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Social Policy: Pensions

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Introduction

> "In all post-war capitalist democracies, economic responsibility for the maintenance of the elderly has been assumed by the state. Because retirement and receipt of a public pension at or near 65 is now universal, state responsibility for the elderly has become a taken-for-granted part of everyday life in these countries — thus it seems mundane. But the fact that a majority of the population over 65 receive the majority of their income from the state, irrespective of their capacity to work, is both historically novel and not entirely expected in view of the principles of social organisation upon which these societies were founded." (Myles, 1984, 1)

This chapter focuses on the role public pension policy played in welfare state development, and the key theories that relate to this element of public policy. We go on to consider the factors that need to be taken into consideration in pension design. Across the world many countries have developed pension systems, but there are considerable variations in the mechanisms which have been adopted to produce income security in old age. From the point of view of policy analysis, we raise some of the fundamental issues to be taken into consideration. However, from the 1970s, public policy became engaged with the feasibility and desirability of existing pension structures — particularly in the OECD nations. Fears that the modern industrial societies faced a "demographic time bomb" were combined with concerns about the long-term affordability of public pensions. As certain nations attempted to retrench or re-shape their pension systems a new strand of analysis entered the debate. It was argued that retrenchment was not the obverse of expansion: in fact it was a fundamentally different form of activity. As a result, commentators have discussed the role of policy legacies or inheritance in either constraining or facilitating reform efforts. In addition, as we examine the differential levels of success that countries have experienced in re-shaping their pension provision since the 1980s, we also need to consider institutional and political factors that give governments the capability or capacity to influence policy-making. Finally, we explore the recent trend observed in a number of nations in which there has been attempts to encourage private pensions as a way of reducing the burdens on the state. This important development at first seems to be a means of cutting costs. However, as we will show, it adds a whole new range of issues. Reliance on the private sector for security in old age brings the issue of the regulation to the fore. How far are governments prepared to regulate the quality of private sector pensions? If regulation is too severe will it act as a disincentive to private pension providers? Most importantly, can the market guarantee to produce good quality pensions for future generations?

The Growth of the Welfare State: Structural Functionalist vs. Political Explanations of Welfare State Development

State pension policy has formed one of the key components of the welfare state. Political scientists have been concerned to explain its role in the development of the welfare state. In the nineteenth century retirement did not exist — the old continued to constitute a part of the workforce, and numerous studies found that the elderly were likely to be in poverty. As a result, structural functionalists have argued that pension provision was a product of the processes of modernisation, industrialisation and demographic change (Wilensky, 1975). As family structure evolved with changing patterns of work, supporting and caring for the elderly was no longer a private concern. While the advantage of structural functionalist explanations of welfare state development is their focus on the important pre-condition of state intervention, such as a nation's economic level of development, political explanations tend to highlight the role of strategic choice between competing alternatives. There are significant differences in the timing of government intervention and the manner in which they chose to intervene. However, there are many important political explanations of welfare state development which highlight a wide range of political variables, such as the rise of universal suffrage and how increased democratisation influenced the growth of public pension provision (Uusitalo, 1984). Other commentators have highlighted the role of political learning (Heclo, 1974). Building on explanations of welfare state development, it is important to explain the variations in the level and types of provision provided by the state. After the Second World War most countries amongst the advanced industrial democracies had consolidated pension provision and, as a result, political scientists were concerned to explain variations in character of public pensions amongst these countries. Many commentators have highlighted the importance of left wing parties, trade unions and the role of social democracy (Esping-Andersen, 1990). Much of the comparative research examining the development of pension policy also confirms the importance of social democracy, and does not support the structural-functionalist hypothesis. Research conducted by Myles questioned the impact of demography on pension development (Myles, 1984). He argued that the effect of increases in the elderly population is the opposite of that predicated by structural functionalist theory. Rather than encouraging the improvement of public pension policy, a large elderly population appears to discourage the development of high quality pensions. In the absence of a political system dominated by the left, it would seem that the characteristic response to a large elderly population is to narrow the entitlements available to the elderly. Using the various indicators of social democratic influence (the size of the vote for the left party, the number of years the left party is in power, union membership, and union centralisation), Myles (1984) found the most convincing correlation between these variables and his index of pension quality. The results suggest that a well-organised and cohesive labour movement that is able to achieve Government office for extended periods of time is the best guarantor of high quality pensions. However, as will be discussed later in this chapter, these results refer to research conducted specifically on the issue of welfare state expansion not retrenchment. In addition, this discussion has focused on the nations that reached a high level of economic development in the late nineteenth and early twentieth century. Provision for the elderly is also an important issue for public policy in countries with fewer resources — those in the medium to low income category (World Bank, 1994) and those transitional democracies of Central and Eastern Europe. All of these countries are, of course, attempting to develop pension systems at a different historical point, and under very different circumstances, in comparison to those which have developed in Western Europe since the nineteenth century.

