run scheme since, for macroeconomic reasons (maintaining a high national saving rate), it should not apply a strict PAYG principle. During a long period of maturation incoming contributions would exceed pension outlays as first full benefits would be paid not earlier than 1980. Placing these surpluses in public buffer funds provided the government with an enormous power to control the economy.

In the end, the Social Democrats prevailed over the bourgeois parties' opposition, and in 1959 a public earnings-related pension scheme (ATP) was enacted. The conflict about ATP-funds continued for some years after that decision (Heclo 1974: 248-52) and again played a role in the reform debate of the early 1990s, as did another feature of the ATP scheme, namely the benefit formula: a “full” pension accrued after 30 years of employment, and the benefit was based on an average of the 15 best years of earnings (up to a ceiling of pensionable income). This 15/30 rule favored those with a steeper lifetime earnings profile and put at a disadvantage others with a long working career and constantly low earnings. At the time of the reform controversy it was meant to particularly “bribe” the white-collar workers who were not much interested in the ATP issue but, in this way, gained most from its introduction.

Over and above this privilege, former inequalities continued persisting since white-collar worker unions successfully renegotiated contractual pensions immediately after ATP legislation was going into effect in 1960. The new defined-benefit (DB) scheme (ITP) extended coverage to all salaried employees but replaced a higher portion of former earnings for those above the ATP ceiling. For blue-collar workers a contractual pension scheme (STP) was set up not earlier than 1973. However, the attempt to catch up was only partly successful. In the end, by means of occupational pensions the earnings distribution was reproduced in old age (Salminen 1993: 223-8). The “structured complementarity of social and occupational pensions” (O'Higgins 1986: 123) was completed as pension plans for central (SPV) and local government employees (KPA) were coordinated with the ATP scheme as well. Despite the high target replacement ratio of

public benefits (60 per cent for workers with average earnings; factually it was dependent on real wage development prior to retirement – Palmer 2001: 187-8) occupational pensions were not “crowded out”. On the contrary, coverage became comprehensive (more than 90 per cent of the work force), and they played a considerable role within the retirement income package as they replaced about 10 per cent of final wages for those below the pensionable income ceiling and much higher rate for those above it.[18]

The statutory scheme evolved without *major* changes until the 1990s. Relevant to the topic of the paper were those of 1976 when retirement age was lowered from 67 to 65[19] and, at the same time, older workers were given flexibility to start drawing their basic as well as their earnings-related pension between age 60 and 70 with corresponding reductions or supplements. Furthermore, it became possible to take them out as “partial pensions” between age 61 and 65 (see above).

3.2.2 Shifting the Risks: Defined–Contribution Schemes All Over

In 1990 when the Swedish economy entered a deep crisis the report of a parliamentary commission on pensions (established in 1984) was published. It emphasized that the costs of the ATP scheme was strongly dependent on economic growth and vulnerable to further increases in longevity. Moreover, the report showed (again) the unfairness of the 15/30 rule to workers with a flat earnings profile and blue-collar workers of both sexes in particular (see Ståhlberg 1991).[20] Finally, the depletion of the ATP funds in future would endanger an adequate national saving rate. These ascertained problems were the starting-point of a pension reform group filled with experts from all seven parties in parliament. It was appointed by the new bourgeois government in 1991. Although the reform that emanated from the reform group's work was at least as radical as was the erection of a new pension edifice forty years before, it was incomparably less controversial. Right from the beginning, it was agreed upon that, even in the long run, a reformed pension system should not become more costly than it was in the early 1990s when the total contribution rate stood at about 18.5 per cent. Additionally, in order to make it politically

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[18] For details on the development of occupational pension schemes after 1960 see O'Higgins 1986: 113-23; Salminen 1993: 223-8; Kangas/Palme 1996; Wadensjö 1997; Palmer/Wadensjö 2004: 230-6.

[19] After 1960, occupational pensions usually started already at age 65, and lowering the statutory retirement age thus meant reduced spending on contractual schemes (Palmer/Wadensjö 2004: 235). To this day, older workers are prematurely laid off on these pensions very often, nowadays between age 60 and 64 (OECD 2003: 44, 64-5).

[20] At the same time, due to price-indexing of all parameters and the low ceiling on pensionable income more and more employees qualified for the maximum amount of pensions so that the link between contributions and benefits became increasingly weakened.

stable it was consented that all parties agreeing to the reform in the first place would have to support the refinements and any further amendments as well (Socialdepartementet/Riksförsakringsverket 2003: 24).

Central feature of the compromise between the four non-socialist parties and the Social Democrats was the transition of the ATP scheme into the by now famous *notional defined-contribution* system (NDC) which almost perfectly mimics a fully funded pension plan (FDC) and provides nearly as much choice for the participants (with regard to sharing pension rights between spouses, retirement age or withdrawal options), but also contains a number of its risks. The new scheme is based on *lifetime* accounts with benefits explicitly linked to contributions paid and individually calculated according to further cohort life expectancy at age 65 when actually taken out.[21] In NDC the accumulation of entitlements becomes transparent and thus creates stronger proprietory rights as well as a sense of actuarial fairness. While it thus minimizes distortions, pensions become *less predictable*: contributions yield an “interest” corresponding to the growth of per capita income subject to contributions, and when the accumulated (notional) pension wealth is converted into an “annuity” at the end of working life, the actual replacement ratio depends on cohort longevity. After retirement, again average wage growth determines the annual adjustment of benefits, i.e. whether the inflation rate is (more than) fully compensated or not. Finally, the new NDC scheme is designed to operate on a stable contribution rate of 16 per cent. If demographic and economic parameters will turn out less favorably than projected an “automatic balance mechanism” is triggered by which NDC pension wealth as well as actual pensions are temporarily indexed at a lower rate (Settergren 2001). In this way violating “property rights” may possibly become the Achilles heel of the NDC scheme.

Transforming the flat-rate basic pension into a *guarantee pension* that is tested against all benefits from the mandatory system (but not private or occupational pensions) is another important element of the reform and means a departure from Scandinavian universalism (Esping-Andersen 1999: 80, 88 n. 16; Palme et al. 2003: 120) that, about the same time, also happened in Finland and is proposed in Norway. It hardly made a difference for current beneficiaries in Sweden but changes the “character” (and perception) of earnings-related contributions: depending on the level of earnings, for a number of years contributions are paid “in vain” because they generate no entitlements beyond the “guarantee pension” and, if discontinuously employed, low-wage workers' entitlements will never exceed this level. This now tax-financed benefit (and its concomitant work disincentive effects) is expected to fade in importance since it is merely price-indexed and an increasing number of employees earn higher

[21] There is no intra-cohort redistribution *within* the NDC (and the FDC – see below) scheme, but rather, it occurs from external funding: contributions are actually paid out of general taxation and, consequently, pension rights are earned for years spent in higher education, military service and child care. Similarly, the social insurance schemes transfer contributions for other periods of non-employment (sickness, disability, unemployment).

income pensions (OECD 2003: 57-8).

2.5 percentage points of the total contribution rate (18.5 per cent) are channeled into individual pre-funded accounts for a *premium pension* (FDC). This partial privatization of the mandatory pension system was a most controversial issue, and battles of the 1950s were fought again. It was calculated that a contribution rate of 16.5 per cent (later revised to 16.0 per cent) to the NDC scheme would suffice to honor all earned entitlements, but future benefits were lower than hitherto provided by the ATP scheme. The bourgeois parties proposed to levy a compulsory rate not higher than 16.5 per cent and to leave the decision for higher pensions with the individuals. The Social Democrats demanded to stick to the present 18.5 per cent rate what would have meant an additional build-up of collective funds. The bourgeois parties rallied behind the position of not having public (pension) funds growing once again (although assets of the ATP buffer funds facilitate the transition to the new NDC scheme) since state-controlled funds and the potential impact on the market economy had been a matter of fierce political controversies – in the late 1950s (see above) as well as during the long struggle about the "wage-earner funds" starting in the late 1970s.[22] The political compromise was modeled after a DC supplement to the occupational pension scheme for white-collar workers (ITP-K) that started in the 1980s: an amount equal to 2 per cent of earnings can be placed with different fund managers chosen by the individual employee (Palme 2003: 150). A *mandatory* layer of funded pensions assuring adequate wage replacement satisfied the Social Democrats, whereas *private ownership* and *individual choice* served bourgeois parties' interests, while increased (forced) savings were a target of both political blocs. The outcome was a highly regulated but not very cost-efficient arrangement that allows individuals to choose up to a maximum of five from now more than 600 fund managers (and to move accounts between them without extra charges) or not to choose in which case the contributions are transferred to the publicly managed "default fund". This FDC part of the mandatory system offers a wide spectrum of options regarding the timing and form of withdrawal, but for reasons mentioned above (section 2.), ultimately pension wealth has to be annuitized (in a flexible or fixed variant regarding annual adjustment – for more details, see Turner 2004).

