

**Paths and Forks or Chutes and
Ladders?: The Dynamics of
Pension Regime Change in
Advanced Industrial Countries**

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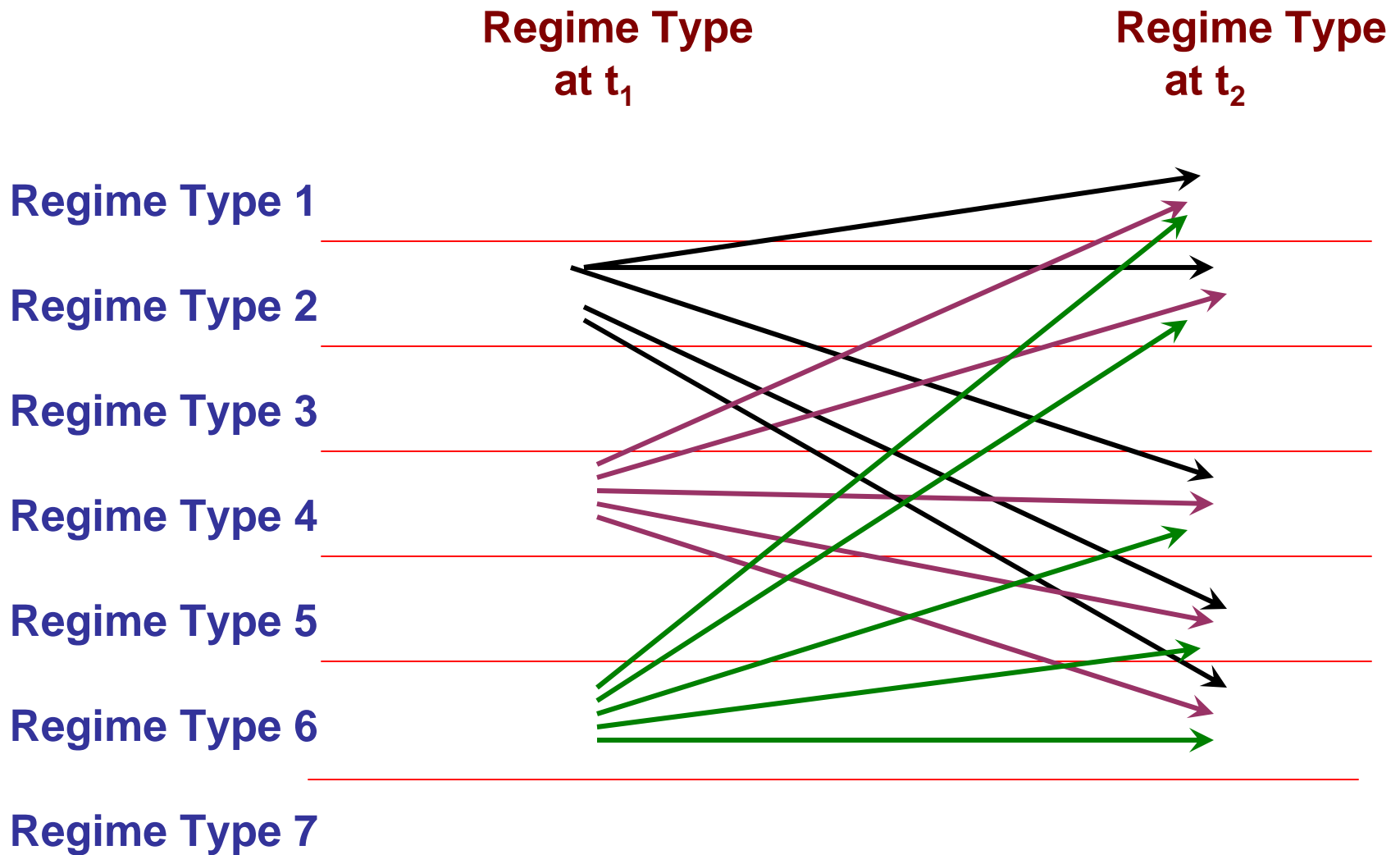
**Georgetown University and
The Brookings Institution**

The Questions:

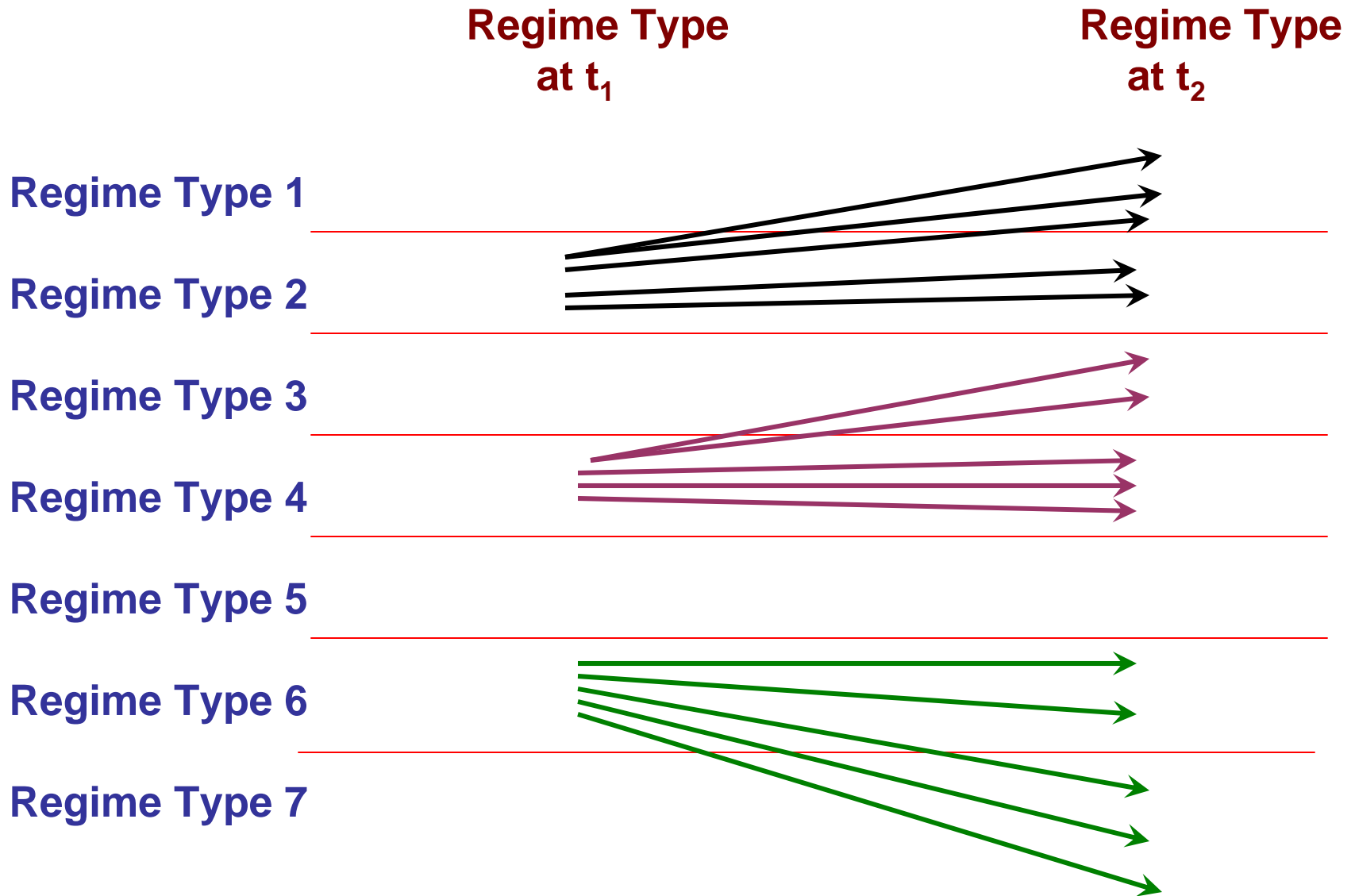
- **How should we categorize national pension systems?**
- **How frequent is a major change in pension policy regimes?**
- **Do policymakers have significant leeway in shifting pension policy paths, or is there significant room for choice?**

Models of Pension Regime Change

Unconstrained choice:



Paths and Forks:



Cul de sac:

