Pension reform and intergenerational redistribution in Italy and Germany

- Similar solutions, different outcomes -

Paper submitted to the
RC 19 Annual Conference (mentoring session)
Montreal 20-22 August 2009

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1. Introduction

Daddy's pension is a mirage.[1] (Boeri and Galasso 2007: 79)

The puzzle addressed in this paper is that, on the one hand, (even) Bismarckian welfare states have radically transformed their pension systems. In some respects their institutional architectures have become surprisingly similar to that of other welfare states founded on traditionally different principles. One may even describe this as policy convergence. I argue, however, that despite the apparent convergence with respect to the overarching institutional architecture and organisational principles, they continue to be functionally different. That is, the emerging alikeness is rather superficial and significant differences persist. More concretely; so far we do not see many signs that these systems are becoming more alike with respect to the outcomes or policy effects they produce.

Castles has argued that "[t]he issues confronting advance welfare states in the coming years are neither universal nor wholly unique, but patterned by their historical and cultural inheritance, including, most prominently sets of institutional preferences peculiar to the welfare state types to which they belong" (Castles 2004: 177). I push this argument one step further and submit that to understand the absence of profound convergence in pension systems, despite the adoption of policy solutions going in broadly similar directions, it is helpful to consider them as a sub-unit which is part of a larger complex system, making up what we more commonly know as an advanced political economy or democratic state. A pension system (or a health system for that matter) should be considered as only one of several pieces embedded in a larger whole. Thus, although recent pension policy measures in many instances have been remarkably similar in countries with traditionally different approaches to social protection, we see that these welfare states to a large extent retain their characteristics and peculiarities with regard to how they actually redistribute resources across population groups. Hence, we should continue to expect a high degree of cross-national variance with regard to the actual functioning and performance of these systems.

Empirically the issues set out above are approached by looking at how (and why) public pension reforms in Italy and Germany have affected redistribution between generations. Who are the winners and losers in the process of making the pension system fit for the future? What explains the differences in outcomes between the two countries, which in the area of pensions are both firmly rooted in the Bismarckian tradition? By outcomes I primarily refer to the burden of readjustment. That is, have pension reforms rewarded or punished younger and older generations in similar ways in the two countries?

In asking these questions the paper takes seriously what Palme (2006: 359) has labelled the *sceptical* hypothesis about redistribution. This refers to the view that welfare states themselves may contribute to social inequalities. That is to say, the welfare state can be seen as a system of social stratification in its own right (Esping-Andersen 1990). I do not contend that the welfare state is always a source of redistributive perversities and increased inequality, but rather that being confronted with modern welfare states, issues of (re)distribution have become far more complex than they were in the post-war years. Hence, one cannot take for granted that the welfare state always performs the "benevolent" function of redistribution from the haves to the have-nots. The question who are the rich (i.e. the ones that should shoulder the largest burden) and who are the deserving poor, is not that straightforward anymore. Due to the increased complexity, over the years the welfare state has typically come to produce some unintended distributional consequences. To see the increased complexity, one should be reminded that redistribution comes in different kinds. Palme (2006) usefully distinguishes between *vertical* (from rich to poor), *horizontal* (over the life-

[1] Original quote: La pensione di papà è un miraggio.

cycle), *risk* (to individuals struck by specific social risks) and *perverse* (poor to rich) redistribution. To complicate the picture even further, one can also meaningfully talk about several *dimensions* along which redistribution can occur. To name but a few examples, redistribution takes place across different income (or wealth) categories or classes, across generations (i.e. cohorts) and age groups, types of regions (urban vs. rural areas), gender, and occupational groups.