Both parts of the mandatory system offer much transparency for the participants. Annual statements explicitly show the "return" of contributions to the NDC accounts as well as of those to the premium pension accounts. This may possibly turn out as a politically risky strategy if

[22] Kangas/Palme 1996: 232-3 and 236; Palmer 2002a: 181 and 187-8; Lindbom 2001; Esping-Andersen 1985: 111-2 and 296-302 (on the wage-earner fund controversy) — The payment of contributions was another controversial issue within the working group. The Social Democrats defended the present employers' contributions while the bourgeois parties demanded a complete switchover to the employees. As it turned out that not even a 50-50 split of pension contributions between employers and employees was possible to administer without violating nobody's present net earnings, the bourgeois parties gave in and successfully demanded a higher contribution rate (2.5 instead of 2.0 per cent) to the premium pension (Lindbom 2001; Andersen/Meyer 2003: 47).

that part of the total contribution rate diverted to the pre-funded (FDC) accounts yields a (much) higher rate of return. Then people might ask why they should contribute to the less profitable public scheme at all or are not being allowed to shift a larger portion of their contributions away from it.

Due to the development of financial markets over the last years such comparisons meant no real threat, but rather, there was widespread disappointment at the poor performance of one's FDC account. However, according to one's choice of fund manager some fared better than others. Since the premium pension is part of the *mandatory* pension systems it is problematic that people with contributions of equal length and amount may end up with very different pension levels, depending on their skills as investors, individual risk aversion or simply luck. Diamond's (2002: 20-8) critique is not exactly to this aspect, but his proposal of a much more limited menu of investment options and prescribing less risky portfolios for people at higher ages would definitely reduce the possibility of such unequal results and also administrative costs since these are directly related to the extent of individual choice (see also Palmer 2002b: 59; Rødseth 2004: 363-9).[23]

When the government set up the working group on pension reform in 1991 it had learned from the inability of the former commission to agree upon any substantial policy change aiming at ascertained deficiencies of the old system because too many diverging societal and political interests were included. The government hoped to attain a compromise more easily and very soon if only party representatives participated in the negotiations and to fix the "basics" of the reform before a broad public debate developed. This strategy turned out successful, not the least because the pension issue "sailed" in the shadow of the unemployment problem which absorbed much more public attention. The framework legislation was approved by the *Riksdag* in June 1994, and the direction of reform remained irrevocable since the Social Democrats held on to it after they had taken over government again. Representatives of the five parties continued compromising on the complicated technical details in an "implementation group". Furthermore, the reform coalition used its joint bargaining power to fend off criticism particularly from the trade unions and the Ministry of Finance (worried about higher expenditure due to the new indexing rules), and the Social Democratic leadership successfully coped with protests from rank and file members. Finally, pushing through the reform between 1994 and 1998 was eased by the fact that the old system's unsustainability was universally accepted and, different from recent German pension reforms, it produced not only losers but also winners (or at least those who felt being treated more fairly now) (Anderson/Meyer 2003; Palme et al. 2003: 121).

The construction of the NDC scheme helped to avoid another potential controversy, namely raising "official" retirement age that was or still is an issue in France, Italy or Germany.

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[23] Administrative costs of one percent means that about 20 per cent of lifetime contributions will not generate pension benefits (Turner 2004).

The conversion factor is age-related and continually adjusted to cohort life expectancy. Therefore, no minimum retirement age is really required anymore. However, for not to impede economic growth due to early exit from the labor force, the NDC (as well as the premium) pension can be claimed at age 61 at earliest, but there is no upper limit for acquiring further entitlements from employment. Moreover, the right to remain at one's job was raised from 65 to 67 years of age.[24] In this way, the potential retiree enjoys extended freedom of choice and always pays an actuarial "price" for her decision *when* to claim the pension and *whether* to take it in full or combining employment with a partial benefit or to take out the NDC and the premium pension at different times (Ministry … 2002a: 32-3, 50-1; OECD 2003: 49-53). Internalizing the costs of retirement decisions discourages early exit, but it remains to be seen if deferred retirement is actually encouraged as there is still a strong preference for early exit (Pensionsforum 2003).

With the new public system phasing in after the year 2000, occupational pensions of the DB type could no longer stay as they were when being coordinated with the (old) ATP scheme on a "final pay" basis. Contractual pension schemes for the different categories of employees were renegotiated and shifted to pre-funded DC plans. For example, the revised STP plan for blue-collar workers provides that 3.5 per cent of earnings may be invested in a variety of funds, and there are several options for workers on how to arrange benefits and at what age they start. Similar choices exist for all public sector workers (at a rate between 3.5 and 4.5 per cent) but for those with high salaries a DB component was retained. White-collar employees were the first ones being granted those options (see above) but an agreement on a complete transition to DC pensions is still expected (Ministry … 2002a: 37-8; Palmer 2002b; Palmer/Wadensjö 2004: 241-5; Palme 2003: 161-2). Contributions to these renegotiated DC schemes are clearly withhold wages. Therefore, the demarcation between second (occupational) and third pillar (personal) pensions becomes increasingly blurred (even more than in Germany – see section 3.1).

Contractual and individual pensions become all the more relevant since public earnings-related benefits will be lower (without deferring one's retirement beyond age 65) and less predictable in future, and the pensionable income ceiling for the NDC scheme amounts to only 122 per cent of the wage of the "average production worker" (or 144 per cent of the median wage of the working population). Contributions to private (unit-link) insurance and individual retirement saving accounts are tax-deductible up to a ceiling. Withdrawals have to be phased over at least five years and must not start before reaching age 55. Already on the increase before 1990, thereafter those saving contracts became much more widespread,

[24] Age 65 remains a central chronological marker since contractual pensions are still related to it, and disability pensions are converted into old-age pensions at this age. Furthermore, the guarantee pension cannot be claimed before age 65 in order to prevent self-inflicted eligibility when one retires earlier with too low entitlements from the NDC and FDC scheme.

particularly among women and older workers. While in 1990 about 17 per cent of the working age population invested in private pensions, at the end of the decade this figure had climbed to 35 per cent (Palmer 2001: 191-9; Palme et al 2003: 67)[25], and many more have entered different saving arrangements (Pensionsforum 2003). The steep rise is partly due to the fact that the NDC scheme pays no widow's benefits for persons born after 1944, but it also shows a spontaneous reaction to anxieties about a lower level of public pensions in future.

In Sweden happened an almost complete transition towards DC pensions and as concomitants a clear trend towards a higher degree of pre-funding as well as a strengthening of private components within a now advanced multi-pillar approach. The overall transition towards FDC and NDC schemes inevitably shifts all risks incorporated in the respective plan (wage growth, performance of capital markets, increased life expectancy etc.) to the future retiree whereas the hitherto prevailing DB approach left all risks with the plan's sponsor (or, concretely, whoever currently contributes to the plan). DC schemes not only facilitate more individual choice, but increased risks for future retirees inevitably *require* extended options in order to respond to them according to individual preferences.

