

Oxford Handbooks Online

Old-Age Pensions

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The Oxford Handbook of the Welfare State

Edited by Francis G. Castles, Stephan Leibfried, Jane Lewis, Herbert Obinger, and Christopher Pierson

Print Publication Date: Jul 2010 Subject: Political Science, Public Policy

Online Publication Date: Sep 2010 DOI: 10.1093/oxfordhb/9780199579396.003.0024

Abstract and Keywords

This article discusses the origins, organization, and social consequences of mature pension systems in the developed welfare states. It also deals with the challenges posed to these systems by demographic, economic, and societal transformations occurring since the 1970s. The trajectories of reform, both actual and anticipated, are covered. Throughout, the focus is on the pension systems of the rich democracies of Western Europe, North America, and the Antipodes, with more selective attention being given to developments in Latin America, Asia, and Eastern Europe. Pension systems are challenged by population aging and by changes to labour markets. Changing family structures also put stress on existing pension system arrangements. Adjustments of pension systems to the challenges of population aging, and labour market and family changes may be divided into *parametric* and *structural* reforms. It is noted that the expanded role for private, funded pensions that has developed in recent decades seems unlikely to be undone.

Keywords: mature pension systems, developed welfare states, parametric reforms, structural reform, population aging, labour markets, family structures

Inventing Pensions

PENSION systems spread in Europe during the late nineteenth and early twentieth century as a political response to industrialization and the concomitant social risks of wage labourers. Prior to the first major pension initiatives, only select groups of elderly enjoyed regular pension payments after terminating employment: employees in the public sector (civil servants, veterans, municipal workers) and certain occupations (miners, railroad workers), and those whose employers voluntarily offered a private pension to their long-serving (white-collar) workforce. All other (blue-collar) labourers ‘worked until death or disability’ (Stearns 1975: 260). Limited pension coverage continues to be the norm in many African and Asian countries; and in these countries, pension privileges for policemen, military personnel, civil servants, and employees in state-owned enterprises are granted for motives similar to those at play in nineteenth-century Europe: namely, to ensure the loyalty of future beneficiaries while they are still at work.

Germany, by legislation of 1889, was the first country that compulsorily insured almost all employees against income loss due to disability and old age. That legislation was not only meant as a pre-emptive strategy to suppress potential working class unrest. It was also part of an unfinished state-building process (unburdening municipalities from poor relief payments) and, besides being supported by both Christian churches and early scholars of social policy, continued the tradition of patriarchal interventions by an authoritarian state. Subsequently, other nations also introduced public pension schemes that varied either slightly or more dramatically from the *Bismarckian* approach (see next section). During that period of maturing industrialization, the declining (p. 354) abilities of older workers were the main social problem and, thus, disability pensions predominated. A fixed retirement age (initially 70 in Germany, lower in other countries) served as a marker for generally assumed disability, but already embodied the concept of a work-free phase of ‘retirement’ within a tripartite life course. Benefits from newly implemented public schemes, however, were largely insufficient to ensure retirement as a universal social achievement before World War II. Rather, public old-age pensions supplemented other economic resources: (lower) earnings from continued employment, individual savings, family support or a private pension from the former employer. In a number of countries today, notably in Latin America and East Asia, one similarly finds broad public pension coverage but with benefit levels generally insufficient to ensure full economic independence at higher ages.

In contrast, welfare states within the traditional OECD area are considered ‘developed’ in part because after 1945 they arranged their pension systems so that complete exit from paid employment during an ever longer retirement period became a universal entitlement. Previously, the majority of men aged 65 and older remained members of the labour force—for example, in the United States three-quarters of them belonged to the labour force in 1890; by 1930 60 per cent still did so; but by 1970 only a quarter (25.7 per cent) of older men were active workers (Jacobs et al. 1991: 41). By the 1970s,

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declining employment rates after age 60 and, even more, after age 65, signalled that this entitlement had been for the most part achieved. In almost all of the advanced welfare states less than one quarter of the male population over age 65 participated in the labour force by 1970 (ILO 2009 a). This institutionalization of retirement resulted from an expansion of pension systems in several dimensions: coverage was broadened to almost the entire (working) population, eligibility criteria for enjoying a pension became liberalized (e.g. flexible retirement), the range of benefits was expanded (e.g. survivors' pensions) and, most importantly, the generosity of benefits substantially increased.