All unfunded, so-called *pay-as-you-go* pension schemes explicitly make workers pay for the pensions of current retirees. In simplified terms, the implicit agreement is that through the contributions made to the system when participating actively in the labour market a worker acquires the right to a pension when (s)he reaches the statutory retirement age. That is to say, the system explicitly redistributes from the young to the old. *Per se* there is nothing wrong with this principle. In fact, the PAYG design made perfect sense at the time when the systems were introduced. It was a way to allow pension payments to the needy elderly to start immediately instead of having to wait for the system to mature. Intergenerational transfers at the societal level can be understood as the net difference between benefits and contributions over the life-course for successive generations in a country[2]. It should be noted that even if focus is kept only at the societal level it is extremely difficult to arrive at an exact balance sheet of intergenerational transfers[3]. Nevertheless, one can speak of some general trends. The hugely influential 1994 World Bank report on pensions, "Averting the Old Age Crisis", reports that "[i]n all cases, earlier generations have done better than later generations, regardless of income. That is, covered workers aged 30 to 50 at the inception of the scheme always gain, whereas their children and grandchildren lose" (World Bank 1994: 132; see also Burtless 2006).

Much has been written about pension reform in recent years as it has become a hot topic in most of the social science disciplines. Contrary to the prediction that in most instances – and in particular in the continental context – we will see a "frozen welfare state landscape" because "long-established policies become institutionalized, and cultivate vested interests in their perpetuation" (Esping-Andersen 1996: 24), the institutional architecture of public pension systems have been radically transformed. Especially over the last 15 years we have seen that when the pressure become large enough even giants (i.e. public pension systems) have to react in order to survive. Indeed, in recent years there has been a proliferation of scholarly work investigating different aspects of social protection for the aged (e.g. Bonoli and Shinkawa 2005; Clark, Munnell et al. 2006; Arza and Kohli 2008).

One tradition describes the institutional and financial consequences of pension reform in the context of demographic change and tight budgets (Disney and Johnson 2001; Feldstein and Siebert 2002; Holzmann and Palmer 2006). However, the assessment of outcomes tends to be rather narrowly focused on a discussion of income replacement and the extent to which the reforms succeed in guaranteeing the financial sustainability of public pension systems in the context of population ageing. Such analyses often become a very technical endeavour and, indeed, this ground is dominated by economists. The centre of attention tends to be on the macroeconomic effects of changing policy instruments and precise targets[4] such as retirement age, methods of benefit calculation and indexation and method of financing.

[2] The paper focuses on intergenerational redistribution at the societal level. This is not, however, to say that intergenerational transfers within the family are unimportant. See e.g. Albertine, Kohli and Vogel (2007) and Börsch-Supan, Brugiavini et al. (2005).
[3] Some economists have tried to do "generational accounting" (see e.g. Auerbach, Kotlikoff et al. 1999),but their findings remains controversial.
[4] Hall (1993: 278) has usefully suggested to think about the policy-making process as consisting of "overarching goals", "policy instruments" and "precise settings or targets".

Another strand of research looks more closely at the political dynamics of pension reform (e.g. Bonoli 2000; Pierson and Myles 2001; Immergut, Anderson et al. 2007). Studies examining the politics of reform tend to take the policy effects, such as for instance likely financial consequences, as given[5] and try instead to explain the political dynamics behind the cross-national differences. Most recent work following this tradition has moved beyond the question whether globalisation is causing welfare state retrenchment or not to look at how reform has been possible despite institutional lock-in effects and a welfare clientele with a strong interest in preserving *status quo* (e.g. Schludi 2005; Natali 2007; Palier and Martin 2008).

The present paper straddles the ground between these two traditions as it empirically addresses an aspect of pension reform which has to do as much with politics as it has to do with the actual policy output, namely how pension reforms in two countries have impacted on the way the pension system treat different generations. As Immergut and Anderson point out, "[p]ublic pension policies are a strong case of "redistributive policies". They involve broad swathes of voters in questions of generational fairness and both class and gender equality" (Immergut and Anderson 2007: 3). Social policy research which examines the consequences of pension reform needs to take account of the more technical matters of financial sustainability and the replacement rates offered by a given system. However, simultaneously it is important to recognise that, "decisions about which types of pension policy change are most effective and most desirable are not merely technical but also political matters. Politics enters into judgements about pension policy proposals because these judgements are based on political priorities and political feasibility" (Immergut and Anderson 2007: 23). As an undergraduate student of political science, I remember being told that politics is about who gets *what*, *when* and *how*, and the process of pension reform seems to touch with an equal weight on all of these dimensions.