3.3 Finland

3.3.1 A Different Route to Earnings-Related Pensions: Consensual and Privately Administered

In Finland and Norway the counterparts of collective actors which lost out in the Swedish ATP struggle – the non-socialist political parties and the employers' association – learned from that experience. They took up a different stance or changed to a more “accommodating” position and thereby avoided similar setbacks (Salminen 1993: 234, 248, 285, 289-93, 295-7, 375).

By the end of the 1950s, Finland was the least industrialized Scandinavian country and, correspondingly, farmers and (small) self-employed *viz.* their representatives (foremost the Agrarian party) had a large influence in the political sphere. Earnings-related pensions were no central topic on the political agenda after national pensions had been reformed in 1956 and now consisted of a low universal flat-rate pension with an income-tested supplement on top (Salminen 1993: 188-91). The breakthrough for earnings-related pensions came about by collective agreement among social partners. It was limited to the largest group of employees, the permanent workers in the private sector, and confirmed by a corresponding pension act (TEL) in 1961 which was initiated by the Social Democrats backed by the Conservative party. The

[25] In 2002, it had risen to 40 per cent (population between 20 and 64 years of age), and more women (44.3 per cent) than men (35.8 per cent) saved for personal pensions. However, the average amount that was put aside (in 2002: SEK 6,100 = about EUR 670) was on the decline (calculated with database of Statistics Sweden).

erection of the TEL scheme and a separate one for temporary workers (LEL) at the same time paved the way for other occupational categories to be included in special schemes so that in the end the whole economically active population became mandatorily covered. The *decentralized*, occupationally segregated system of altogether nine statutory schemes is *partially pre-funded*[26] but, different from Sweden, it is *privately administered* through financial institutions (insurance companies and pension funds), offering considerable choice (*and* control over investment capital) for individual *employers*. In view of Swedish employers' defeat, this feature willingly conceded by the trade unions made private-sector employers less intransigent to earnings-related pensions they alone paid for (until 1993).

Another difference to Sweden's ATP scheme is most relevant for the topic of this paper: in Finland, right from the beginning, there was no ceiling on pensionable income and benefits (and, hence, not on contributions as well). Thus, also high-income earners could attain the target replacement ratio of 60 per cent after 40 years of employment, and until the 1990s the two best out of the last four years prior to retirement determined the benefit amount.[27] In this way, previously not very widespread occupational pensions were factually crowded out or replaced and play no great role so far as do personal pensions (Hinrichs/Kangas 2003: 584-5; see also Ministry … 2002b; Hietaniemi/Vidlund 2003).

3.3.2 Limited Freedom of Choice: Flexible Retirement Age

Compared to the other Scandinavian countries, in Finland the employment rate in the upper age-brackets and, connected to it, the factual retirement age have dropped much farther. Presently, both figures stand at about the same level as in (West) Germany (OECD 2003: 35, 54). Since routes into early retirement had been extended in the mid-1980s and Finland became confronted with extremely high unemployment in the early 1990s, most elderly workers leave the labor market before reaching age 65, and particularly the inflow into disability pensions is still extremely high (OECD 2004a: 39-43, 57-8, 63-73; Gould/Saurama 2004; Hytti 2004). Early exit of cohorts with, on average, low formal qualification helped to "rejuvenate" the work force and ameliorated the overall skill level. Mostly, retiring early was an attractive option for older workers but a costly one for the pension system. Moreover, since demographic aging proceeds more rapidly than in other Scandinavian countries, *the* major objective of Finnish

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[26] The scheme for state employees has always operated on PAYG financing.

[27] The schemes for municipal and state employees (introduced in 1964 and 1966 respectively) provided a replacement rate of 66 per cent after 30 years of service already at age 63. In 1993 these privileges were abolished, but very generous "grandfather clauses" apply. These provisions and that municipal workers got a say in pension fund administration took the edge of potential protests.

pension reforms was thus to attain a higher factual retirement age in order to prevent labor shortages and to achieve higher economic growth. In fact, deferred retirement yields a double dividend as employees contribute to the system (and to economic output) for more years and receive their pensions for a shorter period. The issue of *individual choice* is thus mainly related to pathways into and the timing of retirement. The reforms left the central role of the semi-public mandatory scheme for providing retirement income unchanged and only indirectly affected voluntary occupational and private pensions. Therefore, the Finnish "story" is also much shorter than the Swedish one.

The most significant step of a series of reforms that started in 1993 came about in autumn 2002 when the labor market organizations in the *private sector* finally agreed upon a detailed package of changes. Like in 1961, it was based on recommendations of an expert committee[28], subsequently translated into legislation and in July 2004 it was followed up by similar changes in the schemes covering employees in the *public sector*. Its main element reinforces changes of 1996 that aimed at more actuarial fairness: average *lifetime earnings* will determine benefits when the new formula takes effect between 2005 and 2011. However, the link is not straightforward for two reasons. Entitlements earned between age 18 and 52 accrue at a rate of 1.5 per cent, from age 53 onwards it is 1.9 per cent and between 63 and 68 years of age a "super" accrual rate of 4.5 per cent applies. Moreover, career earnings are revalued by a "bent index" that gives changes in the wage level a weight of only 80 per cent and consumer prices a weight of 20 per cent.

The "reference" retirement age will be 63 years when an old-age pension may be claimed. It is calculated according to the accrued rights. Continuing employment after that age accelerates entitlements because the period of pension receipt is reduced and additional credits are earned.[29] Therefore, the ceiling on the replacement ratio (hitherto 60 per cent at maximum) is lifted and, theoretically, an individual who was continuously employed from age 18 until age 68 (thereafter no more credits can be earned) may end up with a pension that replaces 94 per cent of her average career earnings. While (like in Sweden and Germany) taking into account the complete employment history makes the scheme more equitable to those with a flat lifetime earnings profile, the age-dependent progressive accrual rate nevertheless maintains privileges of white-collar employees since they have a better chance of working longer than manual workers.

The somewhat ambitious objective of the reform is to raise *factual* retirement age by

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[28] In fact, the committee consisted of only one person (Kari Puro) who negotiated the recommended changes with the social partners, political parties and further stakeholders.

[29] Framed that way, the pension increment emanating from the "super" accrual rate thus appears more attractive to older workers who consider retirement after reaching age 63 than it actually is. If first pension receipt is postponed from age 63 to age 68 the replacement ratio increases by 22.5 per cent in Finland whereas it rises by about one third in Sweden (Palmer 2002a: 184).

about 2 to 3 years[30] and thus to stabilize the (average) total contribution rate at about 26 per cent in the long run (in 2003 it stood at 21.4 per cent of which 16.8 per cent were paid by the employers and 4.6 per cent by the employees – Hietaniemi/Vidlund 2003: 74, 104-5). By means of the progressive accrual rate older workers are encouraged to make use of flexible retirement at a later age. An old-age pension may be obtained at age 62 at earliest but it will imply a permanent deduction of 7.2 per cent (or: 0.6 per cent per month), and access to other benefit types which hitherto facilitated early exit was further restricted (part-time pensions, becoming available at age 58 instead of 56) or will phase out completely (individual early old-age and unemployment pensions – OECD 2004a: 76-8). Due to the progressive accrual rate individual choice is a "guided" one, and such discretion on whether to retire (or to take out a part-time pension after age 58) or to continue working is the only choice the Finnish core pension scheme provides.

Additionally, Finnish pension reform includes two "policy transfers" from Sweden: (1) Pension credits are earned for periods of sickness, unemployment, study and child care. (2) Beginning in 2010, a life expectancy coefficient will prevent an implicit expansion of the system when old-age mortality is further declining. Those eligible for an old-age pension may offset a lower benefit by working longer.