In the remainder of this chapter we describe the origins, organization, and social consequences of mature pension systems in the developed welfare states; discuss the challenges posed to these systems by demographic, economic, and societal transformations occurring since the 1970s; and trace trajectories of reform, both actual and anticipated. Throughout, our focus is on the pension systems of the rich democracies of Western Europe, North America, and the Antipodes, with more selective attention to developments in Latin America, Asia, and Eastern Europe.

Old-Age Pensions in Developed Welfare States

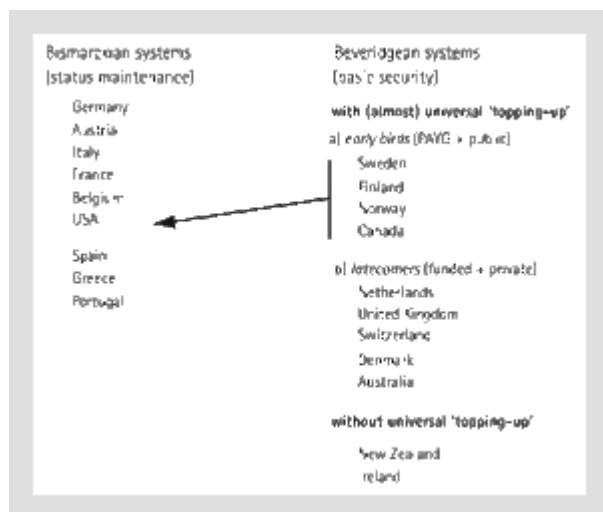
Fully developed national pension systems perform different functions (cf. Barr and Diamond 2006, 2008): They aim to *smooth consumption* by transferring economic resources from the second (employment) to the third stage (retirement) of an institutionalized life course. Pensions as annuities *insure against biometric risks*—in particular, longevity—and thus protect retired individuals from outliving their savings. Pension systems also regularly insure against death and/or disability of the main earner (survivors' and disability benefits, the latter often through a separate scheme). Pension systems aim to *alleviate poverty* when flat-rate benefits are paid to all individuals above a certain age or are targeted at those with insufficient resources. Linked to that function, a final primary objective of pension systems is to *redistribute income*: pension systems may redistribute vertically (e.g. with progressive benefit formulae that replace a higher percentage of previous earnings for low-wage workers than for higher earners), or horizontally (e.g. towards families with a spouse supplement, as in the United States Social Security system; or between males and females when applying unisex mortality tables).

Welfare states differ as to whether the achievement of all four objectives is left to one single pension scheme or is allocated to several components of a 'multi-pillar' system. The distinction between *Bismarckian* and *Beveridgean* approaches to pension provision provides a helpful starting point for understanding how different national pension systems approach these objectives (Hinrichs 2001; Myles and P. Pierson 2001; Bonoli 2003). Both types of public pension provision emerged during the same time period, between 1889 and before World War II. The Bismarckian approach is centered on a main pillar or tier that is public and contribution-financed. This approach is employment-centred (occupational), with benefits derived from work, and implies a priority of status maintenance ('consumption smoothing') over poverty relief. In contrast, Beveridgean pension systems—named for the system that was proposed by the study commission chaired by British economist William Beveridge in 1942 and implemented in the United Kingdom with some modifications in 1946—focus on poverty alleviation via universal flat-rate pensions financed out of taxes or tax-like contributions. Beveridgean pension systems were generally means-tested when first introduced, with some, but not all, later developing into universal 'people's pensions.' In these systems, fully-funded supplementary pension schemes organized by private actors (employers and/or individuals) carry out the functions of status maintenance.