The Key Goals of Pension Policy

Like any other area of welfare provision, the characteristics of national pension systems are subject to considerable variations. The system design of public pensions is based on a variety of different factors. Despite the contemporary focus on the cost of public pensions, it is important to remember the other key objectives of pension provision in system design. If the arrangements for pension delivery fail, the old may have to rely on means-tested assistance or personal saving. This section explores the key factors that need to be taken into account in system design. Myles (1984) outlines six factors which play a critical role in determining the character of state pension provision.

Pension Level

The first factor that influences the character of a state pension system is the value or level of the retirement pension. Pension level can be evaluated in two ways: firstly, the value of the pension in comparison to the pensioner's earnings during working life; and secondly, the value of the retirement pension in comparison to the standard of living enjoyed by the working population.

Pension Structure

The structure of a pension scheme can range from the provision of flat-rate uniform benefits granted to all pensioners on the basis of citizenship, without any reference to their previous earnings or contributions, to the provision of benefits which are strictly related to the contributions which have been paid during working life. As soon as pension arrangements depart from the flat-rate principle and become related to lifetime earnings the wage inequalities which exist among the working population will be extended to the retired.

Income Stability

This is one of the most important features of any pension system because it refers to the mechanisms which ensure the pension will retain its value after the date of retirement. In order to retain its value, the pension must be increased so as to keep pace with inflation. Furthermore, if wage increases are out-pacing those of prices and the standard of living in society as a whole is rising, a pension which reflected the earnings of the previous decade will appear to have depreciated. If pension increases are linked to wage increases, pensioners will benefit from real growth in the economy. With price indexing, the value of the pension is preserved but the pensioner does not share in economic growth. Whichever option is selected, it is vital to ensure that indexing takes place at regular intervals.

Eligibility

Some societies provide retirement pensions as of right to all citizens. However, most base their arrangements on the insurance principle, which means entitlement is based on the contributions made during working life.

Security

When the individual retires from the labour force s/he will normally experience a reduction in income. In order to maintain the standard of living which is comparable to that enjoyed during working life, the retirement pension must replace 60–80% of pre-retirement earnings. The concept of income security refers to the level of income which allows the pensioners to maintain their pre-retirement living standards. Irrespective of the pension structure, the elderly will not receive inadequate financial support if the value of the pension is low in comparison to the standard of living of society as a whole.

Adequacy

Income security will not protect the poorest members of society from poverty in old age. If the pension system is based on the principle of linking earnings to benefits the poor will not have earned enough during working life to allow their income to be reduced on retirement. To avoid this problem the replacement ratios must be higher for the poor than for the well-paid members of society.

System Design Options

By the mid-1990s the World Bank argued that income security in old age was a world wide problem. However, this crisis has manifested itself in different forms in different parts of the world. Over half the world's old people depend on informal provision. In Africa and some parts of Asia, the old tend to rely on the extended family and personal saving. Both state provision and private pensions tend to be rudimentary. However, the ability of families to support their elderly is under threat from the forces of social and economic change: whether that might be industrialisation or the disruption caused by war and famine. Another cluster of countries face the problem of how to afford the pension systems they already have in place. This is a common feature in Latin America and Central and Eastern Europe. However, the more established social security systems of the advanced industrial countries belonging to the Organisation for Economic Co-operation and Development (OECD) are also facing difficulties, in that it is argued that their pension systems have become too generous and are now unaffordable. By the 1970s talk of a crisis in pension provision became the norm and since that time the proportion of spending as a percentage of GDP has been projected to rise over the next fifty years.