Before continuing the discussion, it is necessary to address briefly the conceptual distinction between *generations* and *age groups*. Following Kohli (2005: 518), at the societal level *generations* refer to "the aggregate of persons born in a limited period who therefore experience historical events at similar ages and move up through the lifecourse in unison". *Age group* is of course a related concept, but it is more confined in that it is linked to the age held by a group of individuals at a particular point in time. Hence, as Kohli (2006: PAGE) points out, "age groups are to be viewed not as entities with fixed membership but with regularly changing membership, with all individuals progressing through the life course from one to the next according to an institutionalized schedule ". Considering that age is no fixed characteristic, it can be argued that *per se* unequal treatment of age groups is normatively legitimate. Children are for the most part financed by their parents rather than public resources, but as these young individuals move through the life course to become adults and later elderly, they will reap the benefits of the relevant public resource transfer in due course. However, an elderly biased allocation of public resources can be seen as ineffective or "unjust" if, as a consequence of the skewed resource distribution, one age group, e.g. young adults, is consistently worse off (Kohli 2006: page).

In policy terms, a social protection scheme might be neutral with respect to generations, but at the same time advantage a certain age group. A pure PAYG pension system is an example of such a policy. Benefits accrue only to the most senior age groups, but over overall cohorts get back what they have paid into the system during their working career. Conversely, one can imagine a public policy that is age neutral, but at the same time imply considerable intergenerational transfers. An example here would be an income tax cut which applies in equal measures to wages and pension income. If one imagines that the tax cut is paid for by deficit spending, the burden of financing will

[5] An exception is Bonoli and Shinkawa (2005), whose edited volume to deals with the *politics* of reform, but rather than taking the policy choices as given, investigates how a variation in the socio-economic context (demography, economic pressure) and in starting points generate variations in the *logic* of reform.

fall on the children or grandchildren of the benefiting population (Lynch 2006: 18). Ultimately this paper hopes to arrive at some tentative conclusions about inter*generational* resource allocation. However, in the process of fulfilling this objective, I will inevitably also talk about distribution between age groups. I hope to be clear about which arguments relate to the one or the other.

As hinted at above, the Italian and German pension systems have become more similar at the level of institutional design. However, as will be demonstrated in the course of the paper, there are a range of important differences in the challenge the two countries are facing. These differences in many respects condition the reform outcomes – both politically with regard to the reform trajectory as well as functionally, i.e. at the level of reform effects. In other words, we observe a close interplay between institutional legacies, structural context and new policy challenges. This interaction is what is driving the policy process forward as it structures the game between political actors and arguably also causes similar policy instruments to have differentiated effects. The remainder of the paper is organised as follows: The next section seeks to illustrate the considerable age bias of these two welfare states and to draw attention to important differences despite similar challenges. Furthermore, the section sets out the main institutional characteristics and problems of the Italian and German welfare states and the socio-economic conditions that brought pension reform onto the political agenda. Section three and four provide an overview of recent pension reform in the two countries and discusses some of the consequences for redistribution within and across generations. Section five concludes.

2. Old and young in two Bismarckian welfare states

In this empirical section I start by presenting some data on how the Italian and German welfare states treat different age groups. Then I provide a snapshot comparison of the socio-economic status of the current elderly and working age population. Compared to the OECD average, both Italy and Germany spend much on old age pensions. In recent years Italian public spending on old age and survivor pensions has consistently amounted to nearly 14 per cent of GDP, whereas Germany has spent between 11 and 12 per cent (Adema and Ladaique 2005; OECD 2007b). Using the most recent OECD (2009c) social expenditure figures, Table 2.1 compares Italy, Germany and Sweden and it makes a crude distinction between spending on income support to the working-age population[6] and on old age and survivor pensions. A few observations can be made from just eyeballing these figures. First, the three countries spend between 16 and 20 per cent of Net National Income (NNI)[7] on cash benefits. However, even more interesting for the question of public welfare state treatment across age is that the composition of these across the various headings is very different. Sweden takes a balanced approach to age with only slightly more spent on income support for the aged relative to the working population. Italy stands in stark contrast with more than five times as much spent on cash benefits for the aged as compared to the young. Germany is somewhere in the middle, clearly biased towards the elderly, but not nearly as extreme as Italy.