A large majority of countries on the European continent instituted Bismarckian pensions systems in the late nineteenth and early twentieth centuries. The United States joined the Bismarckian camp with a 'light' version introduced by the Social Security legislation of 1935 and 1939 (see Figure 24.1). In the mid-1960s to mid-1970s the countries of Southern Europe expanded their hitherto meagre public pension systems, which thereafter offered quite generous wage replacement for core workers and became more

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elderly-oriented as public spending on other items (notably unemployment and social services) lagged behind (Lynch 2006). At some stage during their development, all Bismarckian countries established a 'floor' of minimum protection for those elderly whose contribution records resulted in insufficient benefit entitlements. Minimum pensions were introduced either as part of general social assistance schemes or institutionalized as part of the social insurance system. (p. 356)



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Figure 24.1 Typology of pension systems

The Anglo-Saxon nations (minus the United States) and all of the Nordic countries began as Beveridge-style systems—although in the case of the Nordic countries, Beveridge-style pension systems were introduced well before the Beveridge report. Subsequently this initially large group of countries has split, as different countries have supplemented their basic

pension schemes in two main ways. Sweden (1959), Finland (1961), and, somewhat later, Canada (1965) and Norway (1966) were the *early birds*. In light of favourable economic and demographic conditions at that time, they topped up their flat-rate, universal 'people's pensions' with a second *public* pillar. This second pillar was contribution-based, unfunded (at least in principle), yielded an earnings-related supplementary pension, and included redistributive provisions in varying degrees. *De facto*, these countries joined the Bismarckian group during the course of the early 1960s.

The *latecomers*, i.e. Beveridgean countries that provided only a basic flat-rate pension as late as the early 1970s, took a different route to achieving status maintenance in old age on a large scale. An earnings-related topping-up and, hence, an expansion of the system, was accomplished via *occupational* pension schemes that were either mandated by law (Switzerland in 1985, Australia in 1992) or arose through collective agreements and eventually achieved almost universal coverage (Netherlands, Denmark). The United Kingdom, which introduced its State Earnings-Related Pension (p. 357) Scheme (SERPS) in 1975, represents something of a unique 'hybrid' case.¹ Therefore, of the original Beveridgean camp, only Ireland and New Zealand retain systems in which provision for supplementary retirement income beyond public minimum pensions is left to voluntary action of private actors. They have not (yet) mandated occupational or personal pension schemes, but encourage broader coverage.

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In the *latecomer* countries, the second pillar is private and fully funded. However, it is extensively regulated in order to protect employees' claims, and frequently enjoys tax privileges that extend the public's reach into these ostensibly private arrangements. Latecomer countries adopted a *multi-pillar approach*, i.e. a diversification of the structure, funding and administration of benefits, well before it was forcefully propagated by the World Bank (1994 a). In these countries, 'third pillar' pensions resulting from voluntary individual provision regularly also play a substantial role in the retirement income mix.

The different pension systems described above have all facilitated the development of retirement as the third phase of an institutionalized life course by fostering the economic independence of those who are no longer in the workforce. In the advanced welfare states today, on average less than 7 per cent of men and 3 per cent of women over the age of 65 are active in the labour market (OECD 2009c), public pensions assure a net replacement rate vis-à-vis mean wages of 70 per cent (OECD 2007 f: 35) but widely varying among countries (see Table 24.1), and only 12 per cent of the elderly are poor after taking into account taxes and transfers (OECD 2008 d).

However, the diversity of pension system arrangements implies variation in both the means by which the economic independence of the elderly has been accomplished, and the precise contours of the resulting distribution of well-being among the elderly and in society at large. Public pension expenditure as a share of GDP varies from a low of 2.5 per cent in Ireland to a high of 12.4 per cent in Austria (see Figure 24.2). And while latecomer countries supplement relatively low levels of public spending on pensions with privately funded topping-up schemes, Bismarckian systems in general show markedly higher levels of public spending on pensions than do Beveridgean systems. Similar diversity across pension system types marks the weight of total social spending that is dedicated to pensions. Bismarckian systems on average spend more than half of their welfare resources on pensions, while in the Beveridgean countries generally less than one-third of social spending is devoted to pensions (Figure 24.3).