Finnish pension reform occurred as a piecemeal process with a considerable cumulative impact. It nevertheless proceeded in a very peaceful manner. Even the break with universalism in 1996 – abolition of the basic pension[31] – passed without conflict. A major reason for the smooth development of the Finnish earnings-related pension system may be that – although covered by comprehensive legislation – it is the least "statist" one among the four countries in question. The willingness of the social partners to compromise on reforming "their" scheme largely rendered government intervention unnecessary, albeit the government was involved in tripartite negotiations and maintained a stake in the reform process when it came to tax money (contributions for periods of child care and study) or protecting certain beneficiaries (indexing of disability pensions). Party politics played almost no role, rather, tensions were strongest among trade unions when organizations of white-collar employees and academic professionals tried to defend their traditional privileges but eventually gave in. Partial pre-funding of the system (which will be increased over the next decades) excluded (further) privatization as a

[30] The improved labor market situation and effects of measures against early retirement taken during the 1990s have already reversed the downward trend in employment rates of people between 55 and 64 years of age (OECD 2004a: 41; Gould/Saurama 2004).

[31] It was transformed into a guarantee pension that is tested against other pension income. In case of eligibility it is paid at age 65. The guarantee pension will play a decreasing role since the earnings-related pension scheme is fully matured and the increasing employment rate ensures sufficient entitlements for the large majority of pensioners. However, incentives for low-wage laborers (with a discontinuous career) to stay on at work after age 65 (or 63) remain weak although accruals on earnings-related pensions after reaching age 63 are disregarded when eligibility for the guarantee pension is determined (Ministry … 2002b).

strategic (or: ideological) element of reforms meant to keep the pension system sustainable.

Since pension reform in Finland implied no risk-shifting (beyond the life expectancy coefficient) and no lower benefits (if working longer), choice is related to supplementary *private pensions* that mainly bolster the consequences of individual retirement decisions in the mandatory system. They are not an integrated component of the Finnish pension system, nor are employer-based pensions which are a voluntarily offered fringe benefit (apart from a few industry-wide arrangements). Due to the relatively high replacement ratio of TEL and other schemes' benefits for all income groups, *occupational pensions* are not "closing a gap", but rather, function as an "extra". The number of covered workers has declined to a low level (Hietaniemi/Vidlund 2003: 109-10). It is conceivable that occupational pensions will spread wider in future when, in view of labor shortages, employers utilize them as an incentive for recruiting personnel, particularly, white-collar employees who will partly loose out from the new benefit formula (Hinrichs/Kangas 2003: 587). Already on a steep increase are private pensions. Younger birth cohorts take out those tax-deductible policies most frequently. At the end of 2002, about 12 per cent of the working-age population paid into personal pension schemes (Hietaniemi/Vidlund 2003: 115-6, 123). Like in Sweden, two motivations stand out: although confidence in the core system has improved (Ministry … 2002b) there is some mistrust whether the actual pension level will turn out to be as high as expected ("just in case …"). A supplementary personal pension would then fill a potential gap. As an alternative to such precautionary saving, the accrual of a personal pension scheme is designated to compensate for a benefit deduction when one retires at the preferred age or on a part-time pension, i.e. serves to "buy an extra year of retirement". Insofar, increased freedom of choice with regard to the retirement age "crowds in" private pensions to some extent, and individual decisions about the respective financial market products go along with the usual inherent risks.

3.4 Norway

3.4.1 Folketrygden – the Norwegian Version of ATP

At the end of the 1950s, when about two in three Norwegian wager earners were either covered by earnings-related (white-collar and public sector employees) or flat-rate pensions (blue-collar workers) over and above the national basic pension, the constellation of collective actors approving or opposing public supplementary pensions was somewhat different than in Sweden. The Liberal and the Christian People's Party were the main protagonists. The trade union (LO) was in favor of expanding contractual pensions, and the majority within the Social Democratic party was inclined to that position as well. The Conservatives and the Center Party proposed voluntary individual pensions on top of increased basic security. In the course of the reform

struggle that never became as controversial as in Sweden, the Social Democrats tactically changed position and subsequently opted for a statutory scheme closely resembling the Swedish ATP model, and previous opponents went along with a more "meager" version of it in order to avoid a complete defeat. Thus, the stands of the labor market organizations and political parties on this issue largely converged, and in 1966 all parties supported the introduction of *Folketrygden* when a bourgeois government held office. However, the Conservatives succeeded in the fund question: the scheme should be close to PAYG so that no substantial assets were accumulated in the National Insurance Fund. Indeed, after 1979 contribution revenue was no longer used to increase the fund's assets. Merely interest yields kept it growing afterwards (Salminen 1993: 281-99, 324-33; Øverbye 2001).

The earnings-related scheme (in the following: *FT* pensions) covers all gainfully employed. It provides "full" benefits after 40 years of insurance (including periods of care for children or other needy persons) which are calculated on the basis of best 20 income years. The ceiling on pensionable income is comparatively low. Since 1992, when a first attempt was made to contain the long-term cost of scheme, full account is taken of income up to about the average wage, and earnings up to two times that level produce additional entitlements of only one third. The reform also included a reduction of the factor by which accrued pension points are multiplied from 45 to 42 per cent so that an average worker may attain a maximum wage replacement of about 55 per cent (earnings twice the average: about 33 per cent). The changes of 1992 compress (or: flatten) the distribution of public pensions and increase the "pension gap" for all employees with above-average earnings (Pensjonskommisjonen 2002: 86-7).

Among the Scandinavian countries only Iceland and Norway have maintained a statutory retirement age of 67. Apart from being employed in certain occupations (like police, firemen etc.) or being a state employee, until 1988 the award of a disability pension was the only pathway into earlier retirement. Afterwards, the AFP (*Avtalefestet pensjonsordning*) scheme "opened the door" for flexible early retirement. Since 1998 it can be drawn after reaching age 62. This publicly subsidized scheme is based upon agreements between the social partners, covering about 60 per cent of employees (a higher percentage in the upper age brackets – Midtsundstad 2004). Originally, AFP was intended to offer long-tenured worn-out workers a decent way to terminate employment without cutbacks on their subsequent old-age pensions. These incentives made the scheme most popular also for healthy workers in less strenuous jobs. AFP has thus not affected the high recipiency rate of disability pensions, but voluntarily retiring on AFP benefits (or sometimes pushed by employers as well) contributed to the considerable fall in effective retirement ages. Nevertheless, the employment rate in the upper age brackets is still well above the OECD average (Røed/Haugen 2003; NOU 2004: 177-81; OECD 2004b: 45, 57-9, 67-72).

Due to the comparatively low wage replacement provided by the (still maturing) public pension scheme the demand for occupational pensions should have been large but, factually,

coverage is far from complete (for the reasons see Øverbye 1998: 178-80). All public-sector employees can expect a total pension (including *FT* benefits) amounting to 66 per cent of their final wages. At the end of the 1990s, between only 34 and 54 per cent of private-sector workers – depending on the data source – were covered by single-employer plans. Until 2001 only DB-type pension were permitted, and in order to enjoy tax privileges they (and personal pension plans as well) still must not pay benefits before age 67. Regularly, those plans are arranged with the private insurance industry and guarantee a final-wage replacement between 59 and 70 per cent after 30 years of service (Pedersen 2000; NOU 2004: 247-51). As a means to increase coverage particularly in low-wage sectors, since 2001 also DC schemes are allowed. They offer employees some choice on investment alternatives (Pensjonskommisjonen 2002: 90-1). Although quite numerous and on the increase, contracts for private (3rd pillar) pensions play no large role within Norway's retirement income system so far since the amounts placed in individual accounts are quite low on average. More important are other, mostly non-tax-privileged sources, like payments out of life insurance, savings or the cash value of homeownership.

So far, individual choice is largely – and not even for all employees – restricted to the timing of retirement after age 62. There was obviously a demand on part of elderly workers for flexible and preferably early retirement as offered by the AFP scheme. Due to its popularity it should be complicated to again “close the door” or, at lest, to restrict the financially attractive conditions.