Table 2.1: Composition of public social expenditure (as a percentage of NNI, 2005)

Country (public social expenditure)	*Pensions (old age and survivors)*	*Income support to the working-age population*	*Total CASH*
Italy (29.7)	16.6	3.2	19.8
Germany (31.1)	13.2	5.2	18.5
Sweden (33.6)	8.8	7.8	16.5

Source: OECD (2009c; 2009a; 2009b)

[6] This includes cash benefits in the form of family assistance, sickness and disability, unemployment.

[7] NNI is the gross domestic product plus net receipts of income from abroad, minus depreciation of fixed capital assets (see OECD 2009c: 62).

Looking more closely at how Italy distributes its social expenditure, Table 2.2 shows how resources were allocated across the main headings of the Italian social expenditure budget in 2003. Almost half the budget was spent on benefits and services for the aged. Furthermore, Italy spends a non-negligible amount of resources on survivors' pensions, which also benefit above all the older population (such as widows). When one, in addition, takes into account that the elderly is typically the main beneficiaries of the public health system, the considerable age-bias of the Italian welfare state becomes readily apparent. By contrast, very little was spent on the unemployed.

Table 2.2: Public social expenditure by spending category, 2003[8]

	Italy				*Germany*		
	Millions of €	% of public SOCX	SOCX as % of GDP		Millions of €	% of public SOCX	SOCX as % of GDP
Old age	152,049	47.0	11.4		244,126	41.4	11.3
Survivors	32,989	10.2	2.5		9,356	1.6	0.4
Family	16,546	5.1	1.2		42,008	7.1	1.9
Incapacity (incl. sickness)	23,632	7.3	1.8		42,872	7.3	2
Health	82,382	25.5	6.2		172,526	29.3	8
Unemployment	5,929	1.8	0.4		38,929	6.6	1.8
ALMPs	8,886	2.8	0.7		24,319	4.1	1.1
Housing	279	0.1	0		4,888	0.8	0.2
Other social policy areas	335	0.1	0		10,552	1.8	0.5
Total public social spending	323,027		24.2		589,577		27.3

Source: OECD Social Expenditure Database 2007, own calculations

Table 2.2 also shows the equivalent figures for Germany. If adopting old age expenditure as a percentage of GDP as the measure of the seniority bias, Germany spends as much as Italy on the elderly. Even so, a closer look at the different social spending categories as a share of total public expenditure shows that the seniority bias is *de facto* stronger in Italy. The conclusion rests on two observations: First, survivor pensions are much less widespread in the German case. Second, Germany clearly dedicates more resources to the working-aged than does Italy. This is particularly due to a more extensive support for the unemployed through cash benefits and active labour market initiatives. With regard to health, family and sickness Germany and Italy show fairly similar priorities. In sum, considering a more detailed breakdown of public social expenditure in the two countries confirms that we are dealing with two welfare states that are strongly tilted towards the older population, but that Italy is clearly the more extreme case of the two.

In a world in which resources are limited and fiscal budgets tight, it has become part of a policy maker's everyday life to make tough and often unpleasant policy choices. Giving more to one group will in one way or the other involve taking away from someone else (Chopel, Kuno et al. 2005: 22). The exact impact of social policies on the household or individual level is hard to quantify, but the distribution of income across socio-economic groups at least tells us something about how the different groups typically targeted by social policy are doing and puts us in a better position to assess the impact of policy changes. Looking first at Italy, estimates based on the Italian Survey of Household Income and Wealth (SHIW) (see Boeri and Brandolini 2005), show that the mean real (i.e. net of inflation) monthly income of a retiree increased by 178 euros between 1993 and 2002. By contrast a production worker's mean wage increased by only 29 euros. Whereas a production worker earned on average 1.001 euros a month, a retiree received 1.269 Euros. Furthermore, the