System Design and Delivery

According to the World Bank, 40 percent of the world's workers and 30 percent of its old are covered by formal arrangements for old age. In the post-war era this type of state provision followed some basic patterns. First of all, some countries adopted a universal flat-rate state pension aimed at providing basic income security in old age. This was then supplemented by a second tier of earnings-related provision. Other countries instituted a fully earnings-related system. Some countries encouraged the growth of private sector occupational schemes. Other countries had a system design which resulted in the private sector focusing its efforts on the better off or the self employed.

However, government intervention is not limited to the role of pension provider. The state also has a role in regulating private pension, creating a legal framework for financial institutions and pension funds, and offering tax incentives to promote saving for old age. In this sense the state is always involved in pension arrangements whether or not they are a provider.

The types of pension delivery were described above. However, there are many issues of system design that go beyond the basic structure. One of the most important is whether contributions are defined, which is a system under which the contributions are known but not the size of the final pensions. By contrast, defined benefit (otherwise known as final salary) schemes set out the size of the final pension in advance. Equally, there is the issue of how the system should be financed. Some systems operate on a pay-as-you-go basis, in which current pensions are financed by taxes on the current workforce. Other systems operate on a funded basis, in which pensions are financed by accumulated savings. The pay-as-you-go (PAYG) system has tended to be the norm, and has also tended to be mandatory. As the World Bank pointed out, coverage has been “almost universal in high income countries and widespread in middle-income countries. As its name suggests, it places the greatest responsibility on government, which mandates, finances, manages and insures public pensions. It offers defined benefits that are not actuarially tied to contributions and finances them out of a payroll tax (sometimes supplemented from government revenues) on a pay-as-you-go basis. And it redistributes real income, both across and within the generations" (World Bank, 8).

The development of the occupational sector has been an important feature of the post-war period, starting to grow in coverage in the 1950s and 1960s. These are private pensions offered by employers which, in the past, were largely organised around the principle of defined benefit or final salary. Employers and employees both contributed to partially funded schemes, and there are the usual tax advantages attached to the scheme. Employers regarded these schemes as a way of attracting and retaining labour. However, in recent years, as will be discussed later, these schemes have undergone reform, and their generosity has declined. The funding requirements have tightened and many have moved to a less generous defined contribution system. As a result, employees do not know what pension entitlements they will have upon retirement because the final pension depends on contributions and investment. A second common form of private pension saving is Personal Pensions, sometimes known as individual accounts. These plans are fully funded and are based on defined contributions. Again, this form of personnel saving is often aided by tax incentives. The size of the final pension is contingent on stock market performance, so the individual bears the risk. However, in recent years, some countries have made these types of individual pensions mandatory. Sometimes government has managed these mandatory schemes and in others they have been arranged by the private sector.

Pension Reform

From the 1980s and throughout the 1990s, public pension systems have undergone a period of transition and reform. In many countries public pensions constitute the largest segment of the social security budget, which has meant there have been powerful economic reasons to either curtail the state's generosity or to privatise elements of provision, thus reducing the state's obligations. However, efforts to reform public pensions have not followed a uniform path, nor have they had uniform consequences. As Bonoli notes, the pension reform trajectory is based on an interaction between the structure of political institutions and the design of the pension schemes operating in each country (Bonoli, 2000). As a result, the impact of retrenchment is subject to marked variations. In the 1990s, the Swedish welfare state offered extensive coverage of the workforce and very generous pensions replacing a high percentage of average male earnings. By contrast the UK public pension system was far less generous, replacing a far smaller proportion of average male earnings. When the Swedish pension scheme was reformed, the cut backs meant that it was still replacing a significant percentage of average male earnings, and as a result continued to provide good quality provision. In the UK, the base point from which reform took place was already barely providing an adequate pension.