(p. 358)

Table 24.1 Net replacement rates^a of public pensions at various earnings levels (2004)

	50% of mean earnings	Mean earnings	200% of mean earnings
United States	67	52	43
Germany	53	58	44
Belgium	77	63	41

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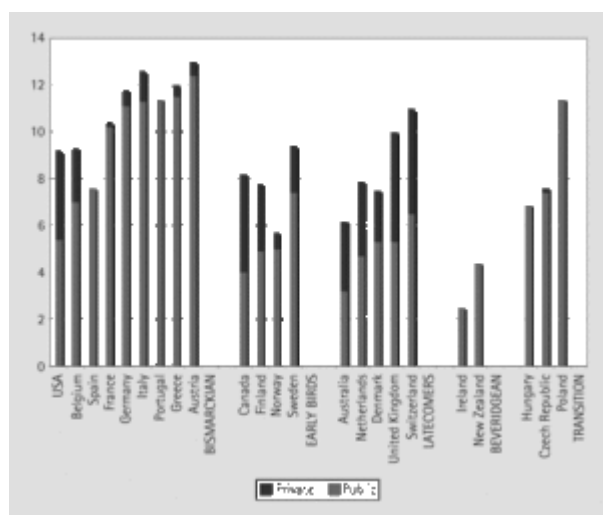
France	78	63	55
Portugal	82	69	74
Italy	82	78	79
Spain	82	85	72
Austria	90	91	66
Greece	114	110	107
<i>Bismarckian</i>	81	74	65
Canada	89	57	31
Sweden	81	64	74
Finland	77	69	71
Norway	77	69	55
<i>Early birds</i>	81	65	58
United Kingdom	66	41	24
Australia	84	56	41
Switzerland	75	64	35
Denmark	133	87	72
Netherlands	97	97	95
<i>Latecomers</i>	91	69	53
Ireland	66	39	24
New Zealand	81	42	23
<i>Beveridgean</i>	74	40	23

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Czech Republic	99	64	40
Poland	75	75	77
Hungary	95	102	99
<i>Transition</i>	89	81	72

Notes: (a) Pension entitlements as a share of net pre-retirement earnings, net of income taxes and social security contributions paid by workers and pensioners. The OECD figures cited here calculate pension benefits as a share of individual lifetime average earnings, accounting for economy-wide earnings growth, and assuming that workers earn the same percentage of economy-wide average earnings throughout their careers.

Source: OECD 2007 f: 35.



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Figure 24.2 Public and private^a pension spending as a percentage of gross domestic product (2003)

Note: ^aNo data for private pension spending available for Spain, Portugal, New Zealand, Hungary, Poland. Private spending is near zero for Ireland, Czech Republic.

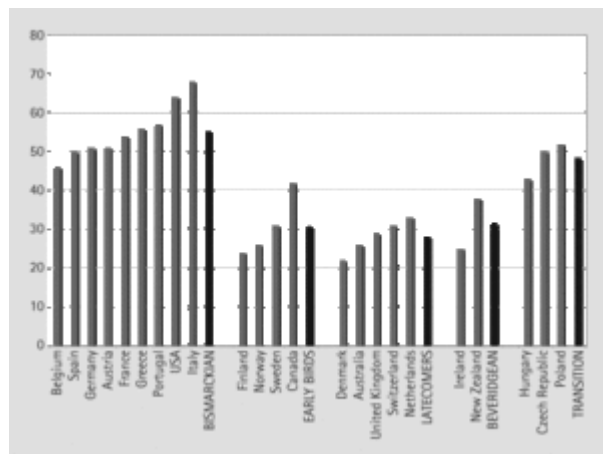
Source: Queisser et al. 2007.