Regime Type
at t_1

Regime Type
at t_2

Regime Type 1

Regime Type 2

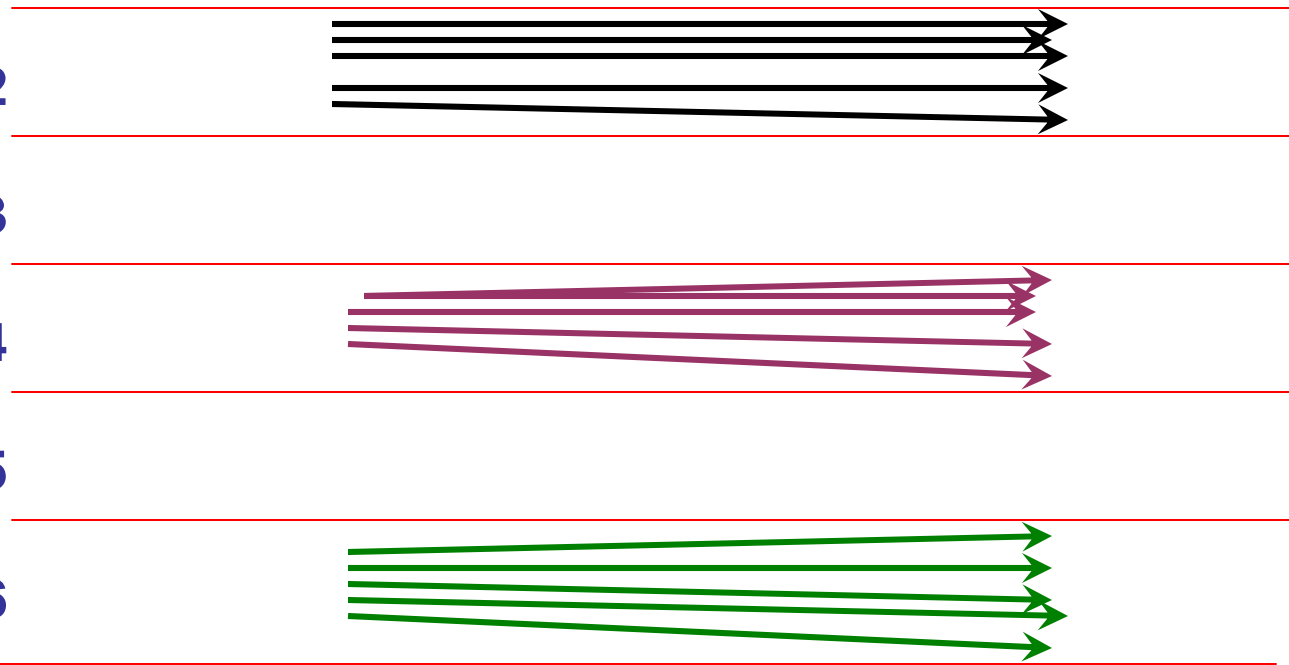
Regime Type 3

Regime Type 4

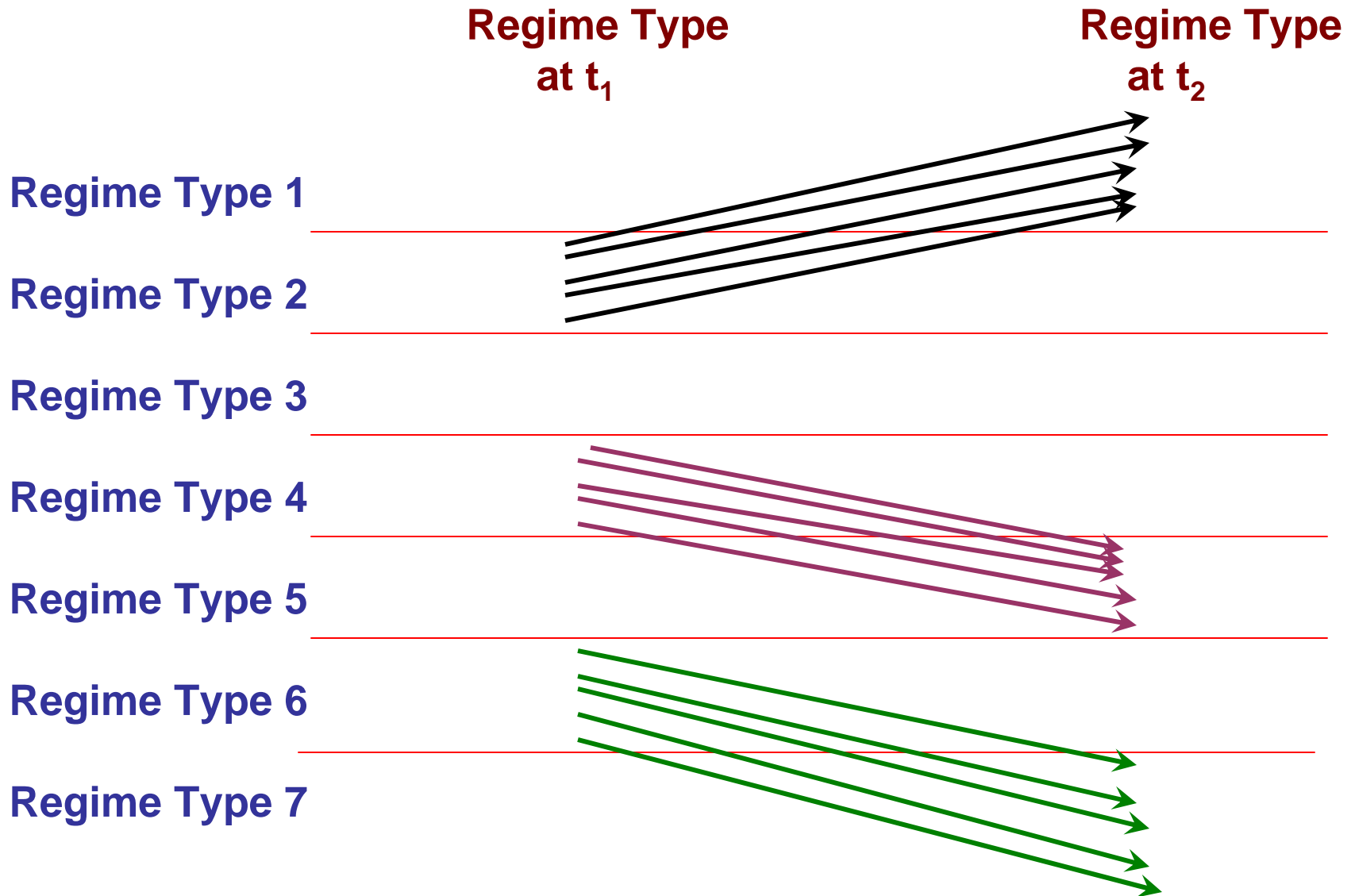
Regime Type 5

Regime Type 6

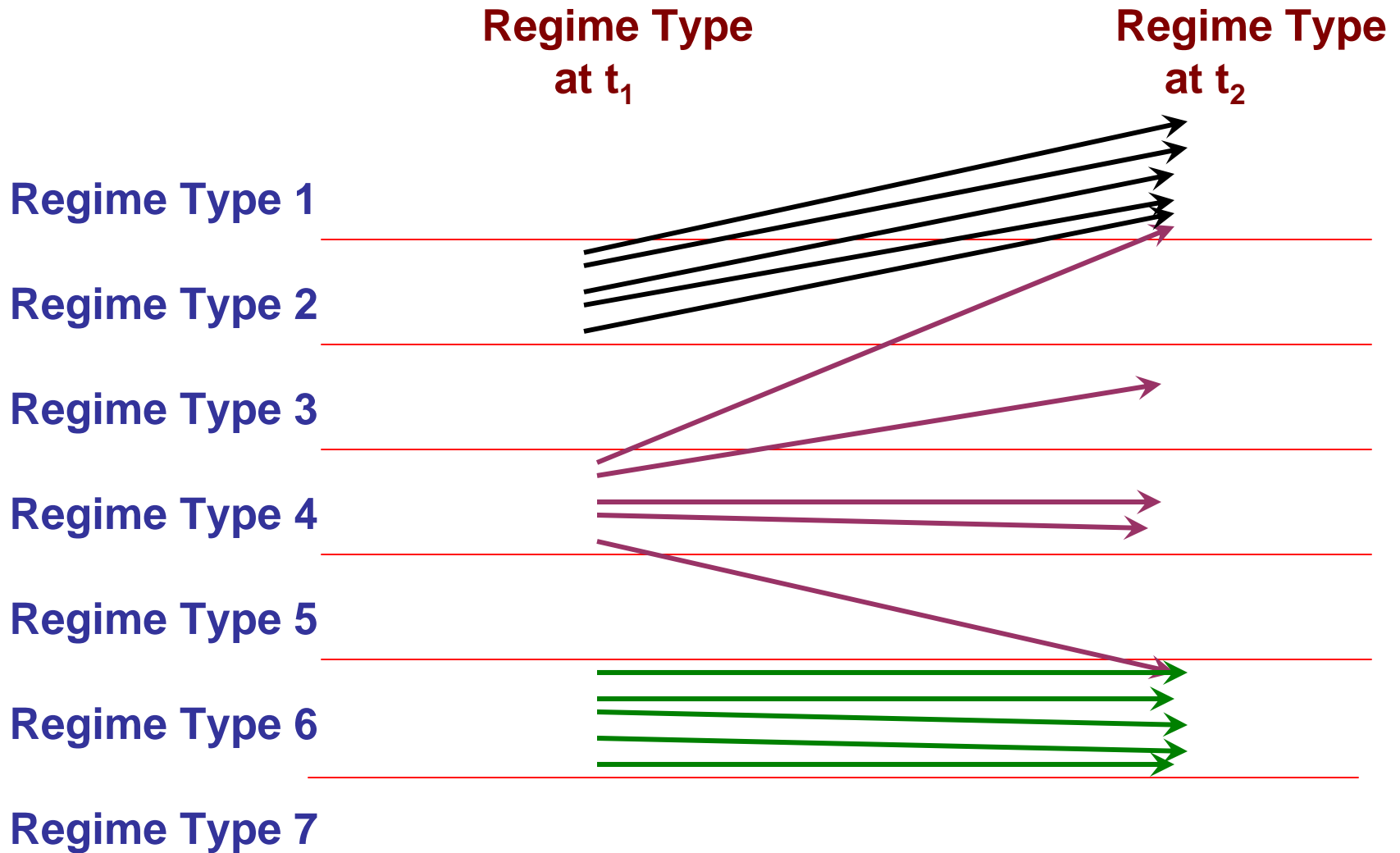
Regime Type 7



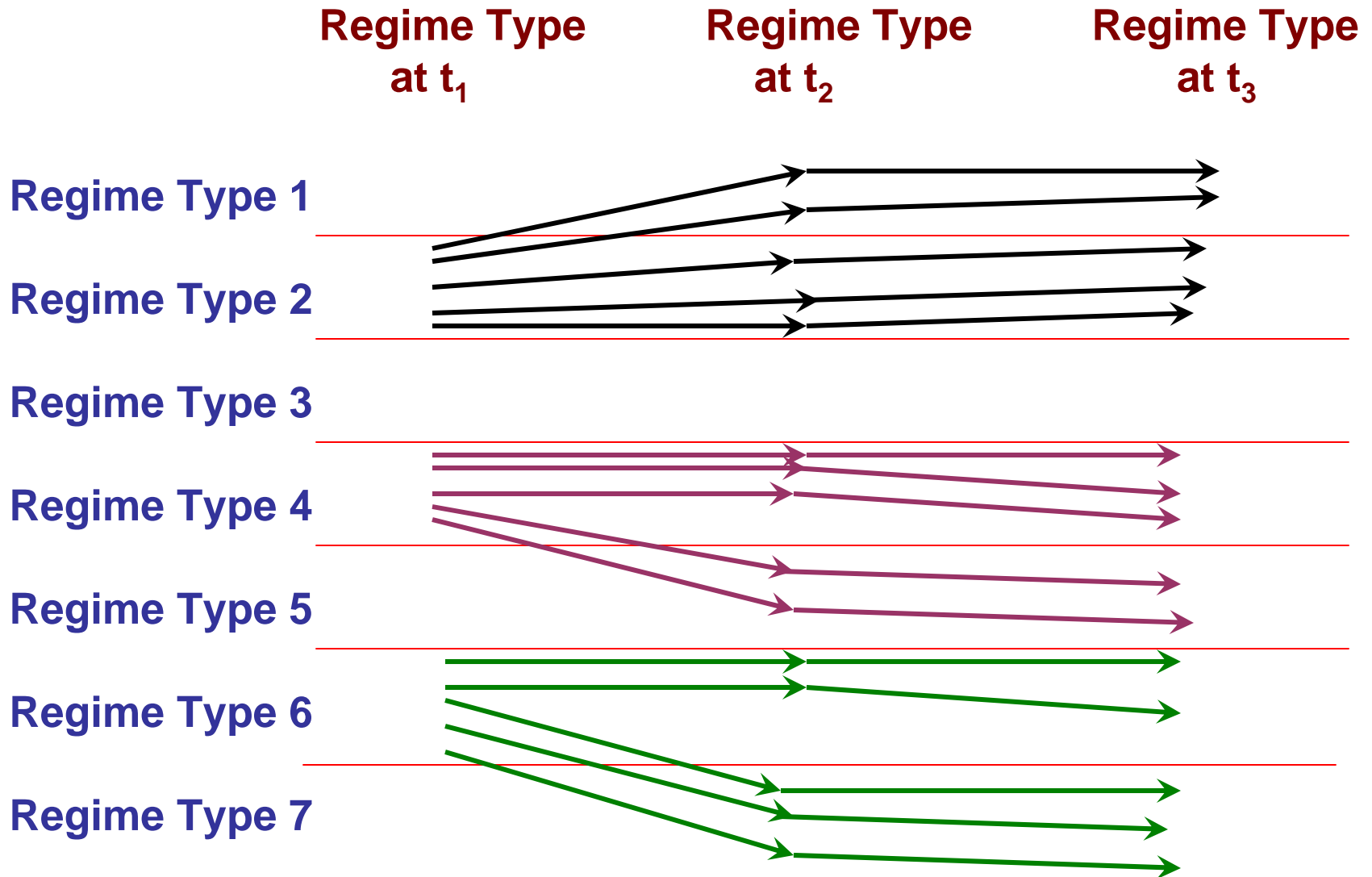
Chutes and Ladders:



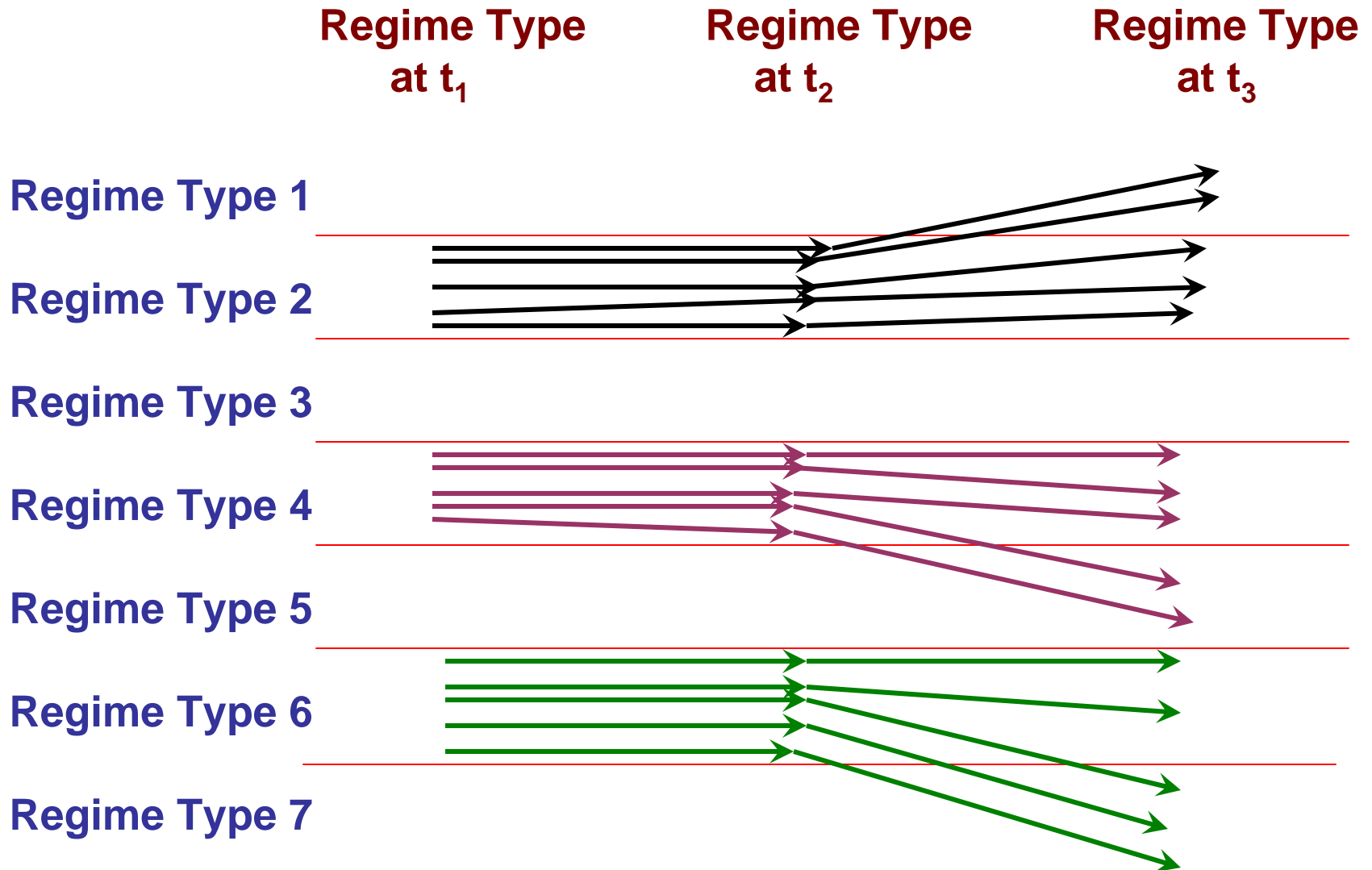
Mixed Patterns Across Regimes:



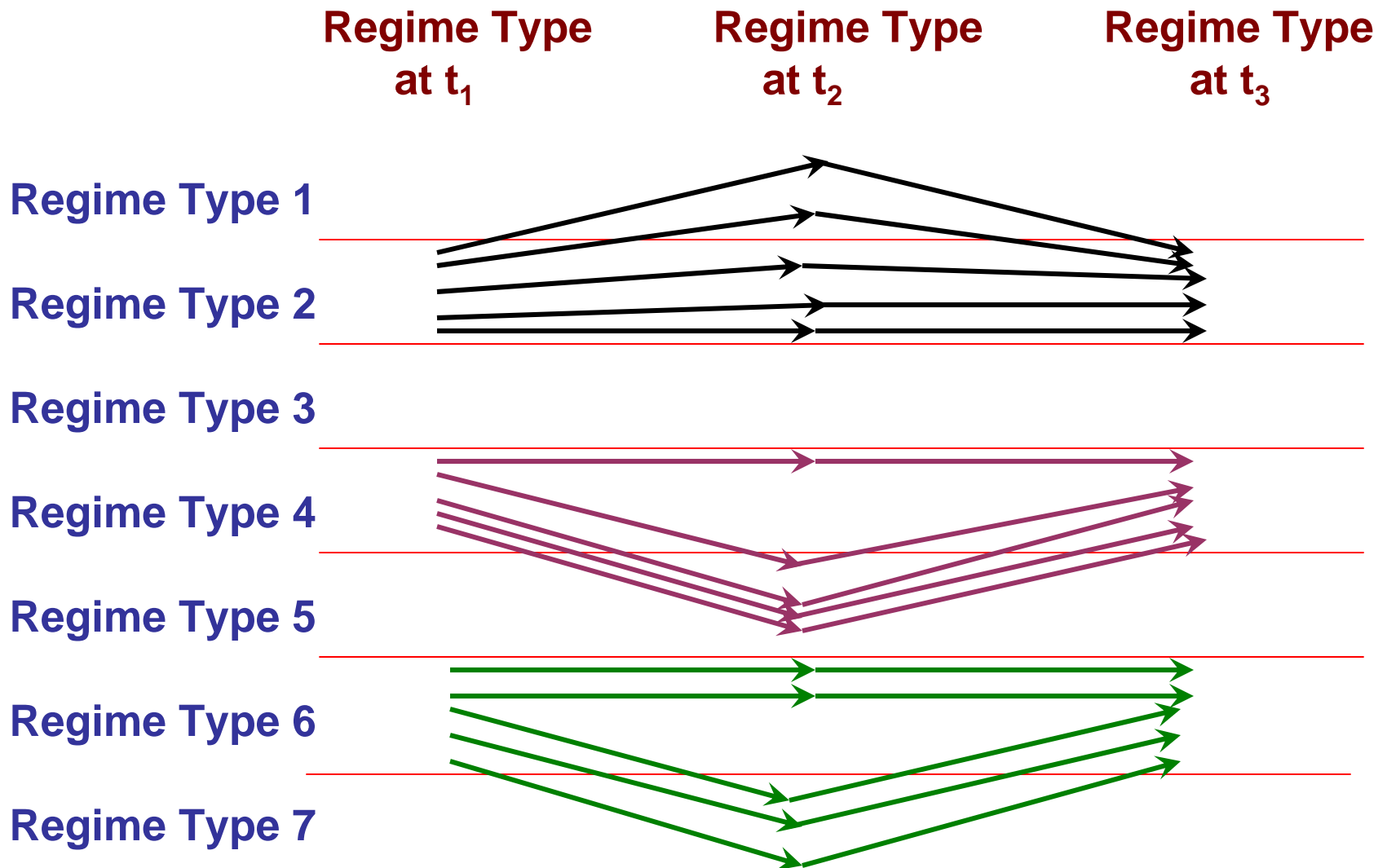
More choice at t_1 :



More choice at t_2 :



Boomerang:



The Convention Wisdom on Pension Regime Change

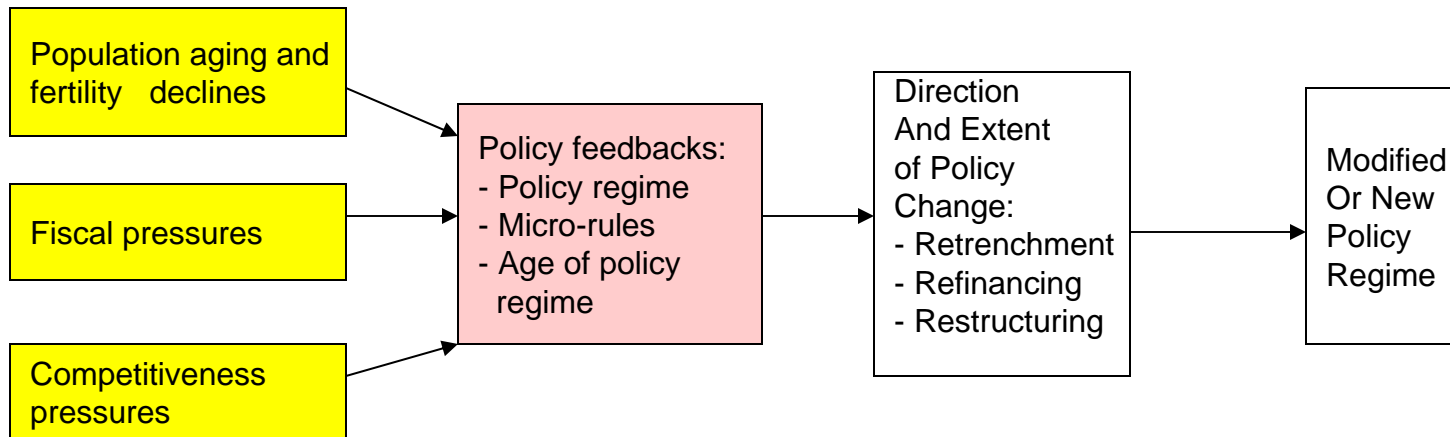
Categorizing Pension Regimes:

- **Welfare states can be divided into three categories**
 - **Universal/citizenship regimes (Scandinavia)**
 - **Social insurance “Bismarckian” regimes (continental Europe)**
 - **Residual regimes (U.K., Canada, United States, Australia)**

The Frequency of Pension Regime Restructuring:

- **Countries hardly ever change between the three broad categories of welfare state regimes: Pension regime change has been largely incremental (or “parametric”) rather than fundamental (or “paradigmatic”)**
- **Welfare states (including pension regimes) have survived economic/demographic retrenchment pressures relatively intact**

Explaining Patterns of Pension Restructuring:



Explaining Patterns of Pension Restructuring:

- **“Positive policy feedbacks” limit the pension reform options of policymakers:**
 - **Constrain choice sets**
 - **Create constituencies who resist any change that would make them worse off**
- **Age and maturity of pension regime matter (e.g., “double payment problem”)**

A Revised Approach

Categorizing Pension Regimes (1):

- **Virtually all rich countries have multi-tier pension systems, organized in a variety of ways**

E.g., Canada has

- **OAS**
- **GIS**
- **CPP/QPP**
- **Tax-advantaged RRP and RRSPs**

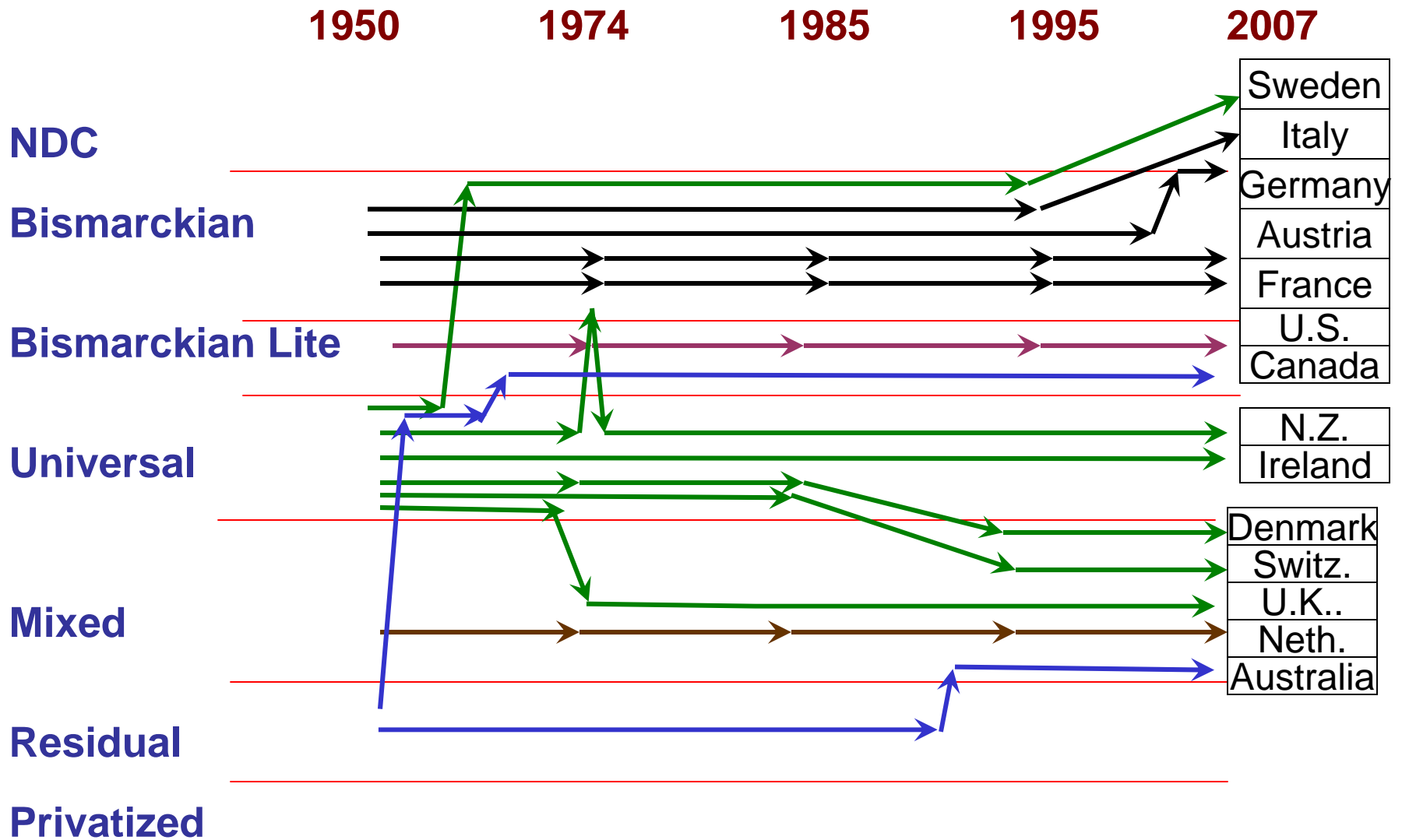
Categorizing Pension Regimes (2):

- **Esping-Andersen's tripartite categories are overly broad and misleading, e.g.:**
 - **Residual category is overly broad mixture of**
 - **means-tested**
 - **“Bismarckian Lite”**
 - **mixed regimes**
with distinctive challenges and transition opportunities
 - **New “Notional Defined Contribution” (NDC) pension has different challenges and transition opportunities from continental/Bismarckian regimes**

Recategorizing Pension Regimes:

- **Universal/citizenship regimes (New Zealand)**
- **Social insurance “Bismarckian” regimes (continental Europe)**
- **“Bismarckian Lite” regimes (U.S., Canada)**
- **NDC regimes (Sweden, Italy)**
- **Residual regimes (formerly Australia)**
- **Mixed regimes (U.K., Netherlands, Switzerland, Denmark)**
- **Privatized regimes (none among rich countries)**

Pension Regime Transitions:



The Frequency of Pension Regime Restructuring:

- **Pension regime change is fairly frequent**
 - 9 of 14 countries in sample have at least one
 - Only two (Sweden and NZ) have more than one
 - Regime reversals (“Boomerangs”) are very rare
 - No shifts to privatized model
- **Many recent changes are difficult to categorize (e.g., Germany, Sweden)**

Pension Regime Restructuring— Regime Durability:

- **Pension regimes differ significantly in their durability**
 - **“Bismarckian Lite” and mixed regimes are highly durable (cul-de-sac) in post WW II period**
 - **Universal and residual regimes virtually disappeared after World War II, with multiple destinations (paths and forks)**
 - **Bismarckian regimes were very durable until mid 1990s**

Pension Regime Restructuring— Timing:

- **Different types of regime transitions are concentrated in different periods:**
 - **Shifts to Bismarckian regimes pre-1973**
 - **Shifts to mixed regimes post-1973**
 - **Shifts from Bismarckian to NDC regimes post 1994**

Feedback Effects and Explaining Pension Restructuring:

- **Policy feedbacks may undermine as well as reinforce existing regimes**
- **Some policy regimes have higher “hazard rates” of exit than others**

Prospects for regime change depend on:

- The balance of positive and negative feedbacks and the challenges they present
- The availability and efficacy of incremental (or “parametric”) reforms to address those challenges
- The availability of paradigmatic reform options (a/k/a “regime transition options”)

Public pension systems face common challenges of:

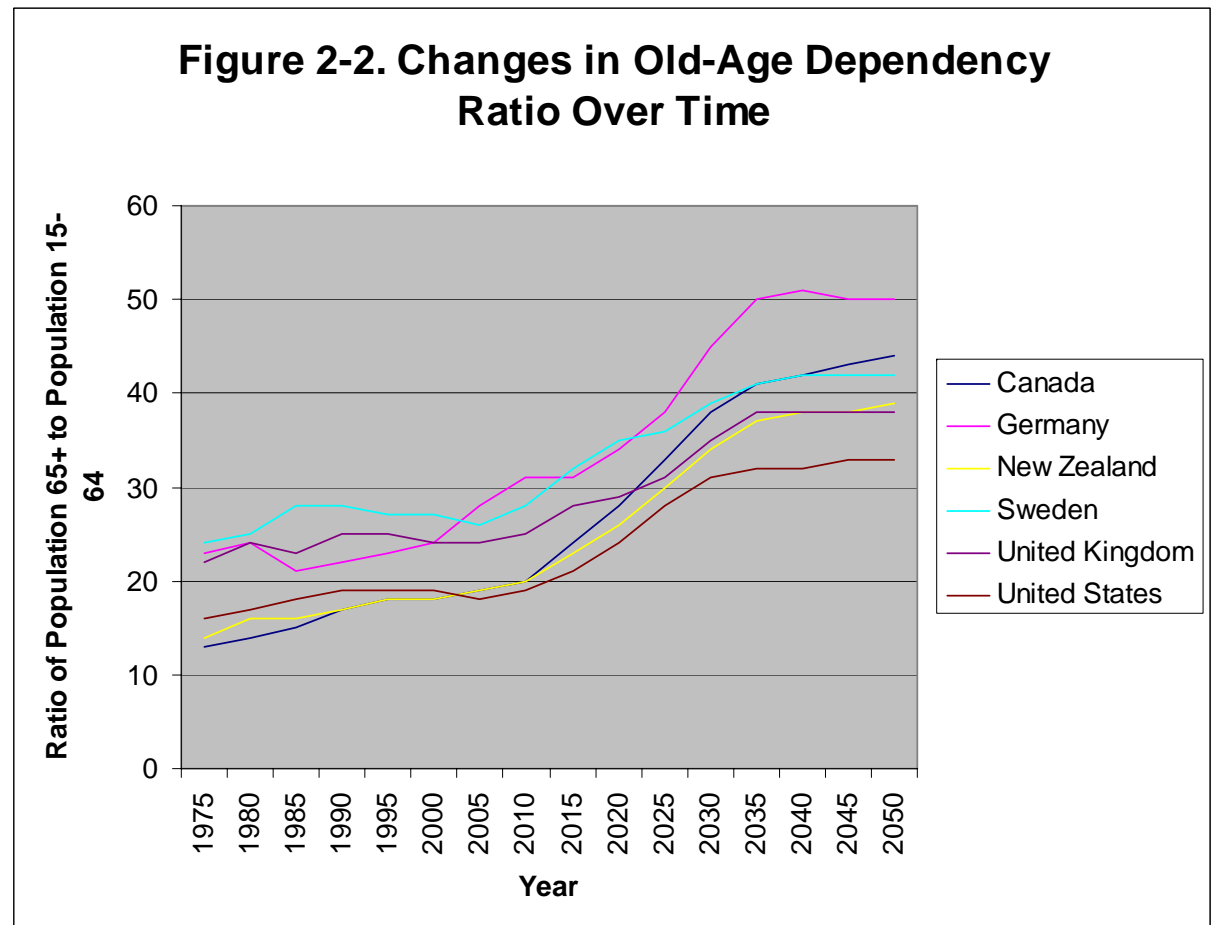
- **Adequacy**
- **Equity**
- **Affordability/Sustainability**