3.4.2 The Forthcoming Pension Reform: Emulating the Swedes Again?

Demographic aging will not spare Norway but is expected to be more moderate than in Finland or Germany. Moreover, because the public pension system is presently less generous expenditures are lower as well, and Norway is in the fortunate situation to earmark the considerable National Insurance Fund and (part of) the Petroleum Fund for future pension financing. Nevertheless, these funds will be insufficient to cope with the steep increase in the GDP ratio of pension expenditure over the next decades (Pensjonskommisjonen 2002: 19-27, NOU 2004: 15-7, 45-65). Despite less urgency to reform the pension system, concerns about its long-term sustainability and future labor shortages aggravated by a decreased effective retirement age led the government to appoint a commission in spring of 2001. In order to achieve a consented reform package close to final legislation the commission was composed of representatives from all parties in parliament (and a few experts) whereas other actors in the pension policy arena (social partners, financial service industry) were confined to an advisory board or will be heard later. Insofar, the Swedish example of bringing about a compromise on

pension reform was imitated (see above, section 3.2.).[32] There was an (informal) understanding that an aspired compromise should at least be supported by the Social Democrats, the Conservative, Christian, Center and Liberal Party to put political weight on the proposals in the subsequent legislative process.

The political parties had developed quite different positions on how to reform the Norwegian pension system before the commission commenced (Ervik 2001: 28-36), and in its interim report (Pensjonskommisjonen 2002) two extreme alternatives were considered. The strongest proponents of the "back to basics" approach were the Progress Party, a large fraction within the Conservative Party and, to some extent, also the Center Party. It meant maintaining a tax-financed universal flat-rate pension of about the present level to be topped up with voluntary contractual and individual pension provision – largely identical with the Beveridge concept (see section 2.). State earnings-related pensions would phase out gradually. This alternative was not identical with the Conservative Party's program (Ervik 2001: 33), but strengthening private ownership and investment choice for the individual was a central issue for the party in general. For the Progress Party (and the Socialist Left as well) holding fast to a generous universal pension was most important (the already considerable increase in 1998 and change to wage indexing was largely due to the Progress Party's pressure). The second alternative the commission investigated was a modernized version of the *FT* scheme that heavily borrows from the recent Swedish reform, increases pre-funding, and possibly includes further arrangements for pensions that provide *individual ownership* and *freedom of choice* (Pensjonskommisjonen 2002: 68-9). The recommendations presented in the commission's final report (NOU 2004) are based on the second alternative.

The reform is scheduled to go into effect by 2010 and will fully affect cohorts born 1965 and later. It is expected to deliver savings of about 20 per cent compared to a continuation of the present system. When calculating the pension the complete employment career will be taken into account so as to abolish inequities resulting from a different distribution of the same lifetime income under the present 20/40 years rule and to reward employment of more than 40 years (NOU 2004: 72-5). The strict link between income subject to contributions (up to a ceiling of 8 times the base amount = about 133 per cent of average wages) and pensions will be attained by an accrual rate of 1,25 per cent p.a. so that a person who had been employed 43 years (from age 24 to 67) will have been replaced 54 per cent of her former earnings.[33] Standard retirement age will remain at 67 years. The minimum pension cannot be claimed earlier but the earnings-related pension may be drawn after reaching age 62. In the long-run, corresponding

[32] Two previous commissions – one on early exit, the other on pension financing – had not been able to present straightforward recommendations and thus failed to initiate legislative action (see Ervik 2001: 36-46).

[33] Credits for periods of taking care of children, sick and disabled persons, already in place since 1992, will be given a increased value of at least 75 per cent of average earnings.

deductions will become fully actuarial. As before, additional entitlements can be earned until age 70. Thus, Norwegian workers will be given the option to individually choose their retirement age within an interval of eight years. However, it pays off to stay on working at least until age 67 because initial pension payments will be adjusted according to remaining life expectancy (at age 67) for one's cohort.

In order to actually attain a high effective retirement age it is proposed that the government should no longer participate in the financing of the AFP scheme. This proposal is most contested because it would render the scheme either more costly for employers or less attractive for potential claimants. Although the modernized scheme would not resemble to the Swedish NDC approach, occupational pensions based on final pay and coordinated with public benefits had to be adapted. It is proposed to transform them into a clear supplement to public pensions. Therefore, the scheme for state employees has to be pre-funded as well. Finally, the Petroleum and the National Insurance fund will be merged into a Government Pension Fund that is going to work as a buffer when expenditures cannot be completely met out of contributions revenues (out of a stable rate of 17.5 per cent, equally shared between employers and employees).

A majority within the commission supports the proposals mentioned before although the details of some elements have not been finally settled. Unsurprisingly, on the conversion of the universal basic pension into a "guarantee pension" there were minority votes from the representatives of the Progress Party and the Socialist Left. Both wanted to retain it (NOU 2004: 25-7, 159-69), and there are indeed some considering arguments for sticking to a universal basic pension (Pensjonskommisjonen 2002: 41-5; Pedersen 2002; see above, section 2.). There was another minority vote on mandatory contributions to individual accounts offering investment choices (comparable to the Swedish premium pensions – see above), either diverted from the 17.5 per cent contribution rate or on top of it. The representatives of the Conservative, Christian, Liberal and Center Party pleaded for this component (NOU 2004: 233-45). Although they do not particularly emphasize principled arguments (ownership or freedom of choice), for the Conservatives at least, the inclusion of individual accounts was a *conditio sine qua non* to agree to any reform package. However, it should be more difficult to defend this position after the year 2001 when pre-funded schemes have not continued to deliver stable and comparatively higher returns. In contrast, representatives of the Left parties took a minority position with regard to a mandate on occupational pensions as lever to cover workers (particularly in low-wage, female-dominated sectors) who are excluded so far (NOU 2004: 273-4).[34]

It remains to be seen whether there will be a smooth legislation of the commission's

[34] Most likely, this issue will become less salient and settled before passing the reform package after both social partners in the manufacturing industry have agreed upon mandatory occupational pensions and in April 2004 jointly asked the government to take legislative action. The government promised to come forward with a bill in parliament in autumn of 2004.

recommendations during the second half of this decade after they have passed the usual parliamentary procedures and the public debate. Opposition on part of those interest groups whose constituency will loose out (or want to gain more) sprang up immediately after the report was disclosed. Compared to the timing of the Swedish pension reform, in Norway at present no other salient political issues distract much attention. Moreover, despite some dissatisfaction, *Folketrygden* as it stands is very popular and obviously not on the brink of collapse. Without a universally perceived urgency of reform and no early framework legislation (like in Sweden) the chances to attain a compromise may possibly vanish. Before the commission finished its work the assessment prevailed that if there was no "oversized majority" in parliament – possibly leaving out the Progress Party and the Socialist Left – no comprehensive reform would be enacted. In that case, the implementation of a "lean version", containing lower benefits, increased pre-funding and a flexible retirement age, was considered as most likely. Both ways, there will be more individual choice over the timing of retirement age.

4 Enlarging Freedom of Choice: Comparative Evaluation of Reasons, Risks and Outcomes

The rationales for a public earnings-related pension scheme discussed at the end of section 2. have played a major role in the politics of pension reform during the late 1950s and early 1960s and, to a large extent, they explain why this type of old-age provision became the core scheme in the four countries in question and elsewhere. In the following, the commonalities and differences of recent (or forthcoming) changes in these schemes and new additions to them, as far as increased freedom of choice in concerned, are analyzed. Then the potential risks of enlarged individual options are looked upon. Next, new demands put on individuals are discussed, and finally the (potential) distributive impact of the reformed pension systems is evaluated.