Different pension systems imply divergent socioeconomic outcomes as well. Traditional Bismarckian systems tend to have higher rates of income inequality among the elderly, a natural consequence of their reliance on a main pillar whose primary goal is status maintenance rather than vertical redistribution (Lynch 2006) (Figure 24.4). In contrast, in countries that started from the Beveridgean approach, flat-rate basic pensions replace a higher proportion of former low-

wage workers' earnings than they do for former high-wage employees (Table 24.1). This is most (p. 359) obvious for the United Kingdom, Ireland, and New Zealand. The OECD includes spending on private quasi-mandatory occupational pension schemes in its calculation of net replacement ratios of *public* pensions, so for the Netherlands (and other countries with such arrangements) the replacement rate appears roughly the same for all earnings levels—much as in Italy, Spain, or Finland, where the public pillar is instead the

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backbone of the pension system (Table 24.1). The figures in Table 24.1 mainly relate to public pensions; the total replacement rate for pensioners with formerly high earnings is contingent on the extent of private components and the selective distribution of occupational and/or personal pensions. Thus, low/high public pension spending (Figure 24.2) is not a good predictor of (un)even replacement rates over the earnings spectrum or of the degree of income inequality among elderly households (Figure 24.4).



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Figure 24.3 Pension spending^a as a share of total non-health social expenditure (2003)

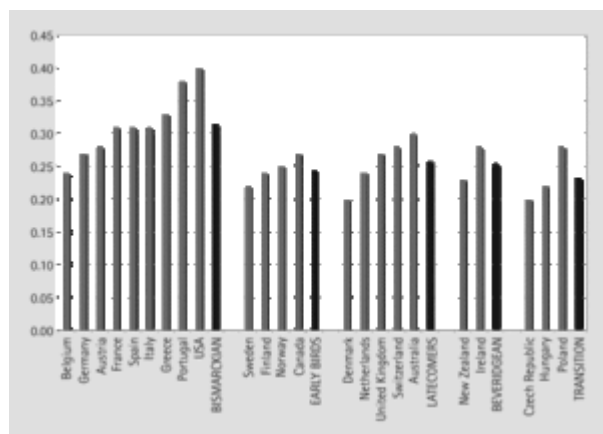
Note: ^a Public and mandatory private spending on old age and survivors pensions.

Source: OECD 2009a.

When very elevated public pension spending crowds out other social functions, Bismarckian systems may also see rates of poverty among the *non*-elderly comparable (p. 360) to countries with much lower levels of total social expenditure (OECD 2008 d; Lynch 2006). While the political mobilization of a growing elderly population is sometimes cited as a cause of this discrepancy (Thomson 1989; Wilensky 1975), 'grey power' is by no means a deterministic

force. The organization of socio-political institutions such as labour unions and the party system can dramatically alter both the policy demands and the political power of elderly voting blocs (Anderson and Lynch 2007; Lynch 2006; Williamson and Pampel 1993).

Challenges and Reforms



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Figure 24.4 Household income inequality,^a population aged 65+ (mid-2000s)

Note: ^aGini coefficient, equivalized household income post-taxes and transfers.

Source: OECD 2009c.

Some challenges to mature pension systems, such as the intergenerational inequities generated by pension-heavy welfare states discussed above, are closely linked to particular

structural attributes of a given type of pension system. However, a number of challenges are more general. Even more than other welfare state domains, pension [\(p. 361\)](#) systems are challenged by population aging. Below-replacement fertility in almost all developed welfare states and increasing longevity combine to increase old age dependency ratios and create problems of financial sustainability and intergenerational equity as more retirees will have to be supported by fewer people of working age. In the G7 countries the ratio of the inactive population aged 65 and over to the total labour force, which in 2005 ranged from 22.6 (Canada) to 45.9 (Italy), is projected to increase to between 50.3 (United States) and 98.5 (Italy) by 2050. This implies that in the absence of sharp increases in either immigration or birth rates, by the end of this century there will be roughly one elderly Italian for every member of the Italian labour force (OECD 2008 d).

Further challenges to pension systems are posed by changes to labour markets. The prolonged period beginning in the 1970s of high unemployment and low activity rates has reduced the resources available to fund pensions, and in many countries has also heightened political pressure for additional spending on early retirement and disability pensions. Where labour markets have been liberalized in response to high unemployment and low growth, 'flexible' jobs may be delinked from social rights and in any case result in intermittent employment histories. This creates a 'new social risk' of ending up with insufficient pension entitlements when exiting employment (Hinrichs 2009). [\(p. 362\)](#) In occupational pension systems in particular, high youth unemployment has made it difficult for young people to begin building eligibility for future pension rights.