Plus

- **Clarity and Transparency in Incentives and Retirement Planning**
- **Encouraging Work among Older Workers**
- **Limiting Investment and Annuitization Risk**
- **Political Sustainability**
- **Administrative cost and effectiveness....**

... but Policy Challenges, Incremental Reform Options and Regime Transition Opportunities differ:

- Over time (e.g., depending on degree of economic/ demographic stress)
- Across pension regimes

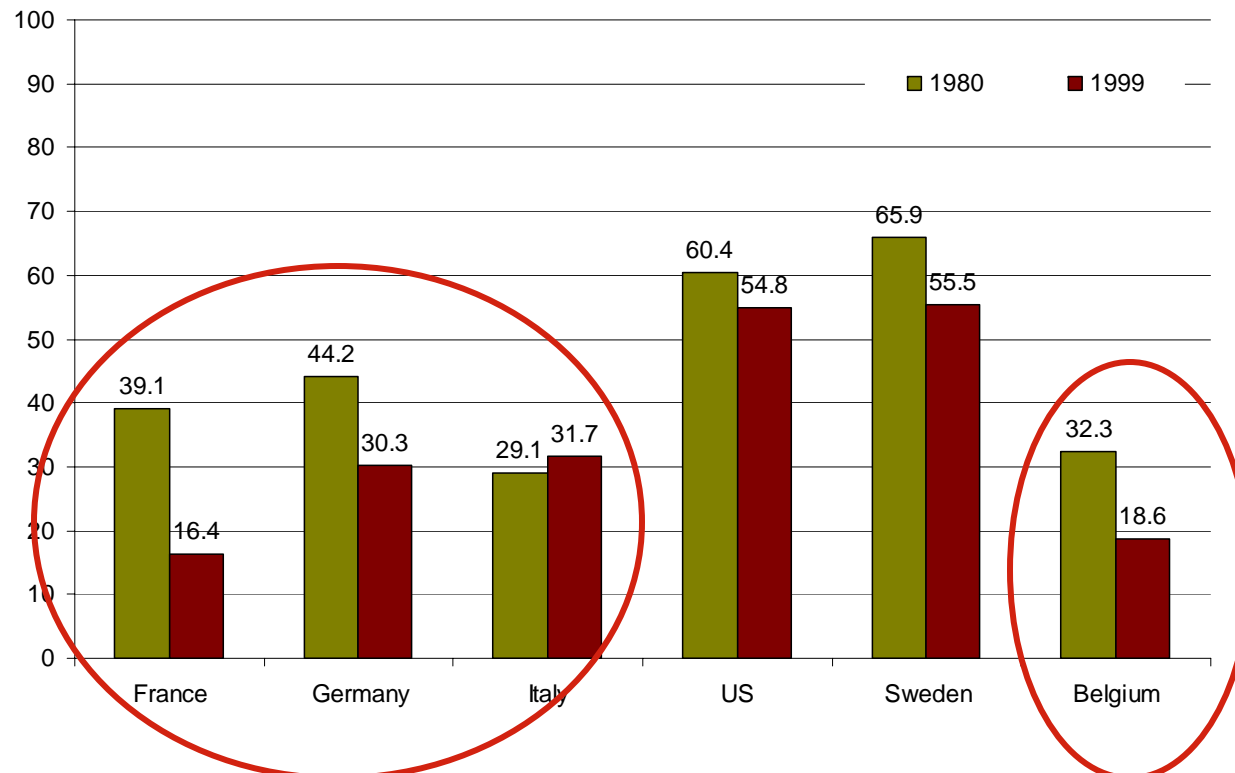


Challenge and Change in Bismarckian Pension Regimes

Challenges for Bismarckian social insurance systems are severe:

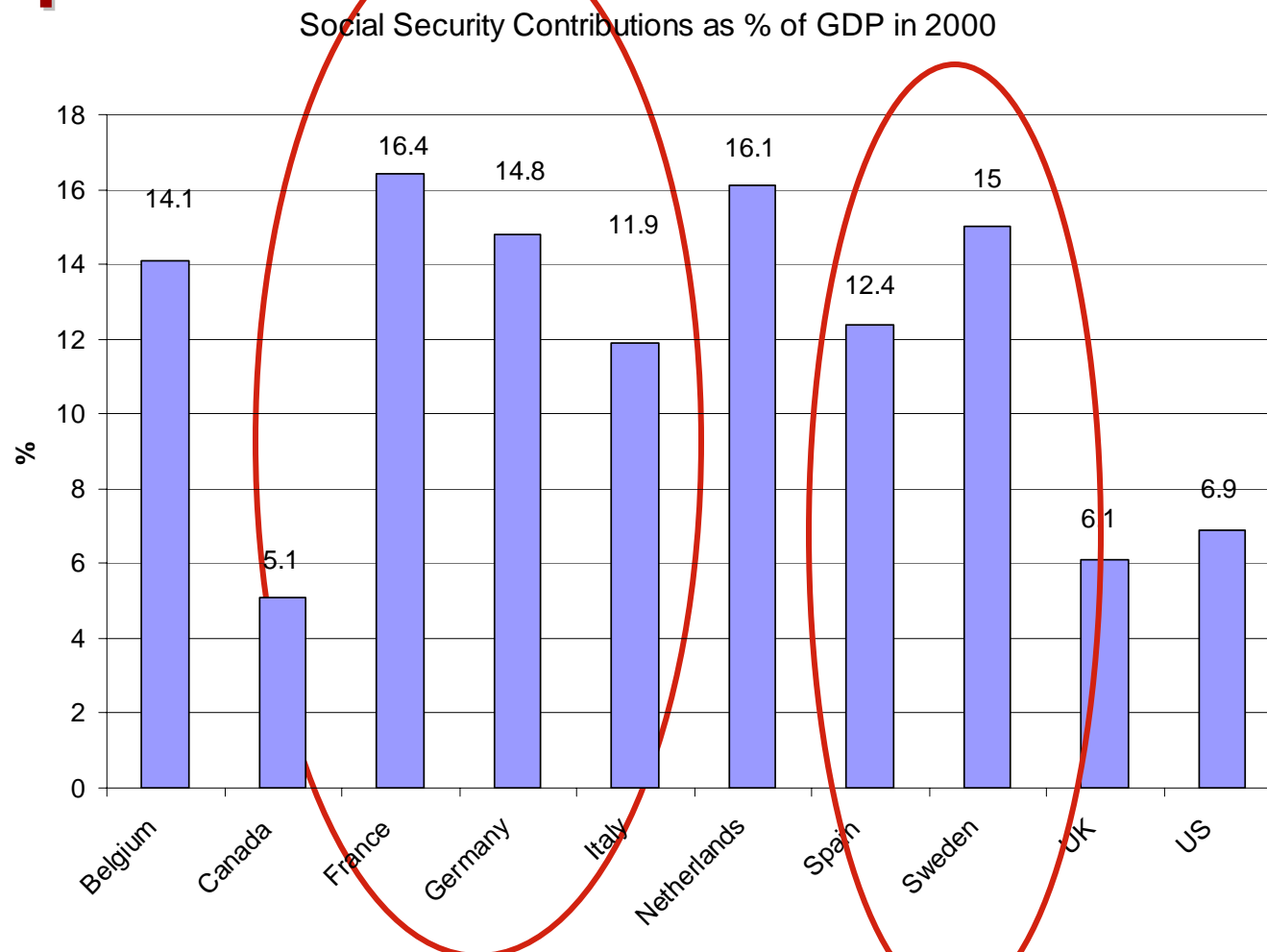
- **Severe sustainability issues with aging**
- **Need to address problems of low labor market participation in 55-64 age group**

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



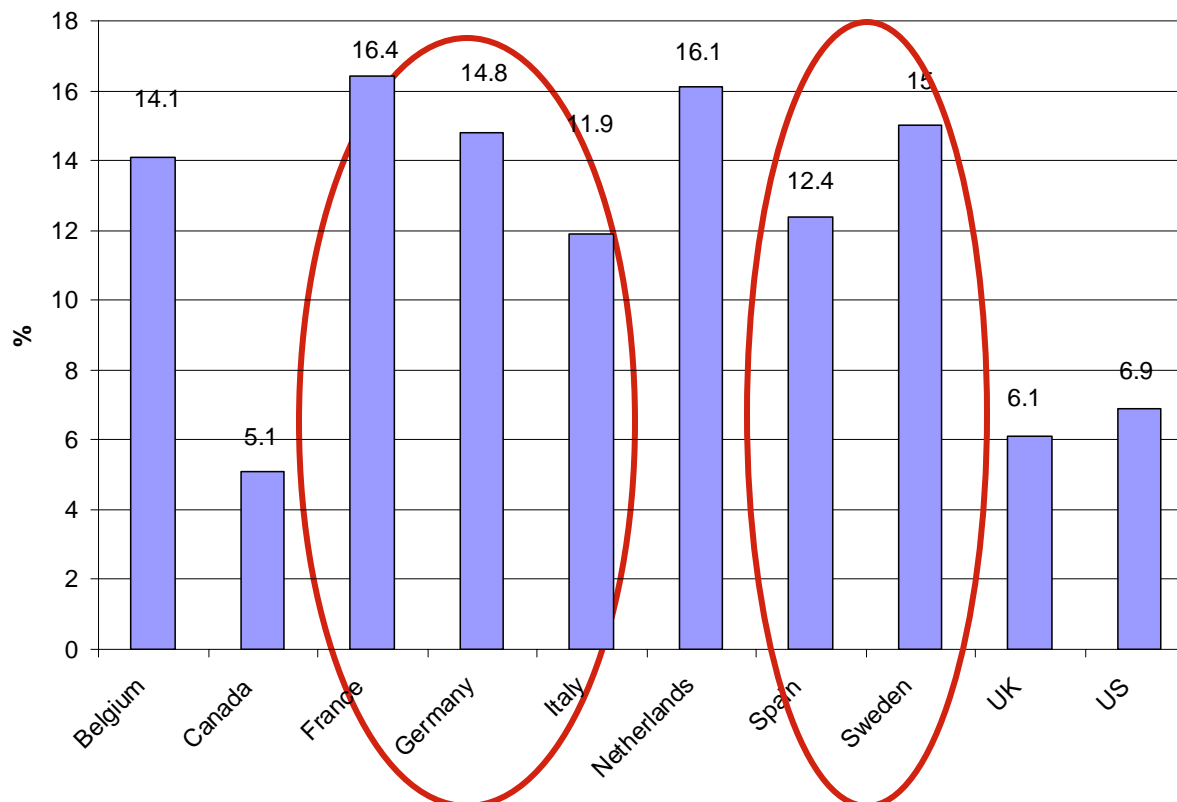
Incremental reform options for Bismarckian social insurance systems are limited:

- **Payroll taxes perceived to hurt competitiveness**



Transition Opportunities for Bismarckian regimes are highly constrained (1):

- **Shift to mixed (except as small “add-on”) or privatized regimes unlikely due to double payment problem**



Transition Opportunities for Bismarckian regimes are highly constrained (2):

- **Can't shift to universal, residual, or Bismarckian Lite regimes because of adequacy concerns**
- **NDC regime is only remaining regime transition option (single chute")– and it is a recent innovation**

Sweden in the 1990s—Policy Feedbacks in a Bismarckian System

- **Universal pension**
- **Earnings-related pension on top**
- **Generous income-tested pension
removes almost all seniors from
poverty**

Sweden--

Policy Challenges

- **Demography: Very serious challenge in both short run and long run**
- **Financial/Budgetary: Severe fiscal crisis in early 1990s**
- **Competitive: Very high payroll taxes and overall tax burden**

Incremental reform options

- **Strong resistance to payroll tax increases**
- **Strong union resistance to visible benefit cuts**

Regime Transition Opportunities:

- **Shift to a Mixed System very difficult given high current commitments and payroll tax**
- **Shift to NDC system compatible with existing earnings-related system**

Sweden Today—An NDC System with an Individual Account Add-On:

- **Universal tier eliminated**
- **Benefits based on lifetime earnings**
- **Flexible retirement age with increased work incentives**
- **Stabilized contribution rate with 16% in state system and 2.5% in individual accounts**
- **Risk of poor economic performance and increased longevity shifted from state to workers**
- **Central management of individual account system**

Germany—Policy Feedbacks in a Challenged Bismarckian system:

- **Overwhelming reliance on social insurance tier**
- **Partial general revenue financing of pension system**
- **Generous early retirement programs**

Germany

Policy Challenges

- **Demography: Very serious challenge in short run and much worse in longer run**
- **Affordability: Very high payroll taxes and overall tax burden**

Incremental reform options

- **Strong resistance to further payroll tax increases**
- **Some political capacity for non payroll tax revenue increases**
- **Can address problems of low earners through addition of income-tested tier**

Regime Transition Opportunities:

- **Shift to a Mixed System very difficult given high current commitments and payroll tax**
- **Shift to NDC system compatible with existing earnings-related system**

Germany Today—Still a Bismarckian system?

Multiple rounds of Retrenchment including:

- Multiple reductions in generosity of early retirement benefits, but still less than complete actuarial reduction
- Planned reductions over time in replacement rate

Refinancing:

- Increases in payroll tax
- Future increases in payroll taxes capped
- Eco-tax revenues dedicated to pension system

Germany Today—Still a Bismarckian system?

Restructuring

- **“Voluntary” quasi-mandatory tax advantaged individual account tier added to make up for planned future declines in public system replacement rates**
- **Sustainability factor added to lower future pension payouts**

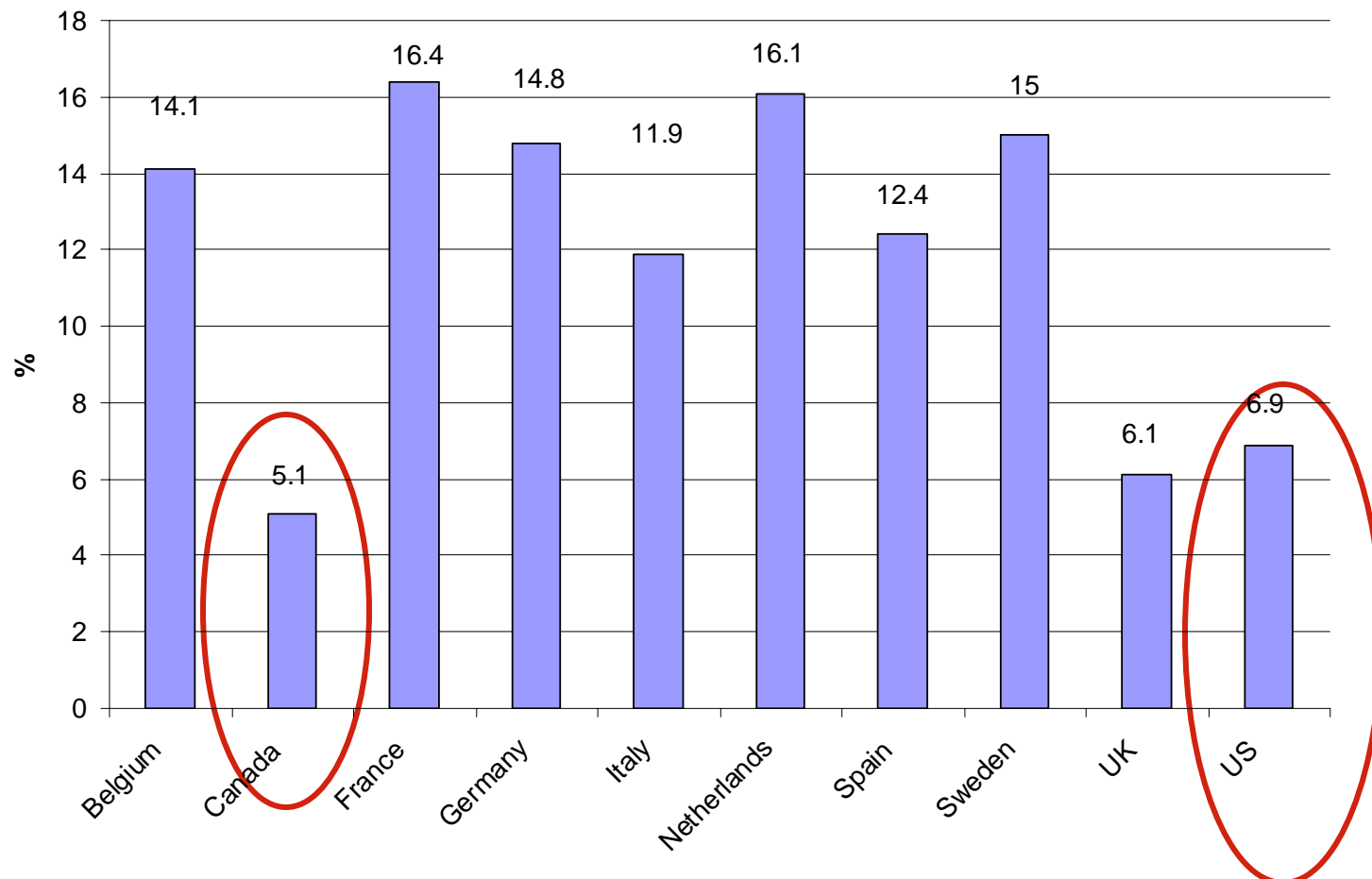
Challenge and Change in “Bismarckian Lite” Pension Regimes

Challenges for “Bismarckian Lite” social insurance systems include:

- Developing adequate mechanisms to deal with senior poverty**
- Adapting to changes in supplementary occupational and personal pension sectors**
- Addressing long-term pension funding problems in the absence of an immediate funding crisis**

“Bismarckian Lite” pension regimes contain room for refinancing without restructuring

Social Security Contributions as % of GDP in 2000



“Bismarckian Lite” pension regimes have multiple incremental reform options, including:

- Incremental payroll tax increases**
- Increased income-testing at upper end**
- Improving tax incentives for private sector pensions**

“Bismarckian Lite” pension regimes have multiple transition opportunities:

- Can shift to Bismarckian regime only before demographic crisis hits**
- Can shift to mixed regime (especially if “add-on”) with higher contributions**
- Can shift to NDC regime**
- Can’t shift to universal or residual regimes because of adequacy concerns**
- Shift to privatized regimes unlikely due to double payment problem**

But also have less need to shift

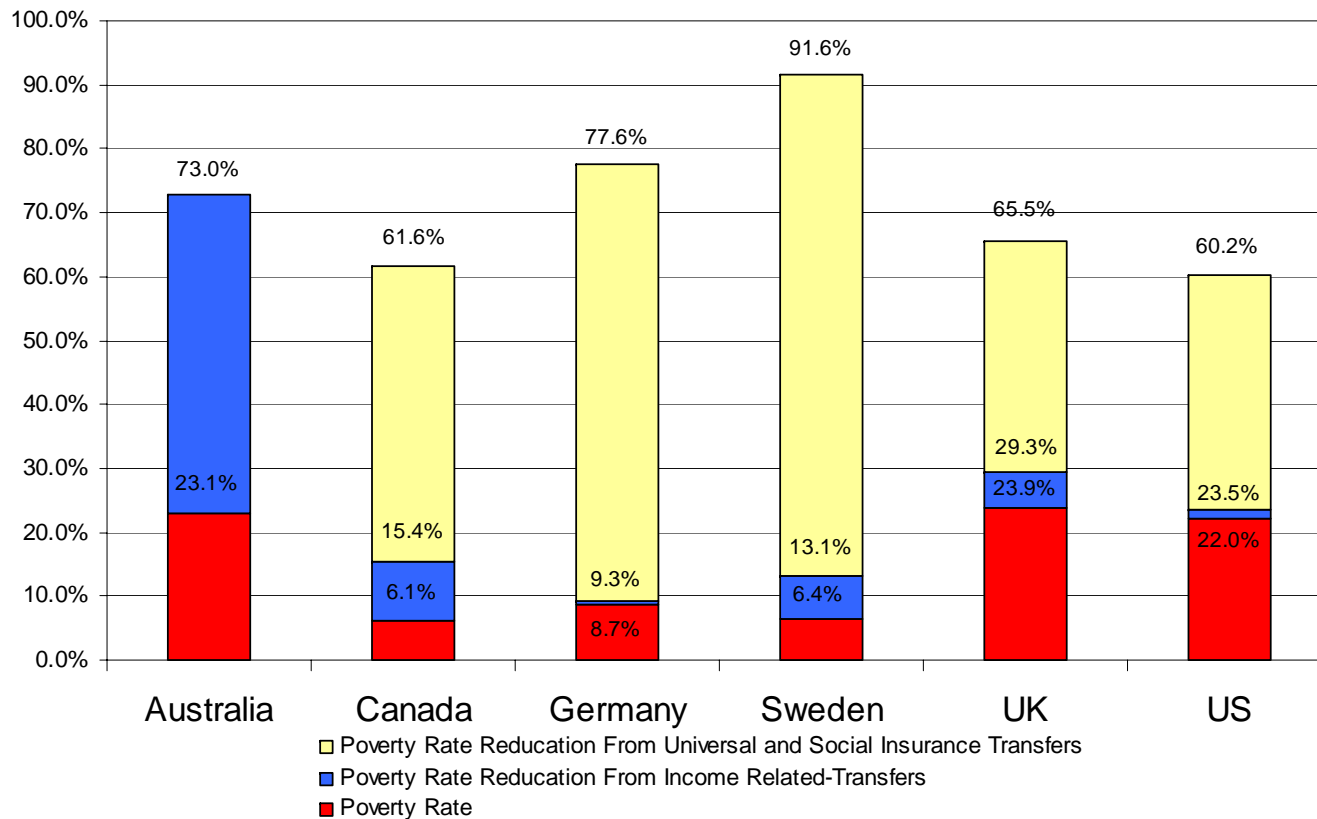
Canada Policy Feedbacks: A Bismarckian Lite System with a Generous Minimum

- **Old Age Security**
- **Guaranteed Income Supplement**
- **Canada Pension Plan / Quebec Pension Plan**

Canada: Policy Challenges in 1990s and Beyond– A Scorecard

Adequacy: A-

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



due to OAS-GIS floor for most recipients

Source: Timothy M. Smeeding. "Income Maintenance in Old Age: Current Status and Future Prospects for Rich Countries" October, 2002.