4.1 New Pension Politics and Path Dependence

During the mid-/late-1950 there were broad similarities in Germany and the three Nordic countries in the political debate about pension reform. The central issue was to ensure adequate income maintenance for *all* employees. Again, at the turn of the century the themes are similar: structural reform in order to stabilize pension systems in view of imminent demographic aging. Corresponding political attempts are characterized as the "new politics" of the welfare state which is argued to be a distinct political exercise: Goals have shifted – from expansion to retrenchment – and the context is different due to the constituencies that have developed in line

with respective welfare institutions (Pierson 1994, 1996). The common objective of pension reforms concluded in Sweden, Germany and Finland or underway in Norway clearly was to contain the future increase in public spending by various means. However, of all social security institutions it is the pension system that is most prone to path-dependent development since it bridges long time spans and thus implies strong policy legacies (Hinrichs 2004). It is not always easy to decide whether a path departure (or: “system shift”) has actually taken place. Whereas such a claim may be contestable for the Finnish case (Hinrichs/Kangas 2003), it is undeniably true for the reforms in Sweden and Germany (in Norway it should be contingent upon including DC components in the final reform package). In Sweden, path departure meant an *extension* of the multi-pillar approach in a system that now completely consists of DC components. In Germany, it was a *turning* to a multi-pillar approach since the still prevailing public scheme will no longer provide status maintenance after retirement. The policy changes in both Sweden and Germany followed from a shift of the relevant *policy paradigm* that combines goals and techniques within an intellectual framework of interpreting the rationales for a policy and defining its problems (Hall 1993).

In these two countries with the most far-reaching changes, “old politics” actors (foremost the social partners) were pushed back and treated as interest groups among others. In contrast, *expert commissions*, defining the problems and proposing concrete solutions based on knowledge, and *political parties* gained a stronger role in the reform process. The formal exclusion of the labor market organizations from a first attempt of compromise building in Norway's pension commission largely confirms this observation. Here and in Sweden and Germany as well they retained influence via their overlaps with respective political parties. Such rearrangement of the actor constellation and departure from corporatist pension policy was definitely not true for the Finnish reforms. As a result of the original institutional setup the social partners kept a pivotal grip on “their scheme” as against the parliament or individual political parties. In Sweden and, to a lesser extent, in Norway and Germany “old conflicts” about collective funds versus privately owned accounts comprising choice reappeared in the reform struggle. “New conflicts” have arisen in Sweden and even more so in Germany since *regulation* of newly established private pillars has become an issue in order to protect contributors. Thereby, new actors, namely the financial service industry and consumer organizations, have entered the arena of pension politics. In Norway, as yet this issue has not been settled. A broadly supported compromise was attained in Sweden and Finland, and pension reform is largely (Finland) or completely (Sweden) off the agenda by now. In contrast, the German reform process remains a “never ending story”, increasingly disputed and dominated by party politics, while in Norway the story has not really begun and it remains to be seen whether a reform consensus will come about at all.

In Sweden, Germany and Finland, governments led by Social Democrats have eventually carried out the major reforms. It remains somewhat unclear what these parties' imprint actually

was – at least in Sweden and Germany where the reforms have departed from central features hitherto characterizing a conservative or Social Democratic “pension regime”, namely a high level of public benefits securing adequate retirement income. Obviously, in the latter two countries the élite of the respective Social Democratic Party has upgraded values like individual responsibility/initiative and freedom (of choice) at the expense of hitherto upheld values like solidarity and social justice (Germany) or, additionally, was prepared to accept a corresponding rearrangement for the sake of a compromise (Sweden). Such shift fits into the overall move from simply *protecting* citizens against market forces (while at or outside work) to *enabling* them to succeed in markets of all kind. In contrast, Finnish pension reform was not accompanied by such frame shift whereas in Norway the Social Democrats seem to be more intransigent towards demands for more individual choice.

The central idea of active citizenship is to return decision-making to the discretion of the people and to enable them to take individual responsibility. For (Neo-)Liberals increased freedom of choice as a welfare enhancing device has always been a most central tenet. The Swedish non-socialist government that took office in 1991 proclaimed a “freedom-of-choice revolution in the welfare system” (Palme et al. 2003: 82), but outspokenly libertarian arguments that are most influential in the U.S. American debate about “privatizing” Social Security (Weaver 2003) were neither prevalent in Sweden nor in Germany (and, so far, in Norway). Enlarged self-responsibility with regard to newly established individual accounts (variants of the *Riester-Rente* in Germany or concerning the premium pension and adjusted occupational pension schemes in Sweden) were foremost an inevitable consequence of the respective route of reform that followed from the specific legacy of the systems and the politics clung to them. Individual accounts in Sweden and Germany came about as a by-product of *public* pension reforms aimed at financial viability, intergenerational equity or economic competitiveness and were meant to compensate for an arising benefit gap. Pensions accruing are of the DC type and thus shift all risks and true property rights to (prospective) pensioners. Therefore, they *have* to be given individual choice with regard to their privately owned assets in order to minimize the risks involved in such type of provision for old age or to act according to one's degree of risk aversion. Obviously, enlarging the range of choice did not address a strong demand for variety “from below”, and the spreading of voluntary retirement saving was more or less a spontaneous reaction to an expected decrease of public pensions. The converse is true for the timing of retirement. In all four countries demands for flexibility were strong, and options provided to older workers were mainly utilized to exit employment as early as possible. The extension of flexible retirement in recent reforms, however, exactly aspires the opposite, namely to raise factual retirement age.

4.2 New Risks – New Options

It is a central goal of pension schemes that benefits are predictable and maintain their value during retirement. Public PAYG schemes may not always live up to this goal due to political rule instability. However, policy changes in view of an altered economic or demographic environment regularly exempt those age groups too old to accommodate or changes are phased in gradually. Conversely, private pre-funded schemes face (financial) market risks which may hit without prior warning and mess up even careful retirement planning. In general, one can distinguish three types of market risks, relevant at different stages of the life course (see also section 2.1.).

First, there is an *investment risk*. Accumulated contributions plus accrued interests and other re-/devaluation (asset prices) determine the amount that is available as a lump sum or for conversion into an annuity at the end of working life. The actual result is contingent upon the management of the pension fund (and the respective administrative charges), the portfolio chosen and the performance of financial markets during the accumulation period. When the introduction of a supplementary private pillar was politically debated in Sweden and Germany, it was perceived as an appealing option since financial markets provided high and stable returns, i.e. better value than for contributions to public pension schemes. The substantial decline of stock prices has however proven that financial market risks are real and may have made the benefit of “ownership” a less pleasant experience for many contributors. Still, mainstream economists argue in favor of private, pre-funded components for the sake of better diversifying political and market risks (see e.g. OECD 2001: 106, 109-10).

Second, an *annuity risk* emerges exactly at the timing of retirement. The interest rate valid then and, additionally, the mortality rates on which the insurers' calculations are based on determine the price of an annuity. Fluctuating annuity prices mean different intercohort levels of security and are adverse to the objective of predictable pensions.

Third, post-retirement *inflation risk* becomes all the more important as still improving longevity of pensioners implies a longer period of benefit receipt. Even a low inflation rate will have reduced the purchasing power of a level annuity considerably after 15 years. An index-linked annuity copes with a predetermined inflation rate, but is much lower in the beginning and nevertheless decouples the pensioner from improved living standards of the working population (Rødseth 2004: 370-5).

Within the new architecture of pension systems in Sweden, Germany and (possibly) Norway, the actual occurrence of the aforementioned risks does not mean that (future) pensioners will fall into an abyss. Due to the still strong role of the respective public schemes and effective vehicles preventing poverty, mostly, the potential loss should not be dramatic. However, (risen) expectations of financial security in old age may not be met and consumption plans will fail. Arising disappointment could then become a problem for governments (or social partners) which compel or strongly encourage employees to contribute to private pensions that

turn out to be bad investments.

Choosing one's retirement within a given age interval and in view of the financial consequences means a complex decision (even more so when both spouses are employed) that may still hold some negative surprises after the process has been completed. However, among individual options that have been enlarged, those concerning a flexible retirement age appear to be least risky and, at the same time, immediately welfare-improving since the range of choice about the time path of consumption smoothing is increased. This welfare argument holds true as long as individual agency is truly unconstrained. In Finland, Sweden and Germany the departure from a schematic tripartion of the life course was continued despite several pathways into early retirement being closed or systematized. Hitherto existing opportunities for premature exit were meant to hide open unemployment among older workers and/or to facilitate a decent termination of working life for worn-out but not completely invalid employees. In contrast, the incentives going along with extended options to individually determine one's (full) exit from employment are meant to achieve just the opposite, namely to break up an established early retirement culture and to make employment until statutory retirement age or even beyond more attractive. Insofar, they provide a kind of “guided choice” since the “implicit tax” on prolonged employment is lowered and the consequences of individual choice are intensified. Thereby, at least in Sweden and Finland, the unpopular issue of raising *standard* retirement age has become depolitized.