Changing family structures also put stress on existing pension system arrangements, particularly where there is a substantial occupational pillar. Increases in both divorce rates and the number of women in full-time employment have challenged arrangements that linked women's pension rights to their husbands' employment. As women have entered as full participants into occupational pension schemes, however, there have also come calls to grant pension entitlements for time spent in child-rearing or elder-care.

Adjustments of pension systems to the challenges of population aging, labour market and family changes may be divided into *parametric* and *structural* reforms. The latter are systemic changes that move systems 'off path' (see below), while the former constitute incremental adjustments to elements of the basic equation linking contributions and benefits.² Parametric reforms aim to stabilize or contain a further rise of pension contribution rates by altering the worker/pensioner ratio, the wage replacement ratio, or by adding new sources of funding.

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In countries with Bismarckian pension systems, five main types of parametric reforms have occurred beginning in about 1990.

(1) The *contribution/benefit link* has been tightened. Where previously a certain number of years in covered employment sufficed to attain a 'full' pension and the benefit level was determined by earnings achieved during a number of 'best years' or 'last years' prior to retirement, benefit formulae have been changed so that earnings over the entire employment career are taken into account. The strictest (and most transparent) link between lifetime contributions and benefits, which eliminates all internal redistribution, occurs in so called *notional defined contribution* (NDC) schemes, which mimic fully funded plans (with growth of covered wages defining the 'interest rate') but actually operate on a pay-as-you-go (PAYG) basis. Among others, Italy, Sweden, and Poland have shifted their public employment-related schemes to this almost actuarial mode of benefit calculation.

(2) The standard *retirement age* has been lifted from 65 to 67 in the United States and Germany, and made more uniform for the entire workforce in a number of countries, i.e. raised for women when it was lower than for men and for public sector employees if a lower eligibility age existed before. In addition to raising the statutory age of eligibility for full retirement, new or extended options for flexible retirement have been introduced in a number of countries. Individuals who decide to claim a public pension before reaching the standard retirement age incur permanent (and more or less actuarial) deductions from the standard benefit, while those who prolong their working lives beyond the standard age are rewarded with corresponding bonuses.

(3) In almost all countries *indexing formulae* have been modified. Past earnings, which determine the level of the first claimed pension entitlements, are less often (p. 363) valued in line with average earnings growth, and increasingly adjusted to match the inflation rate (e.g. in France). Elsewhere, demographic parameters—further life expectancy at retirement age, as in all the Nordic countries and Austria, or the changing contributor/pensioner ratio in Germany (Whitehouse 2009)—have been incorporated in the formula by which the benefit level is determined at the time of retirement. Finally, current pension benefits are increasingly adjusted to consumer prices instead of previous wage development.

(4) The only expansionary type of reform that has been visible in Bismarckian countries since the 1990s is the incorporation of *unpaid family work* into the benefit calculation, so that raising children and/or taking care of frail relatives may now result in (higher) pension entitlements. The procedures for crediting care work and the benefits that accrue to such work vary widely across countries. In most cases the costs of these expansions have been covered out of general tax revenues.

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(5) Public pension schemes normally operate on a PAYG basis, holding reserve funds of varying amounts. In a number of countries these *reserves have been temporarily augmented* through a variety of means: by charging a higher contribution rate than is necessary to meet current expenditures (United States, Canada, and Finland), by incorporating revenues from privatizing public enterprises or state budget surpluses, often set aside in earmarked funds to be incorporated in the pension system at a later date (Belgium and France), or by drawing on other publicly owned funds (Norway).

Pressure from population ageing on public schemes that provide only basic pensions (among others, the latecomer countries) is less pronounced than in Bismarckian systems, since in the former the pension systems operate on a smaller scale. Nevertheless even the latecomer countries have undertaken reform measures similar to those seen in Bismarckian systems, for example raising the retirement age (United Kingdom, Denmark and New Zealand) or building up reserve funds (Netherlands, Ireland). Moreover, demographic change has also been utilized as an argument to cut back on basic pensions, e.g. by stricter testing against other (retirement) income (Denmark).