If the design of the pension scheme is important to reform efforts, so too are political institutions, the configuration of societal and political interests and interest groups formation. If welfare reform efforts retrench benefits in such a way that certain individuals lose out, then there will, of course, be political consequences. The issue is how to implement reform measures that avoid blame being attributed to the governing party. In some countries the progress of reform has been relatively easy because the government of the day has not faced effective opposition, or been forced to deal with institutional obstacles. The best example of this was the case of the UK. However, in continental Europe, while reform has taken place, the governments have faced opposition from entrenched interests, which has slowed the progress of reform and also conditioned the character of the reforms that have been attempted. In Germany, attempts to reform the pension system began under Helmut Kohl. The problem with the German pension scheme was that high contributions and high rates of income replacement discouraged growth in employment. High wage costs made employers cautious about expanding their work force and high benefits encouraged early retirement. The public pension scheme was un-funded, which left government responsible for a greater share of the cost (Cox and Fawcett, 2000). However, reform efforts were difficult in Germany because of the contentious nature of the issue: there has been disagreement between the governing parties, opposition from the social partners, and institutional obstacles in the form of the bicameral, federal system of government. In addition, there was great public loyalty to the "conservative-corporatist" welfare state, in which citizens had become accustomed to a state which provided income security. This was a marked contrast to a liberal welfare state such as the UK, in which there are strong cross-class divisions in welfare. In the 1970s and 1980s, around half the population were covered by private occupational pensions and were used to market welfare. The state pension had never reached the generous levels of other continental European nations, and therefore was easier to reform.

The German pension reform of 2001 was interesting because it might be termed a "direction-setting or pioneering law" which changed the course of the German pension system set in place in 1957, appearing to introduce minor changes in the first instance (Lamping and Rub: 2004). The law introduced a public private mix in pension provision, with a new private tier of provision, subsidised by the state and based on defined contributions. However, the public PAYG pillar remained the dominant component of provision. The law also introduced a new formula aimed at slowing down or even stopping increases in the contribution rate.[1] Contributing to private pensions is voluntary. The plan had been to make it compulsory in 1999, but now employees are encouraged to contribute via tax incentives.

There are a variety of reforms measures available when attempting to contract expenditure on public pensions, and generally they are associated with attempts to reduce the scope and generosity of the state scheme. First of all, governments can increase the age of retirement. In addition they can reduce the quality of the pension by increasing the eligibility and qualifying criteria. For example, in the past pension levels were often based on something like the "best twenty years" of earnings. This can be extended to the whole of individuals' working life. Equally, the number of qualifying contribution years may be extended. Finally, the proportion of earnings replaced by each year's pension contribution can be made less generous (Fawcett, 1995). Another method of reducing costs is to target benefits. This has generally been applied in countries that had a basic flat-rate state pension, such as Australia and New Zealand. In addition, the indexation of the pension once it is in payment can also be altered. Some pensions systems have moved from indexation that was based on an annual re-valuation, based on increases in average earnings, to one which increased the pension in line with prices. As a result, the value of the basic state pension fell progressively over the years (Fawcett, 1995).

A further method is to encourage the growth of private sector pensions, by increasing tax incentives or offering other forms of subsidy. Governments attempt to shape individual preferences by reducing the value of the state pension while simultaneously encouraging private sector growth. Increasing private sector coverage overall expands the size of funded pension schemes. In the case of the UK, many of these measures were successfully implemented during the 1980s in combination. The basic state pension was reduced in value by altering the indexation criteria. The State Earnings Related Pension was reduced in generosity and the government encouraged the growth of Personal Pensions with generous incentives.

However, the UK experience also draws our attention to another aspect of how the state is involved in pension provision: the regulation of the private sector. During the 1980s, the government took steps to deregulate occupation pensions, allowing contracting out of the state scheme if they offered pensions based on defined contributions rather then defined benefit; as a result the number of occupation schemes increased (Fawcett, 1995). In this way, the government re-orientated the UK system, encouraging the growth of private sector pensions in order to reduce the size and the cost of public sector pensions.

Reforming Pension Systems: Issues of Path Dependency

From the 1980s, many governments have sought to pursue a welfare reform agenda. However, despite a number of governments committing themselves to change, many commentators observed that the welfare state seemed somewhat impervious to reform attempts, in particular that it appeared difficult to reduce the overall levels of spending on state welfare. This gave rise to a number of theories attempting to explain welfare state retrenchment, one in particular focuses on the notion of path dependency. This appeared highly relevant to the study of pension reform because, of all the component parts of the welfare state, pensions seem highly susceptible to path dependent effects. If we consider the basic characteristics of a pension scheme we can immediately observe certain difficulties in reform measures. The contributory nature of pension schemes means that pension rights are accrued over a long period of time. In addition, there are significant problems in the transition from one pension scheme to another, when pensions are already in payment under one scheme and a high proportion of workers will not have time to contribute to a new scheme. The public pension system of most advanced industrial countries means that governments have made long term pension commitments to large sections of the electorate. In addition, those with a stake in existing programmes and policies have a high level of influence over the reform measures that can be attempted. Since abolition or cuts in provision have significant political risks and may reflect negatively on the government of the day, is it possible to avoid blame?