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

Affordability: B

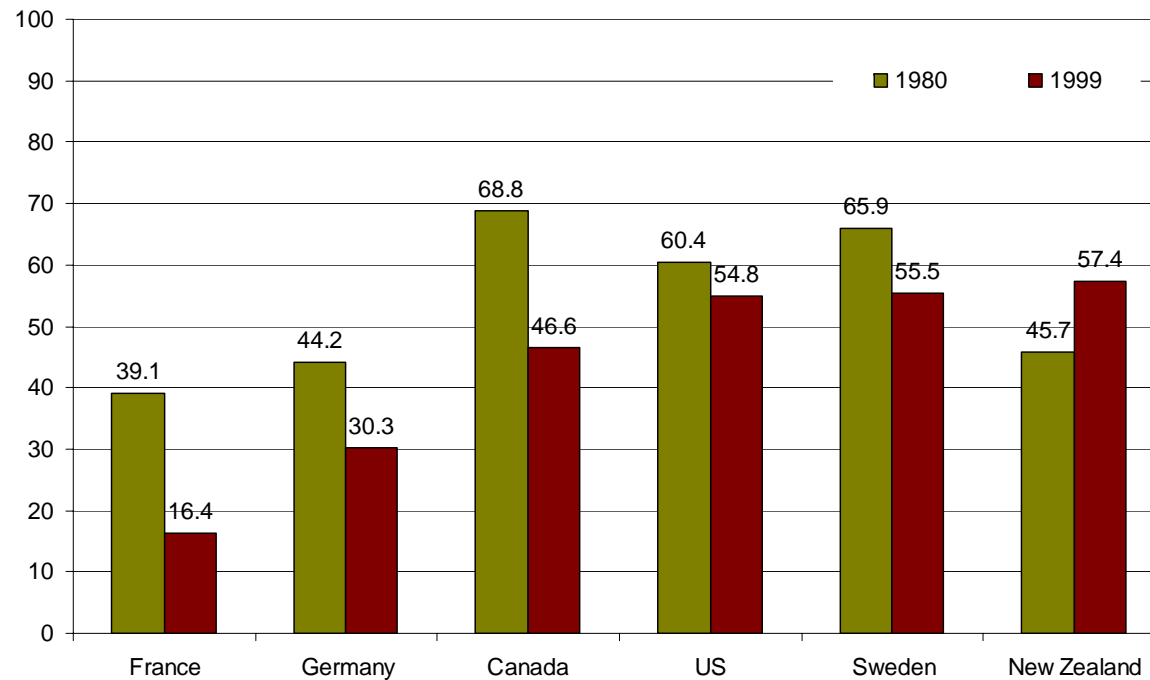
PENSION EFFORT IN SELECTED OECD COUNTRIES, 2000 AND PROJECTED FOR 2050

			Change
Australia	3.0	4.6	1.6
Belgium	8.8	12.1	3.3
Canada	5.1	10.9	5.8
France	12.1	16.0	3.9
Germany	11.8	16.8	5.0
Italy	14.2	13.9	-0.3
Netherlands	5.2	10.0	4.8
New Zealand	4.8	10.5	5.7
Sweden	9.2	10.8	1.6
United Kingdom	4.3	3.6	-0.7
United States	4.4	6.2	1.8

Source: Bernard Casey, Howard Oxley, Edward Whitehouse, Pablo Antolin, Romain Duval and Willi Leibfritz,
Policies for An Ageing Society: Recent Measures and Areas for Further Reform, p. 35

Encouraging continued labor force participation: C+

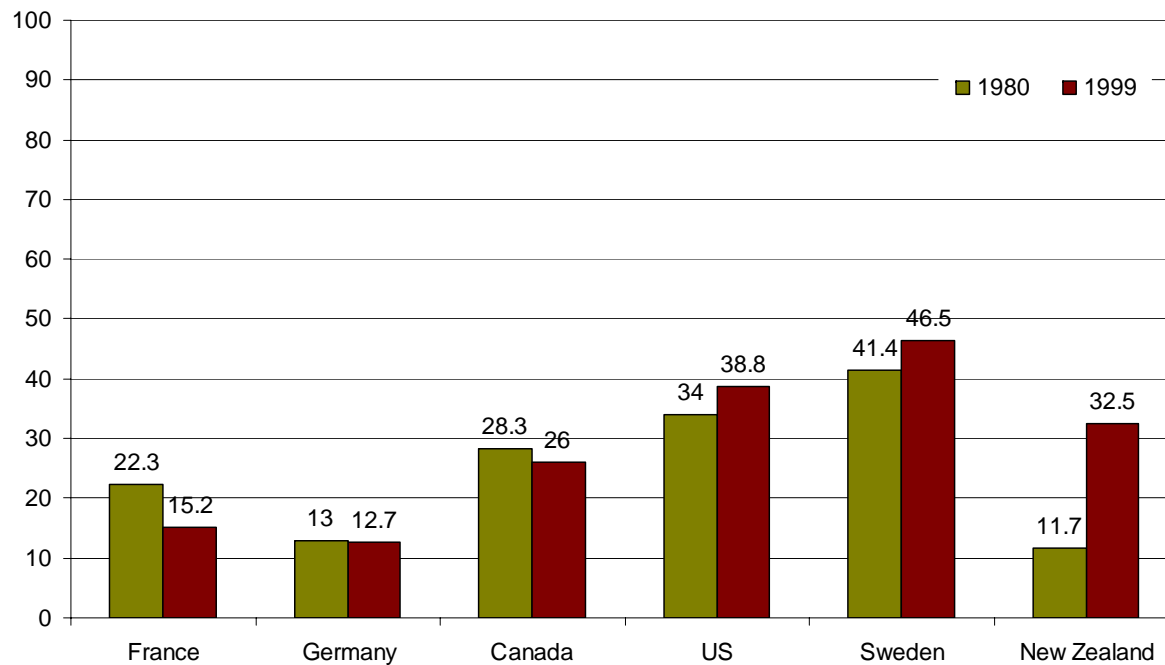
Male Labor Force Participation Rates
age 60 to 64 c. 1980 and 1999 (approx.)



Source: Social Security Administration, *An Aging World, 2001*. The initial year is 1981 for Canada and New Zealand, 1982 for France. The final year is 1996 for France.

Encouraging continued labor force participation: C+

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



Source: Social Security Administration, *An Aging World, 2001*. The initial year is 1981 for Canada and New Zealand, 1982 for France. The final year is 1996 for France.

Political risk: A-

- **Good governance structure for CPPIB, although likely to be increasing pressures with more active investment policy**
- **Will an income-indexed OAS be sustainable over time—and will bidding wars break out?**

Canada:

Incremental reform options

- Increased income-testing at upper end
- Possibility of increased payroll taxes to fund CPP

Regime Transition Opportunities

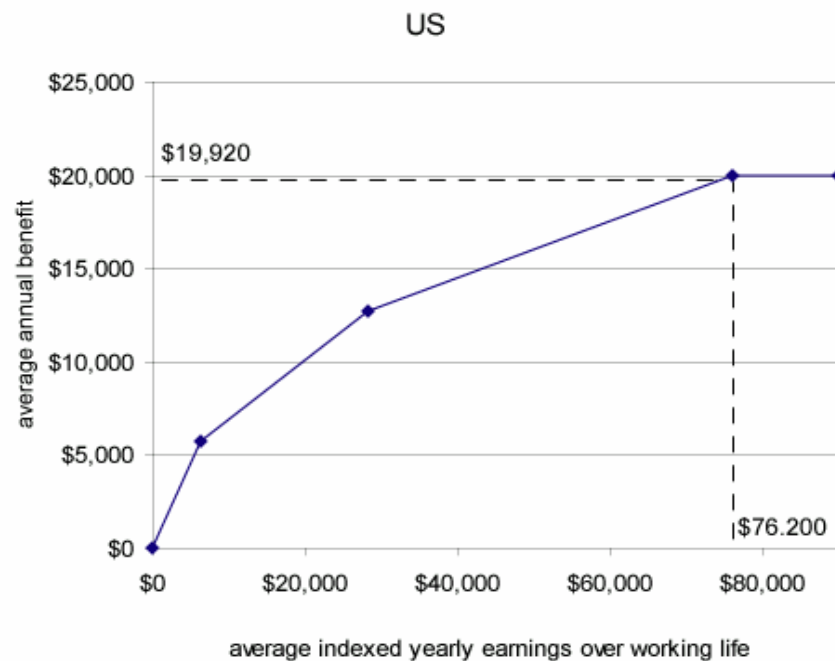
- Shift to a Bismarckian regime blocked by affordability issues
- Shift to a mixed system blocked by weakness of adequacy and affordability challenges—and for political reasons

Canada Today: Still a Bismarckian Lite system

- **Retrenchment in Old Age Security universal program**
- **Increase in payroll tax**
- **No serious consideration of individual accounts**

United States: Policy Feedbacks in a Bismarckian Lite System

- **Overwhelming reliance on social insurance tier (Social Security)**
- **Very small means-tested tier (SSI)**
- **Large but changing occupational and personal sector**



United States: Policy Challenges

- **Demography: Moderate challenge in short run and relatively modest in longer run**
- **Financial/Budgetary: Severe fiscal pressures in early 1980s and post 2017**
- **Adequacy: High poverty rates for older women have not been on the agenda**

Incremental reform options

- **Increased income-testing at upper end**
- **Increased payroll taxes limited by Republican opposition**

Regime Transition Opportunities

- **Shift to mixed system inhibited by financing unless new revenues added**
- **NDC system possible but inhibited by internal cross-subsidies unless new revenues added**

United States Today— “Bismarckian Lite” Stability :

Social Security in the U.S.:

- Parametric reform in 1977 and 1983**
- Virtually no policy change since then**
- Efforts by Bush II to get opt-out reform on the agenda failed**

Challenge and Change in Mixed Pension Regimes

Challenges for “Mixed” Pension systems:

- **Integrate public and private tiers and provide transparency, equity and universal coverage**
- **Provide adequate minimum pension**
- **Control administrative costs and market and annuitization risks in private tiers**

are serious but usually not regime threatening

A variety of incremental reform options are available for Mixed regimes:

- Improve benefit minima**
- Increase regulation to address administrative cost and investment/annuity risk concerns**
- Subsidize accounts for low-earners**

Transition Opportunities for Mixed regimes are highly constrained (Cul de sac):

- Can't shift to universal or residual regimes because of adequacy concerns**
- Shift to Bismarckian or Bismarckian Lite regimes unlikely due to affordability concerns**
- Shift to privatized regimes unlikely due to adequacy and risk concerns**
- Shift to NDC regime unlikely due to low affordability challenge**

U.K. Policy Feedbacks: A Mixed System

- **Quasi-universal flat-rate basic pension**
- **Opt-out from state earnings-related scheme into occupational or personal pensions rather than as add-on to state scheme**
- **Substantial reliance on income- tested benefits among the elderly**

U.K. Policy Challenges

- **Demography: Moderate challenge in short run and relatively modest in longer run**
- **Affordability: Moderate payroll taxes and low overall burden on the state**
- **Administrative effectiveness: very high costs**
- **Clarity: multiple pensions make predicting pensions difficult**

Regime Transition Opportunities

- **Shift away from mixed system inhibited by barriers to all alternatives and imbeddedness of private pensions**

U.K. Today—Still a Mixed System

The U.K. retirement system has been subjected to frequent tinkering with individual tiers:

- **Shift to price indexing under Thatcher**
- **Cutbacks in SERPS under Thatcher**
- **Shift from SERPS to State Second Pension (SSP)**
- **Shift from Minimum Income Guarantee to Pension Credit**
- **Introduction of stakeholder pension**
- **Ad hoc changes in Basic Pension**
- **Proposed Turner Commission reforms**

But no fundamental change

Conclusions

Some conclusions (1):

- **Tri-partite conceptualization of pension regimes is inadequate**
- **Amount of pension regime change over last fifty years has been substantial in OECD countries**
- **Pension regime feedbacks can be transition-encouraging as well as regime-reinforcing (e.g., affordability of Bismarckian regimes)**

Some conclusions (2):

- **Amount and direction of pension policy regime change depends in large part on:**
 - **Policy feedbacks and the challenges they create**
 - **Incremental reform options available to policymakers—and whether they have been exhausted**
 - **Regime Transition opportunities available to policymakers**

Some conclusions (3):

- **Feedback effects are insufficient to explain why:**
 - **Some Bismarckian systems (e.g., Sweden) shift to NDC while others do not**
 - **U.S. has not followed Canada's lead in addressing pension funding**

**The menu of incremental
and fundamental reform
options for pension systems
is evolving**

1. New mechanisms for automatic stabilizers in public pension liabilities as populations age

- **NDC reforms in Sweden, Italy, etc.**
- **Sustainability mechanism in Germany**
- **Failsafe mechanism in Canada Pension Plan**

But....

- **Unclear that shifting all demographic and economic performance risks to the benefit side will be sustainable**

2. Centralized management of some DC individual account functions

- Collecting contributions**
- Transferring to fund managers and managing fund-switching**
- Communication with fund holders**

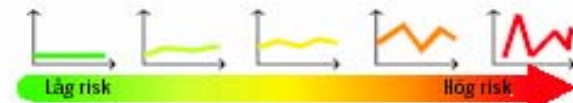
can produce major savings in administrative costs but

But much work needs to be done on:

Increasing transparency and lowering information costs associated with fund choice

A K T I E F O N D E R

SVENSKA AKTIEFONDER



Fond-nummer	Fondnamn Fondförvaltare	Information om fonderna	Fondförmögenhet mkr 01-12-31	Fondavgift %	Värdeutveckling % (efter TKA)					senaste 5 åren	Total risk (senaste 3 åren)
					97	98	99	00	01		
SVERIGE (NORMAL)											
576 710	Alfred Berg Pension Sverige Alfred Berg Fonder Aktiefond	Investerar på den svenska aktiemarknaden.	16	0,9	-	-	-	-	-15	-	
681 783	AMF Pensions Aktiefond Sverige AMF Pension Fondförvaltning AB	Aktier i bolag noterade i Sverige.	2 232	0,4	-	-	73	13	-5	-	
344 739	Ansvar Aktiefond Sverige Aktie-Ansvar AB	Svensk bankoberoende aktiefond med etiska placeringsregler.	586	1,2	25	17	59	-5	-6	108	
218 412	Aragon Aktiefond Sverige Aragon Fonder Aktiefond	Branschfördelning enligt Affärsvärldens generalindex och mål att slå detta.	22	1,2	-	-	62	-8	-17	-	
524 470	Aragon SICAV Swedish Equities Aragon Asset Management S A Luxembourg	Svenska aktiemarknadens A-, OTC- och O-lista med en övervikt i tillväxtaktier.	83	1,3	29	6	109	-33	-19	56	
986 018	Banco Human Pension Banco Pensionsfonder AB	Kopia av Humanfonden. Etiska placeringskrav. Banco ger till organisationerna.	20	0,8	-	-	-	-	-14	-	
121 848	Banco Samarit Pension Banco Pensionsfonder AB	Kopia av Samaritfonden. Etiska placeringskrav. Banco ger till organisationerna.	17	0,8	-	-	-	-	-14	-	
871 855	Banco Sverige Pension Banco Pensionsfonder AB	Kopia av Banco Sverige. Min 90% svenska aktier, bred placeringsinriktning.	19	0,8	-	-	-	-	-15	-	
907 683	Bancos Etiska Sverigefond Pension Banco Pensionsfonder AB	Min 90% svenska aktier. Ej alkohol-, tobaks-, och vapenbranscher.	36	0,8	-	-	-	-	-15	-	
730 366	Carlson Sverigefond Carlson Fondförvaltning AB	Fonden placerar i svenska börsbolag.	710	1,0	25	39	61	-7	-14	126	

All information i tabellerna grundas på information från fondförvaltarna.

▲ Avgiften varierar beroende på fondens resultat, se fondfaktablad. ■ Avgiften varierar beroende på fondens förmögenhet, se fondfaktablad. ● Avgiften inkluderar alla kostnader, dvs är densamma som TNA och bestäms på förhand.

Educating workers on the need to work later....

Om du tar ut din allmänna pension från

61 år: Vid 0 % tillväxt får du 8 900 kr/mån

Vid 2 % tillväxt får du 12 700 kr/mån

65 år: Vid 0 % tillväxt får du 11 100 kr/mån

Vid 2 % tillväxt får du 17 700 kr/mån

70 år: Vid 0 % tillväxt får du 16 000 kr/mån

Vid 2 % tillväxt får du 28 200 kr/mån

Din allmänna pension vid 65 års ålder och noll procents tillväxt (11 100 kr/mån) består av: 9 300 kr inkomstpension och 1 800 kr premiepension (beräkningsantaganden för premiepension, se *Prognos* i ordförklaringarna).

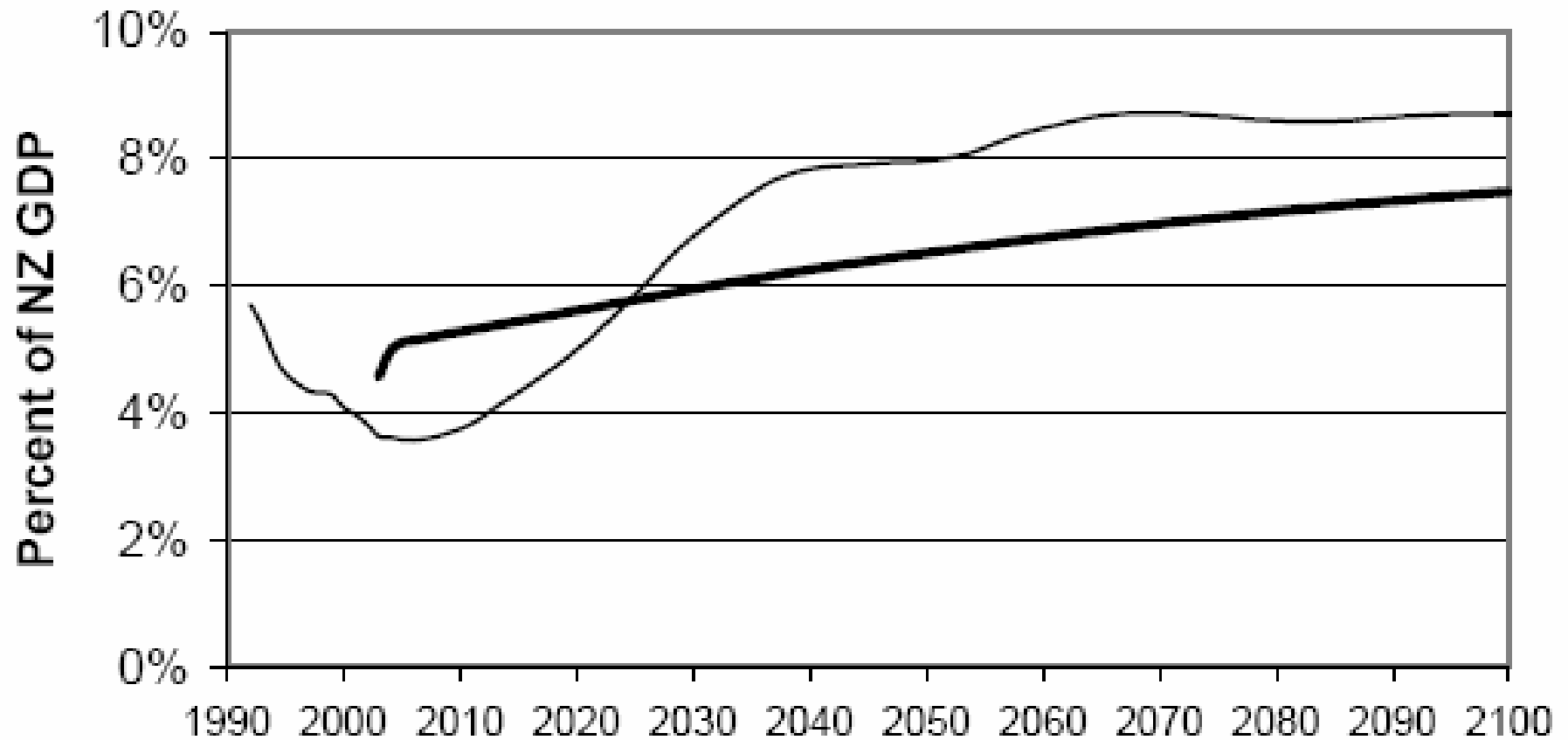
Source: Prognos för din allmänna pension '04

...and goals and design of a default fund

" People who do not have a Fund Manager, for whatever reason, should receive the same pension as others - that is our goal. "

--Seventh Swedish AP Fund

3. Governments can pre-fund general revenue financed public pension programs



(Source: McCulloch and Frances, *Governance of Public Pension Funds: New Zealand Superannuation Fund*)

The End