[8] ISTAT (2007) which uses Eurostat as their source, operates with an estimated figure of 61.3 % for old age and survivor spending for 2004. It should be noted, however, that Eurostat and the OECD figures are normally not identical.

share of total equivalent income going to households headed by a retired person increased by more than the corresponding increase in population share. Since we know that to date a private pension pillar has been virtually inexistent, one can assume that this increase in real pension earnings have been financed largely from the public purse. Due to long phase-in periods, which are linked to the political risk of reneging on promised entitlements, it will take a long time for reform effects to show in the data. Most individuals, who retired during the period covered by the SHIW data, have had their pensions calculated according to the pre-1993 benefit formula. Here one of the key dilemmas of pension reform becomes visible, namely the challenge of cost reduction whilst at the same time giving individuals their acquired rights, i.e. the old age pension entitlements they have accrued during their working career.

The SHIW also gives us information about the status of the elderly as a vulnerable age group. This is relevant from a normative point of view: Are public resources well spent? How do the elderly fare relative to other categories? The SHIW shows that during the 1990s the income distribution shifted to the advantage of the elderly, along with the self-employed and public and private managers. The losers were above all production workers, but also clerical workers and teachers. These income dynamics are also reflected in group specific poverty ratios. The overall relative headcount poverty ratio[9] went down by 0.6 percentage points. However, there was an increase in poverty among households of blue- and white-collar workers as well as unemployed. Consequently, also the composition of the poor population changed (see Table 2.3 and Figure 2.1). Households with an unemployed head saw a clear worsening of their situation relative to other groups. The situation appeared even graver for production workers. In 2002, more than one third of the total poor population belonged to households with a production worker head. By contrast, there was in the same period a clear improvement of both absolute and relative poverty in old age. Arguably the most important conclusion to draw from these data is that employment *per se* is no guarantee against poverty. Particularly in the production sector, (too) low wages seem to be a prevalent problem. Furthermore, the increasing poverty rate for the unemployed suggests that this group finds it increasingly difficult to maintain an adequate income. In summary, although poverty in old age has not been eradicated, there seem to be other socio-economic groups that are facing greater social risks than Italian pensioners.

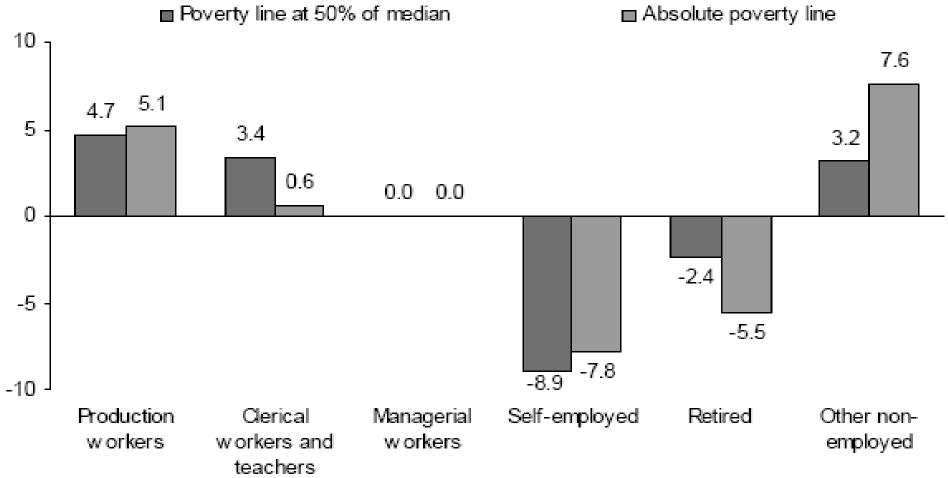
Table 2.3: Poverty statistics per social group