The most common technique that has been used in pension reform is introducing policies which defer the impact of reform until some future date. Another technique that has been used is to contract or re-shape a pension system by making a variety of small scale reform measures that erode the value of benefits over time. Pension policy is highly complex and it has been shown that consumers have imperfect knowledge of the options available (Mayhew, 2002). As a result, governments can enact highly technical changes that may have a very big impact on the long-term value of these commitments. Often the implications of these changes do not become apparent for some time (Fawcett, 1995).

The path dependency argument, associated with the new institutionalist school of political science, refers to the legacies of past policy: the way in which previous political choices effect the current political agenda and the options open to political parties. Firstly, it is argued that public policies give rise to structures and resources that either encourage or inhibit the formation of interest groups. In this sense, as Schattschneider wrote, “new policies create a new politics” (1935: 288). Policies themselves create a specific constellation of interests and interest groups, and generate incentives which either facilitate or inhibit their expansion. Secondly, existing policies influence the perceptions and agendas of key political actors. Past policy plays an important role in framing political actors' perceptions of policy alternatives.

When we examine the various attempts to reform pension policy since the 1980s we can see that these concepts have some purchase. For example, many continental European countries lacked a well-developed private sector which was ready to take over the burden of public pension provision. Indeed, in some countries, such as Germany and Sweden, the majority of wage earners relied on state provision for all or most of their retirement income. As a result, there was a substantial cross-class coalition in support of public provision which was difficult to destabilise.

By the same token, the example of the UK shows how the policy choices of political actors shaped the behaviour of ordinary citizens. 11 million workers joined private sector occupational schemes in the 1960s because the UK lacked a good earnings-related second tier of state pension provision. Future attempts to improve public provision in the late 1960s and 1970s were constrained by these choices. The growth of the private sector created new interests: insurance companies, white collar trade unions, and of course, members of the public who had joined private sector schemes. The design of a state earnings-related scheme in 1975 was based on the notion of partnership rather than competition with the private sector. Equally, any attempt to regulate the quality of pensions offered by the private sector in order to improve quality was likely to provoke opposition from pension providers and resistance from those who had become clients of the private sector. Whereas it had been possible to think of launching an ambitious state scheme in the 1950s and early 1960s, when private pensions accounted for a relatively small sector of the market, and the existing state pension was set at a basic level, there were now severe political costs to be taken into consideration. (Fawcett, 1995,1996) As Pierson writes:

> “Policies may create incentives that encourage the emergence of elaborate social and economic networks, greatly increasing the cost of adopting once possible alternative and inhibiting exit from a current policy path. Individuals make important commitments in response to certain types of government action. These commitments in turn may vastly increase the disruption caused by new politics, effectively locking in previous decisions.” (Pierson, 1994, 41–3)

However, the importance of path dependency and the feedback effects of previous policy choices should not be exaggerated. Some of the literature in this school has emphasised these factors as a reason why it was difficult to retrench the welfare state during the 1980s. The fundamental problem with this literature is the specification of the dependent variable “welfare state retrenchment”. What do we understand by change and how best to measure the degree of change that has taken place? For example, in the mid-1980s, the UK Conservative government under Margaret Thatcher considered abolishing the State Earnings Related Pension Scheme. The fact that the government chose not to pursue all-out abolition has been cited as an example that shows how difficult it was to retrench the welfare state and as proof of the path dependency argument (Pierson, 1996). In fact, the State Earnings Related Pension scheme was not defended by any significant interests. The then Chancellor of the Exchequer, Nigel Lawson, did not see immediate benefit in terms of the administration's priorities and opposed the plan. However, the strategy that was chosen was equally effective but far more politically astute. The government pursued a dual strategy of reducing the generosity of the second tier of earnings-related state pensions, while changing the way in which the basic pension indexed so it rose in line with prices. At the same time, the government deregulated the occupational sector and created a new market in private sector defined contribution Personal Pensions. The Personal Pension market was stimulated by generous tax incentives. In the 1970s, about a half of the UK work force was covered by private pensions. By the end of the 1980s, around two-thirds of the workforce was covered by the private sector. The state sector was in long-term decline, and as its benefits became less competitive and the numbers covered less substantial, this paved the way for further retrenchment, eventually leading to the greater reform efforts (Fawcett, 1995).