4.3 New Demands on Citizens

Mandatory membership in public pension schemes and, additionally, in occupational pension plans – almost universal in Sweden, more selective in Germany and Norway – has largely relieved employees from retirement planning and the need to assess risks mentioned in the section before. A structural shift from those schemes providing DB-type benefits towards an enlarged role of private, DC-type components increases the demand for *individual risk management* or “do-it-yourself social policy” (Klein/Millar 1995). Changes in pension policy which imply a transfer of responsibility and thus demand individual initiative are to a lesser extent attempts to strengthen “active citizenship”, but rather refer to citizens as *active* and *knowledgeable consumers* responsible for their well-being, regardless of the rationales for those changes (inevitable concomitants of respective pension reforms or ideological predisposition of key actors). Shifting risks back to citizens and consequently offering them more choice does not automatically guarantee that emerging (though regulated) welfare markets will produce appropriately active consumers, able to cope with those risks in a rational way and, at the same

time, retaining their trust in those markets (Taylor-Gooby 1999).[35] Such a rational approach to consumer choice suffers from serious human limitations of which three closely interrelated kinds are most central: *financial illiteracy*, *procrastination* and *short time h*orizon.

In the United Kingdom, private pension components play a much larger role than in the Nordic countries or Germany, and the government is keen to remove the obstacles to informed retirement planning that have been ascertained time and again in quantitative and qualitative studies (Department for Work and Pensions 2004). Therefore, in addition to research results from Sweden and Germany studies from the UK are taken into account because the main findings are largely the same all over.

Pensions are complex products, and individual retirement planning gets more complicated the more the income package in old age will consist of different components over which considerable scope of agency exist during the life course. *Knowledge* thus becomes all the more important, but even public schemes are incomprehensible to the ordinary citizen. For example, less than 40 per cent of respondents in a recent Swedish survey reported that they had "good knowledge" about the reformed (NDC) system, and about one third did not at all care about the information received (Sundén 2003). Very often, people overestimate their future entitlements to public pensions and neglect the cumulative impact of previous retrenchments (Deutsches Institut für Altersvorsorge 1999; Leinert 2003). Such misjudgement is most prevalent among workers with low and average earnings while, at the same time, they underestimate their income needs in old age and thus abstain from taking appropriate action (Rowlingson 2002; Financial Services Authority 2002). Unfortunately, private pensions are even more complicated and require broad *financial literacy* in order to make informed choices. However, those skills are largely lacking. In a UK government document various findings are summarized as follows: "Few people really understand pensions. Few know about their own provision and the action they need to take to improve it" (Department of Social Security 1998: 27; for Germany see Leinert 2004). Results from recent surveys in the UK demonstrate that such knowledge not much improved over time and, hardly surprising, it directly increases with income or education (Mayhew 2003: 73-93). More information provided by public or private pension carriers (including statements on individual accounts and prospective benefits) can be helpful but is of little relevance unless the core logic and financial principles of pensions are understood, but "most people do not have this understanding and cannot therefore effectively process or evaluate the information they are given" (Vickerstaff et al. 2004: 16).

Pension planning and acquiring the appropriate knowledge is hardly an interesting subject at all. Rather, it is time-consuming and a source of anticipated regret for not having taken the best choice (Loewenstein 2000). For most people it is thus an unpleasant exercise

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[35] No further attention will be paid to potential repercussions on the citizens' acceptance of mutual obligations presupposed in welfare state institutions when expectations on self-interested individual risk management are heightened.

which one prefers to postpone in favor of currently more "important" or more satisfying activities, especially if decisions are at stake that only become important years or even decades from now.[36] Such *procrastination* shows up in inertia based upon the false belief that acting later will produce no other result than acting now. Another common expression of procrastination is a status quo bias: Once an active choice has been made one sticks to it and almost never searches for more beneficial alternatives (Thaler/Benartzi 2004: 167-8; Cronqvist/Thaler 2004: 427). With regard to the FDC accounts (or the new DC-type occupational pensions) in Sweden, inertia is not extremely harmful since, due to (quasi-)mandatory participation, there is always the default option which, however, is not individually optimized. A recent Swedish survey shows that higher education and/or income, existing personal pension savings and being born in the Nordic countries are among the most relevant determinants of whether people make active investment decisions, i.e. choose from the available funds or reallocate their portfolios (Engström/Westerberg 2003).[37] In 2000, when the gainfully employed could decide upon their portfolios for the first time 68 per cent made an active choice. At that time equity markets were "bullish", and the new premium pension plan received much attention. In 2004, among the new (foremost young) entrants only 10 per cent made an active decision (Sundén 2004).[38] A most convincing explanation is that participants with limited financial experience are demotivated to make an individual selection when being confronted with a bewildering range of over 600 fund alternatives (Sundén 2004). In view of so few participants exercising their right to choose, Cronqvist/Thaler (2004: 428) go as far as to propose just *one* single fund for FDC accounts, thereby reaping the benefits of low(er) administrative charges. Investors could still exercise choice by adjusting their overall asset allocation elsewhere, i.e. when it comes to personal or occupational pensions.

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[36] It could also be argued that the neglect of rational retirement planning results from competing needs to acquire competence for actively organizing everyday's affairs (*Daseinskompetenzen*) as there is an increasing range of informed decisions to make which require a time-consuming evaluation of information. For example, enlarged choice and a compulsion to choose have developed for consumers of utilities (like electric power or telecommunication), bank and insurance products or as patients (medical treatment) or parents (education and care). The more complex interaction between private households and markets as well as non-market institutions may indeed lead to a "decision overload" (Loewenstein 2000; Piorkowsky 2003).

[37] If participants with low lifetime earnings who can expect to qualify for the guarantee pension make an active choice at all, they tend to select a high-risk portfolio. Since the *concrete* outcome in the premium pension leaves the guarantee pension unaffected they have little to lose when "gambling" on a high return (Sundén 2004: 6).

[38] For a large number of the remaining 90 per cent the default fund may have been a deliberate choice since it charges lower administrative fees than the others (Turner 2004) and because the return was less *negative* than that of the actively chosen funds (between 2000 and 2003 – Cronqvist/Thaler 2004: 427). As about 40 per cent present participants have made no active choice the default fund (*Premiesparfonden*) now manages 30 per cent of total assets. The growing market share of this *publicly* managed fund runs somewhat counter to the original intentions of the proponents of a partly privatized pension scheme.

In Germany, the tendency to postpone unpleasant tasks is more problematic since taking out a *Riester-Rente* or enrolling in the new occupational pension plans is *voluntary*. Surveys conducted in Germany have repeatedly confirmed that a large majority is aware of the need to additionally save for retirement, but a much lower percentage has actually taken initiative. Those who have not are still in the “planning phase” or say that they cannot afford to put money aside (Leinert 2003; Wunder/Schwarze 2004). Financial illiteracy and perceived difficulties or bother to overcome it are most important for constantly postponing a decision (Leinert 2004). In the UK, low confidence in private pensions after several scandals and frequent policy changes that made ill-informed people even more confused turned out to be additional obstacles to attaining a high coverage.

While it is obvious that procrastinators act on a *short time horizon*, “telescopic faculty” is one dimension of social inequality in general. Rowlingson (2002) shows that the UK government's emphasis on individual responsibility contradicts many people's capacity to rationally plan for long periods ahead. Adequate forward planning for private retirement income is largely restricted to those with a high and secure income who indeed have greater control over their future. Results from a survey recently conducted in Germany (Allianz 2004) confirm that finding: the majority of the population acts on a short time horizon when it comes to financial planning – even if they consider intensified individual efforts to save for retirement as being necessary.[39]

In sum, if citizens are expected to take greater responsibility for their financial security in old age and, consequently, are given more choice one has to reckon with persisting financial illiteracy, inertia to take action at all (or too late) or people making bad choices which are costly to revise. Those barriers to rational retirement planning are most prevalent at the lower end of the income distribution. Most likely, financial education, transparent information and more comprehensible pension products cannot fully remove those unequally distributed limitations to individual decision-making.