Year	1993	1995	1998	2000	2002	Absolute change 1993-2002
Statistic (per cent)						
	Poverty line at 50 per cent of median income					
Headcount poverty ratio						
Production workers	17.1	16.4	18.6	18.6	20.5	3.4
Clerical workers and teachers	3.6	3.8	3.5	3.6	5.7	2.1
Managerial workers	0.0	0.0	0.0	1.3	0.0	0.0
Self-employed	18.6	15.1	11.8	12.1	11.1	-7.5
Retired	14.8	13.3	13.9	12.6	11.8	-3.0
Other non-employed	65.9	80.9	71.1	71.9	68.4	2.5
Total	14.0	13.7	14.0	13.4	13.4	-0.6

Source: Boeri and Brandolini (2005)

[9] The headcount poverty ratio is simply the proportion (%) of the population below the poverty line. The poverty line can be defined in a variety of ways, e.g. in relation to median income or in absolute terms. The total headcount poverty ratio can be written as $H = \sum_k p_k H_k$. The contribution of group k to total poverty is equal to the population share p_k multiplied by the group specific headcount ratio H_k. [10] Following Mattil (2006: 125), individuals aged between 55 and 64 are considered to be in transition between work and retirement and should be left out of an income comparison of the elderly relative to the working aged.

Figure 2.1: Change in the composition of the poor, 1993-2002



Source: Boeri and Brandolini (2005: 33). The categories are defined by the occupational status of the household head.

Shifting to the German case, the data are not identical and directly comparable to those used for the Italian case. Nevertheless, a similar picture will be drawn to facilitate comparison. How is the situation of German retirees in comparison to the working-age population and children? The data go contrary to the common belief that the elderly are particularly poor and vulnerable. With respect to income, the data in Table 2.4 show that the working age population (aged 25-54) has a somewhat higher disposable income than the elderly (here defined as those over 65)[10], but in absolute terms the income of the elderly has grown by almost twice as much as that of the working age population (2194 euros vs. 1147 euros). As a consequence the income gap between the working aged and elderly individuals that have reached retirement age has been significantly reduced – in absolute terms, from 2227 euros in 1992 to 1180 euros in 2001.

Table 2.4: Age distribution of median net equivalent (yearly) income

	1992	*1996*	*2001*	Absolute change 1992-2001	Percentage change 1992-2001
Age					
25-54	11892	12379	13039	1147	9.6
55-64	11768	12691	13661	1893	16.1
Above 65 yrs	9665	11242	11859	2194	22.7
All	10796	11401	12143	1347	12.5
Income gap					
Δ in real income: working age (age 25-54) and elderly (age 65+)	2227	1137	1180		

Source: Mattil (2006, table A.7), own calculations

Another relevant question is the extent to which the likelihood of being poor increases with age. The biannual report of the German statistical office on the latest developments in social research, states that with increasing age, the poverty rate goes down. If looking at poverty across age groups, persons aged 61-70 years have the lowest likelihood of being poor. In 2006 the age group most at risk of poverty was those aged 21-30 (Statistisches Bundesamt Deutschland 2008: 167). During the first years of the new millennium, poverty has increased for all age groups (see Table 2.5). The youngest old, i.e. those in the age group 61-70, nevertheless, seem to fare reasonably well. For this group poverty has gone up by only 0.2 percentage points, whereas, for instance, those aged 41-50 have seen poverty increase by more than five percentage points. Though the oldest old (70+) are generally more at risk of being poor, also this group does well compared to the younger segments of the German population. Indeed, with regard to the age distribution of poverty in Germany, poverty is most widespread among teenagers and young adults. It should, however, be noted that these are static, cross-sectional data. Thus, recalling the distinction between *generations* and *age groups*, one cannot exclude that the findings can be explained by cohort-specific factors rather than to the age of the individuals in the sample.

Table 2.5: Poverty rates (%) across gender and age, 2006

Total population	13.9
Gender	
Female	14.7
Male	13.1
Age (yrs)	
0-10	16.3
11-20	18.7
21-30	19.2
31-40	11.4
41-50	14.2
51-60	13.0
61-70	8.9
71+	11.2
Source: Statistisches Bundesamt Deutschland (2008: 167), own calculations	

Nevertheless, the general conclusion with regard to the economic standing of the German elderly relative to the working age populations seems fairly unambiguous – being old *per se* is not synonymous with a weak economic status. Even if their income position is on average somewhat weaker than the working aged, one should also keep in mind that the elderly generally have lower living costs than younger people. That is to say, typically an individual's consumption pattern changes over the lifecourse. As an example, Eurostat figures show that in all EU-15 countries apart from Sweden, average household expenditure for households whose head was over 60 years of age was lower than in all other all other age cohorts[11]. Hence, the aged will generally be less affected by indirect taxes on consumption, which tend to impose a significant burden on consumers in European OECD countries in particular[12]. For instance, it follows from the preceding argument that the unprecedented three percentage point increase in the German VAT rate on 1. January 2007, would have affected young families more than retired households.