Beyond these incremental changes, *structural reforms* have been implemented in a number of countries that previously relied on earnings-related public schemes as the sole or predominant source of retirement income. International organizations, including the IMF, the OECD, and notably the World Bank, have pressed for such changes. The World Bank has even been directly involved in the reform process in some Latin American and Central and East European transition countries (Müller 2003; Orenstein 2005). In the 1994 publication *Averting the Old Age Crisis*, the World Bank argued that under current demographic and fiscal conditions, a three-pillar pension system was the soundest form of pension system for most polities and praised the Chilean pension reform of 1981 as a model. The type of system the World Bank envisioned would combine a small tax-funded basic pillar to assure a minimum income in old age, a mandatory employment-related funded pillar to provide more substantial benefits, and on top of those, personal pension savings plans to allow for increased consumption in retirement. Because of pre-funding, the latter two pillars (p. 364) were also meant to increase national savings as a vehicle for enhanced economic growth in emerging welfare states.

Therefore, the World Bank's advice was less directed towards welfare states with mature PAYG schemes but, nevertheless, contributed to weakening the prevailing pension policy paradigm in Bismarckian countries. Until about the 1990s, this paradigm had rested on cognitive and normative beliefs about the superiority of the social insurance approach vis-à-vis multi-pillar arrangements. This view was widely shared among political and social actors. The apparent exhaustion of this single-pillar approach in light of long-term financial problems, however, has allowed the competing multi-pillar approach to gain ground in these countries. Real path departure took place when private, funded pillars were introduced or substantially expanded in order to compensate for lower wage replacement that was caused by the first three reform trends mentioned above. Participation in those supplementary schemes is now either mandatory (Sweden, Poland)

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or voluntary but stimulated by tax advantages (Germany, Austria, France, Italy). By embracing the multi-pillar approach, pension systems in almost all Bismarckian countries have come closer to the structure implemented in *latecomer* countries.

Pension reforms in developed welfare states have followed a general trend of moving away from public (and private) defined benefit schemes towards those that are characterized by the defined contribution (DC) principle (see Table 24.2). This goes along with a 'risk shift' (Hacker 2006): future pensioners will bear as individuals the risks of exposure to financial markets and of increasing longevity.

Both parametric and paradigmatic pension reforms have proved to be difficult, and often involve serious political conflicts (Myles and P. Pierson 2001; Hinrichs 2001). Because pension systems bridge extended time spans—from the start of an earning career until the receipt of the final pension payout—and because the capacity of individuals to adjust to institutional changes decreases with proximity to retirement age, reforms regularly include long phasing-in periods. Nevertheless, public schemes have created large constituencies for whom pensions are of vital significance, and governments' reform efforts may be risky undertakings if they aim at cutbacks of vested rights of current and future pensioners. In order to mitigate the political risks of pension reform, governments have chosen a variety of strategies including forming coalitions with opposition parties to create oversized majorities in (p. 365) parliament; seeking out cooperation with major stakeholders, notably labour unions and interest organizations of seniors; and/or forming expert commissions to furnish advice that can help legitimize painful decisions.

Table 24.2 Funding and types of pension schemes

Pension funding/type	Defined benefit	Defined contribution
Pay as you go	Social insurance type public scheme	Notional defined pension scheme (e.g. Sweden, Italy)
Fully funded	Traditional employer sponsored private pensions	Individual retirement accounts—voluntary (e.g. United States, Germany) or mandatory (e.g. Poland, Chile)

The Future of Old-Age Pensions

At least three emerging trends in pension systems challenge existing arrangements for current pensioners, and even more for future beneficiaries. As mortality rates at higher ages decline further and, thus, longevity increases, finding a sustainable balance between the length of the working life and the length of retirement will demand an increase in the age of exit from the labour market. Most countries have already taken measures to increase the statutory retirement age, and that at least in theory should lead to a higher average age at retirement. The implementation of such reforms, however, has the potential to increase income inequality in old age because not all employees will be able to work up to age 65 or beyond. Workers in certain disproportionately low-paid occupations often have to terminate employment prematurely due to health reasons. There is a clear negative correlation between individual earnings, ill health, and the risk of forced exit from the labour force. Workers in low-paid occupations are thus penalized on two counts: they tend to have a shorter than 'normal' employment record, which results in lower pension benefits no matter the type or pillar of the pension system; and, on average, given the close relationship between income and life expectancy, they receive these benefits for a shorter period of time.