4.4 New Patterns of Inequality in Old Age

In cross-national comparison, disposable income of pensioner households (in relation to that of working-age population) in Finland, Germany and Sweden is higher than in many other OECD

[39] Quite often, those who enter long-term saving arrangement exhibit a very short time horizon. For example, in Germany altogether nearly 90 million life insurance policies have been taken out but about half of them lapse prematurely with usually tremendous losses for the policy holders (Versicherungsjournal 2001). Either they discover that there are more profitable investments opportunities or, in other cases, they quit due to lack of money (obligation to repay debts, unemployment, divorce etc.). See also Blake (2003: 305-6) on the “durability” of personal pension plans in the UK.

countries, but it is somewhat lower in Norway due to its less generous and still maturing public earnings-related scheme (NOSOSCO 2003: 114; OECD 2001: 21-9). Although the public pension systems in all four countries provide earnings-related and thus differentiated benefits, it was shown that, due to the hitherto predominant role of public benefits, total retirement income is less unequally distributed in these and further countries with comparable pension systems than it is the case in countries where private components make up a larger share in the retirement income mix and public schemes merely provide (equal) basic security (Jäntti et al. 1996; Korpi/Palme 1998).[40] Encompassing social insurance institutions largely “crowd out” unevenly accessible private components with no redistributive impact while public schemes regularly effect interpersonal redistribution to some extent.

One can assume that “cleaning” the public scheme from its redistributive elements, tightening the contribution/benefit link and, moreover, assigning private pension components a greater weight in the overall retirement income package will increase inequality in old age so that, more or less, the intracohort distribution of the economically active phase is replicated. While interruptions of employment (due to unemployment or parenthood) are partly compensated for by granting non-contributory credits, having worked part-time for a longer period will be reflected more directly in the individual pension level with a presumably clear gender bias. Earnings inequality, growing in all four countries, will further widen income differentials in old age. The impact of these developments is not immediately visible because the present income distribution among the elderly always reflects the general and personal employment fate of respective cohorts of pensioners as well as the institutional history of the country's pension system and individual adjustments to policy changes. For example, if almost all Norwegian workers were covered by occupational pensions the full impact will show not earlier than 40 or 50 years from now.

The tightened link between contributions to and benefits from the public schemes in the Nordic countries will not simply increase intracohort inequality but also modify the present distribution in such a way that future pensioners with long careers and/or a flat lifetime earnings profile gain relatively. Quite obviously, in all four countries additional private provision for retirement is on the increase. However, middle class people with a higher savings capacity are more active to realize risen aspirations for consumption in old age (or other goals). It will imply a larger spread in the distribution of retirement income that may be intensified by higher pensions accruing from their savings due to better financial literacy whereas those with lower income/education, in general, can be assumed to make less informed investment decisions – if they engage in supplementary pension provision at all. The fact that pensions emanating from private, pre-funded plans are contingent upon skill and luck of the investors may pose an equity

[40] This result is furthermore determined by the degree of earnings inequality and to what extent the distribution of elderly households' gross income is modified through progressive taxation.

problem for the mandatory FDC scheme and the quasi-mandatory occupational plans in Sweden (and fiscally encouraged retirement savings in general). Lindbeck/Persson (2003: 103, 109), expecting as larger intracohort dispersion of realized pensions as a result, correctly characterize this as a trade-off between freedom of choice and notions of equal returns on identical saving contributions.

In all four countries, due to actuarial adjustments public as well as private pensions are closely linked to the timing of retirement, and working additional years will become imperative for future retirees in order to obtain benefit levels as high as preceding cohorts of pensioners. If older workers *prefer* to exit employment at the lower end of the given range of flexibility they forego additional entitlements, face permanent deductions as consequence of prolonged benefit receipt and thus end up with a lower pensions. In 2003, one third of new old-age pensioners in Germany accepted a permanent benefit deduction of, on average, ten per cent as a result of retiring before becoming entitled to a full pension (VDR 2004: 18). Those individual decisions influence the intrahort income distribution and renders usual inequality measures less meaningful *if* exiting work at an early age is a result of unconstrained choice.

Despite further improving morbidity rates of higher-aged people and possibly increasing demand for elderly workers, many will be unable to work past age 60 (or 65), either because they are in poor health, because their jobs are too demanding, or because they had been dismissed and cannot find work. Those individuals' agency is constrained since they lack years of contributing to public and private pension schemes for attaining the aspired level of retirement income. Dependent on their frequency those constraints will influence income distribution among pensioner households, but in measuring inequality it is impossible to distinguish those who deliberately opted for lower benefits from others forced to prematurely take up benefits.

Taken together, one can expect higher income inequality in old age to be materializing over time in the three Nordic countries as well as in Germany. Some factors contributing to this development are unproblematic while others raise severe equity problems.

5. Conclusion

One result of analyzing the opportunities and risks of enlarged freedom of choice in retirement planning – and as a response to the initial question – is that there are still good reasons why the government is in the “pension business”. The Director of the UK Government Actuary's Department, Christopher Daykin (1998: 36-7), has nicely qualified the recent emphasis on consumer choice in pension provision:

> It is difficult to be against choice, but the essential factor with pensions is to ensure that the

> consumer has adequate safeguards since the issues are rather too complicated for most people to grasp fully the nature of the choices with which they are faced. Although it may sound paternalistic, it is sometimes better to limit the number of choices, in order to ensure that everyone receives a reasonable level of pension.

In that respect the question remains whether institutionalizing individual choice has (already) gone too far. For an adherent of Beveridge's liberal conception of social security the answer is a clear “no”. If one understands “a reasonable level of pension” as one that safely replaces a sufficient portion of former earnings, strengthening the relative importance of private, DC-type pension components may entail considerable risks to attaining this objective. In Finland, these risks are least likely to actually occur as its pension system is hardly advancing towards a multi-pillar approach and choice within the mandatory scheme is limited to the timing of retirement with predictable consequences for the level of pension.

The four case studies have shown that individual options as well as individual responsibilities to decide on one's retirement age and/or retirement income have been (or, in the case of Norway, will be) enlarged. It may, however, be questioned whether the respective elements of pension reform actually imply more free choice in the true sense. The premium pension in Sweden on top of the NDC pension is intended to close the gap that has arisen from the abolition of the previous ATP scheme. It is paternalistic in that it makes future pensioners better off than without such supplement, and it involves coercion: all employees who contribute to the NDC scheme also pay into the pre-funded component (and the same is true for the quasi-mandatory occupational pensions based on collective agreements). Individual choice comes only second. Regardless of whether employees exercise their right to choose from the menu of investment funds or not, financial market risks remain so that in the worst case paternalistic intentions would be nullified.

In all four countries individual options about the timing of first pension receipt have been extended, and the trade-off between later (earlier) retirement and higher (lower) benefits was strengthened according to actuarial criteria. In Sweden, the extension of flexibility even meant an almost complete abolition of a statutory retirement age. Rational older individuals should choose an exit age that balances their suffering from work and their income needs during retirement. One can assume that very often those income needs are underestimated beforehand and a too early retirement age is chosen. After leaving one's job a re-entry into the labor market (at a similar wage rate) is regularly foreclosed. In other cases impaired health, job loss or inability to find a job impede older workers' free choice about the timing of retirement. In case investments for private pensions have performed worse than expected the choice of the preferred age of labor market exit is further constrained. Finally, if public pension reforms imply that working longer is required in order to obtain benefits of the present level, the “choice” of one's retirement age becomes almost fictitious. Taken together, the promise of a flexible retirement age may either entail inferior choices or that factually there are no choices to

make.

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