3. Generous pensions, but so what?

In the previous section we focused on social spending patterns and the relative economic position of the elderly vis-à-vis the working age population. We saw that both the Italian and the German welfare state have indeed been successful in ensuring that in general individuals are able to maintain their standard of living also in retirement. Old age is no longer synonymous with poverty like it was only three decades ago (Boeri and Galasso 2007). Although net effects of old age security programmes are difficult to quantify, it is beyond doubt that the income position of the elderly seen as an age group has dramatically improved thanks to old age pension benefits. In fact,

[11] The age cohorts were "less than 30", "30-44 years", "45-59 years" and "60 and over". See Eurostat (2001) , table 1.11.

[12] With the exception of Switzerland, standard VAT rates in Europe range from 16 to 25 per cent. See OECD (2006: 30)

old age poverty rates have "decreased faster than for any other population group over the past 30 years" (World Bank 1994: 325). Seen in isolation, this is unquestionably an impressive and laudable achievement. However, as with most things in life, there is a flip-side to the story. More specifically, there are signs that the success have come at the expense of the current young cohorts (or generations).

As we know, according to the PAYG logic of the two public systems compared in this paper, workers that contribute to the system today should be served by the next working generation when they get old. Referring back to the distinction of the age groups and generations, the flow of public resources to the oldest age groups should not be considered illegitimate as such. However, from a generational point of view, we have a problem. The implicit agreement or intergenerational contract, on which the legitimacy of modern pension schemes rests, is becoming increasingly burdensome for younger generations. The birth cohorts (generations) that are about to enter the labour force today not only have to pay for the pensions of a larger elderly population (due to demographic change), but they are also facing a structurally different economic conditions. It is well-known that advanced political economies have entered an era in which full-employment and economic growth, are no longer the norm. Consequently, "standard" career profiles (on which the right to a full pension is normally based) are becoming less common. As we shall see in the next sections, even "standard" old age income replacement rates will be considerably less generous for future retirees. In addition, from an age perspective, it is arguably problematic that other social risk-exposed groups, such as for example the unemployed (particularly in Italy) or families with children (in both countries), do not enjoy the same levels of social protection as the most senior age groups.

These dark clouds on the horizon have long been a debated topic. What made alarm bells ring, were, above all, the combination of stagnating economic growth and demographic estimates, which in turn led to concerns about the financial sustainability of public pension schemes. Even if population ageing is a European-wide trend, particularly the Italians have good reasons to worry. Clearly, the Germans face the challenge of a new socio-economic and demographic reality too, but they have some clear advantages compared to the Italians. Some recent macroeconomic and demographic indicators serve to illustrate the point. Despite achieving admission to the Eurozone, Italy still[13] has a budget deficit and a level of public debt much above the EU average, at 2.7 per cent and 105.8 per cent respectively. The corresponding figures for Germany are much lower, with a deficit of 0.1 per cent and a public debt of 65.9 per cent of GDP.