The fundamental issue here is that a quantitative change can produce a qualitative change. The Conservatives wished to retrench public provision and encourage private provision. The strategy they pursued had a number of component parts which produced the same result in a very short time period. As a result, the state pension system in the UK underwent retrenchment; however, it did so by a rather different route than all-out abolition at one particular time. Hence, the way in which we understand the specification of retrenchment and how we chose to measure it, is the issue here.

In fact, looking back over the history of the 1980s and 1990s, many governments pursued similar courses of action, which we might describe as "path-shaping" (Cox and Fawcett, 2000). The issue of "blame avoidance" is important in devising retrenchment policies, because restructuring can lead to important sectors of the population suffering the negative consequences of retrenchment, which may create electoral losses for politicians. There is some benefit in pursuing a retrenchment strategy that proceeds in a gradual and incremental manner because it assists in a blame avoidance strategy by defusing opposition from groups who feel they will lose out because of reform efforts.

However, the ability to reform public sector pensions varies from country to country. These differences can be explained by the institutional and political veto points which either facilitate or inhibit the progress and the possibility of reform measures. Bonoli points out that the political limits to reform are specific to individual countries, based both on the design of the pension system and the political and institutional structures in place (Bonoli, 2000). His argument is based on new institutionalist focus on the capabilities of government and the fact that the degree of government control over policy-making is subject to significant variation. In any political system there may be institutional structures that have to be managed in order to implement policy change. Equally, there might be coalitions of actors that can obstruct the policy-making process. These "veto points" can act as a major limitation on a government's ability to control policy outcomes. By contrast, the absence of veto points, combined with strong concentrations of power, gives government a much stronger ability to bring about change in policy-making.

The types of factors that impact on government capacities are systems based on a separation of powers; bicameralism; proportional representation; referendums; and balanced dual executive. Policy-makers in the UK, a unitary state with a first-past-the-post-electoral system, and a weak second legislative chamber, faced very few institutional obstacles when passing their reform legislation — especially since the governing parties often enjoyed large majorities. Other countries have had to negotiate and frame reform in a far more complex and cautious manner.

Issues Relating to the Privatisation of Pension Policy: The Public Private Mix

An important part of the welfare reform efforts that have taken place over the last two decades has been the attempt to introduce increase private pensions coverage. However, some countries have always based their retirement provision on a mix of public and private provision. In many cases, funded private pensions have been small in scale aimed at professional well-paid wage earners. In other countries, private provision was extensive and well-institutionalised after the Second World War. For most of the post-war period, private occupational pension schemes existed as supplements to state pension provision. However, in some countries the pension system was designed from the outset to operate on the basis of a public-private mix of provision. From 1946, the Dutch pension scheme combined public sector pensions with private occupational pensions, and occupational coverage expanded over time so that ninety percent of the population was covered. However, in recent years, we have seen a trend towards increasing the extent of private provision as a way of reducing the state's commitments to public pensions. This has been the case in the German pension reform of 2001, the American debate on social security reform, and the Swedish case.

Private Sector: Solution or Problem

Does the shift to the private sector mean less adequate income security in retirement? Rein and Schmahl (2004) argue that, to answer this question, we have to examine the overall mix of the state and private sector income package combined. In many countries there seems to be no immediate cause for concern. In two countries in particular, the UK and the USA, there is high-income inequality and high levels of pensioner poverty.