A second problematic development stems from changes in the labour market (see the previous section). Pension systems generally assume full-time jobs and a continuous employment career in order to guarantee a 'standard' replacement ratio. Women's employment trajectories have never mirrored these assumptions particularly well—so poorly did most women's working lives reflect the normal pattern necessary for a full pension, in fact, that earnings-related pension benefit systems have traditionally treated women as appendages of their working spouses. But factors such as trade internationalization, post-industrialization, labour market deregulation, permanent mass unemployment, and the growth of an informal sector in a number of countries—in addition to rising female participation in the paid labour force—mean that non-standard ('atypical') employment patterns are on the rise. Discontinuous employment careers may result in insufficient pension entitlements if public schemes do not contain redistributive features that ensure socially adequate benefits, and/or if non-redistributive, private DC schemes are prominent in the retirement income mix. The increasing reliance on private, funded pension schemes in the advanced as well as in the less developed welfare states thus increases the risk of [\(p. 366\)](#) insufficient retirement income for citizens with interrupted or otherwise atypical employment histories.

That shift to private, funded DC schemes is also related to a third problematic development. In such schemes, the risks of longevity, inflation, and financial (mis)management and market volatility are all borne by the future retiree. In the aftermath of the financial crisis beginning in the autumn of 2007, the results are painfully clear. Although no final figures are available yet, between January and October 2008, average real pension fund returns in the OECD area was *negative 22 per cent*. Pension

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funds in the United States lost about 27 per cent in real terms during the first nine months of 2008 (OECD 2009 b). These financial losses have serious consequences for current and future pensioners, who may suffer dramatic income losses if they are unable to postpone retirement or receive tax-financed bailouts. Moreover, the objective of temporarily increasing the reserve funds of public pension schemes has been thwarted—at least for the time being, and depending on the share of equities in the portfolio (OECD 2009 b).

Already before the onset of the financial crisis, optimism about funded pensions and the feasibility of the original World Bank strategy had declined in Latin America (Gill et al. 2004). In 2007, Chile put more emphasis on basic security by introducing a tax-funded ‘solidarity pillar’, and Argentina completely abolished the funded individual accounts that had been envisioned as the core component of the modernized pension arrangement. Nevertheless, and despite recent setbacks, the expanded role for private, funded pensions that has developed in recent decades seems unlikely to be undone. While many voters may demand the security that public schemes seem to offer, the underlying challenges that population ageing, slower growth, and declining employment pose to large, unfunded public pension schemes seem unlikely to abate.

Notes:

(1) After introducing a national pension in 1946, the United Kingdom experienced a short ‘Bismarckian’ period, lasting from the mid-1970s until the late 1980s. During that period SERPS was legislated (1975), and the possibilities to ‘contract out’ were limited to employer-provided defined benefit occupational pensions. In 1988, SERPS was substantially cut back and contracting-out extended to include defined contribution occupational pensions and personal pension schemes. Since then, about three-quarters of all employees have left SERPS (which in 2002 was renamed the *State Second Pension—S2P*), so that the public scheme clearly plays a minor and decreasing role in providing earnings replacement for British pensioners. Because the latest pension reform (2007/8) will further enhance private provision through ‘personal accounts’, the United Kingdom now clearly belongs to the latecomer multi-pillar group.

(2) Parametric reforms are related to the terms of the following equation: $c = (P : A) * (B : W) * (1 - S)$ where: c = the required contribution rate, P = the number of pensioners, A = the number of active workers contributing to the scheme, B = the average pension benefit, W = the average wage subject to contribution payments, S = state subsidy from general taxation (also: withdrawal from accumulated funds).

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