The first point to note in a consideration of the private sector is that the state continues to be involved in a variety of important ways, especially as a public sector employer and as a regulator. There are three principle sources of regulation: trust law, taxation policy, and regulatory authorities. In addition, if the mechanisms for privatisation are based on contracting out of the public sector scheme, the state regulates the conditions of pension quality under which occupational schemes are allowed to contract out. Thus it is still the state's role to stipulate the quality of pension the private sector provides. The increase in private provision may have reduced some of the obligations on the state. However, it raises the issue of whether private pension providers will be able to deliver a high quality of provision for future pensioners. A highly privatised configuration of pension arrangements forces politicians to consider the issue of regulation, and the dilemmas posed in trying to balance risk and regulation. The UK now has one of the least expensive public pension schemes in Europe. However, this has come at the price of de-regulating the private sector, and then being forced to re-regulate to restore public confidence in the aftermath of a variety of scandals (Blake, 1995). These scandals increased public awareness of the degree of risk associated with market provision and a re-evaluation of the regulatory regime. Indeed, since de-regulation, pressure has mounted on this issue, because it was becoming increasingly clear that (for a variety of reasons) funded pensions might not deliver the appropriate level of benefits at the point of retirement. In addition, since 1998, two-thirds of final salary schemes closed to new members and fund deficits are estimated to be £100 billion since the stock market slump of 2000. The government seems caught between the proverbial “rock and a hard place” because increasing regulation is likely to provoke a backlash from the private sector — failing to act is likely to further damage public confidence. However, while it has been important to develop a structure for regulation, as has been done since the 1990s, it is equally important to regulate the quality of pension provision for future pensioners. In this sense, the current crisis in British pensions has been the result of the liberalisation of the quality conditions under which the private sector has been allowed to operate. By moving to defined contribution rather than defined benefit schemes, Blake has shown that the overall level of contributions has fallen (Blake, 2001). Indeed, increased regulation has come at the price of a decline in pension quality. In order to get the private sector to contribute to a Pensions Protection scheme, the government allowed a reduction in inflation proofing, which could have serious implications for future pensioners.

The provision of private pensions is a voluntary activity. If the burden of regulation becomes too onerous, the incentive to provide private provision becomes less attractive. However, the UK's pension arrangements are heavily reliant on the private sector, and both the Labour and Conservative parties have encouraged further increases in private provision. Hence the “regulation/risk” dilemma is acute in the British context. The greater the population covered by the private sector, the more important it is to deliver high quality and reliable benefit systems. However, this reliance on the private sector creates a powerful interest group. The development of regulation is a matter for negotiation rather than imposition. In practical terms, the UK has established a relationship of dependency on the private sector, and, as a result, regulation is viewed in terms of what is perceived as feasible for the private sector to provide. The UK case is an extreme example, perhaps because of a mistaken belief that expanding private pensions is the solution to the problem of financing public pensions. In fact, it may be a cautionary tale, demonstrating what can happen when the state becomes over-reliant on the private sector.

Conclusion

During the affluence of the post-war years, pension provision was consolidated and expanded, but by the 1970s pension policy was perceived to be a key part of the “crisis” of the welfare state. In the aftermath of the oil crisis of 1973, stagflation and the pressure to retrench public expenditure, spending on pension policy became of enormous concern in the political and policy debate. At one time, relatively uncontroversial, fears of a demographic crisis — namely a growing number of older citizens living longer — was placing the pension systems under pressure. This was combined with an unfavourable ratio of workers to retired — namely, the size of the working population contributing to the finance of the pension systems — was declining in comparison to the rising number of the elderly.

Since the 1970s, therefore, the succeeding decades of welfare retrenchment and reform have focused heavily on the issue of pension policy. Policy makers have looked for ways to make their pension systems more affordable. This has usually focused on two aspects of system design: first of all reforming public pensions to make them less generous and to reduce the obligations on the state; secondly encouraging the privatisation of provision. Reconstituting pension systems in a way in which the private sector became responsible for some proportion of pension provision would seemingly diminish the obligations on the state. However, in the current economic climate, the way in which this has been done can produce lower quality provision. As a result, a new problem may be on the horizon, namely a retirement income package that fails to produce financial security in old age. In addition, the private public mix in pension provision raised other important issues for public policy, namely the regulation of the private sector, as well as their ability to deliver and guarantee high quality pensions.

Note

1. According to Lamping and Rub the contribution rate is set so that it should not exceed 20 percent in 2020 and subsequently should remain below 22 percent. The result of the new alteration in the pension formula is that pension level should average 67 percent of average net earnings minus the assumed saving rate for private old age provision.

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