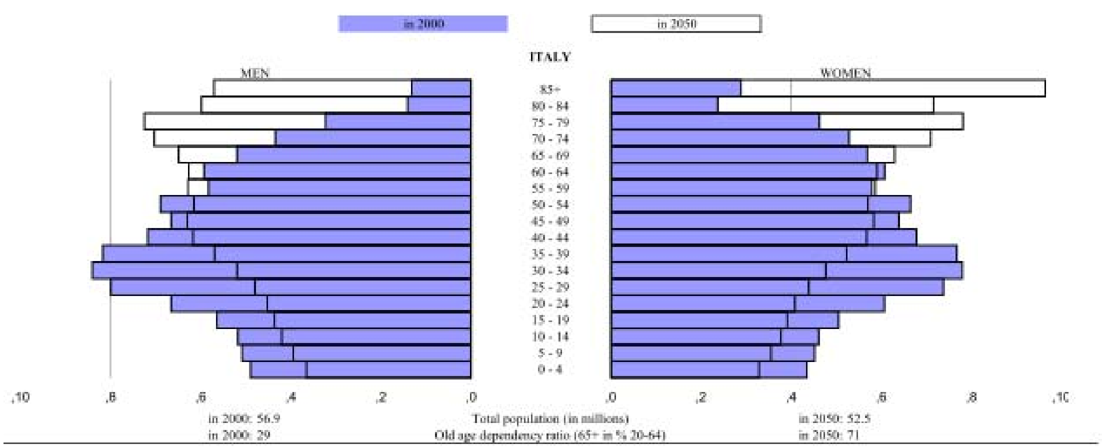
Then there is a whole range of factors which can be subsumed under the heading of demographic change. At an average of 1.34 children per woman in both countries, Italy and Germany have one of the lowest fertility rates in Europe.[14] By contrast, another Bismarckian, France, has a fertility rate of 1.88. At the other end of the life cycle, Italians have one of the highest life expectancies in the EU, whereas for Germany it is somewhat lower for both males and females[15]. The consequences of these demographic trends are further reinforced in Italy because of the structure of the Italian labour market. In 2005 only 57.6 per cent of the working age population (those aged 15-64) was employed. This was considerably below the EU-27 average of 63.4 per cent. In Germany, by contrast, the overall employment rate was above the EU-27 average with 65.4 per cent. The low employment rate in Italy results is a consequence of the second lowest female labour market participation rate in the EU. Germany, on the other hand, was close to the Lisbon female employment target for 2010

[13] Eurostat figures from 2008, http://epp.eurostat.ec.europa.eu/portal/page/portal/statistics/themes, last accessed 09. July 2009.
[14] Compared to an EU-27 average of 1.52 (figures for 2005).
[15] ISTAT (2007) reports for Italy 77.6 and 83.2 years for men and females respectively. For Germany the male life expectancy at birth is 76.2 years and for women it is 81.8 years (for the year 2005).

already in 2005 (ISTAT 2007: Appendix 51)[16]. Beside its relevance for the socio-economic status and well-being of individuals, the rate of employment is important because it has implications for the size of a country's tax base and consequently also for its capacities to react and finance increased demands for welfare services and social protection (Esping-Andersen 2006: 17).

Figure 3.1 and Figure 3.2 serve to illustrate graphically the demographic pressures that Italy and Germany have to grapple with. The white segments illustrate how the oldest age cohorts will grow in size over the next decades. There will be an impressive increase in old people. The trend is unambiguous and especially for Italy the figures are startling. As late as 1970, only about 1 in 10 Italians was above 65 years of age. By 2005 the elderly share of the total population had grown to 20 per cent, i.e. every fifth Italian could be defined as aged. Over the next ten to fifteen years, this figure will remain fairly stable, but then between 2020 and 2050 one expects a real surge of elderly. It is projected that the share of the population above 65 years of age will by then have reached about 35 per cent. By contrast, the same figure for the United States will be just over 20 per cent. Also in Germany the real demographic crunch sets in only after 2020, but it will not be as dramatic as in Italy. According to OECD estimates, the share of the population over 65 will reach just under 30 per cent and the old age dependency ratio will rise to almost 55 per cent (compared over 70 per cent for Italy) over the next forty years. The conclusion to draw from these data is that there exist rather big differences in the extent of the demographic challenge among the Western advanced political economies in general and even among the institutionally similar Bismarckian welfare states. These differences imply different starting points for reform efforts and in the level of difficulty of the reform task (Schludi 2005). I submit that these structural differences are crucial when trying to explain why variations in outcomes may persist despite what seems to be institutional convergence around a multipillar pension system.

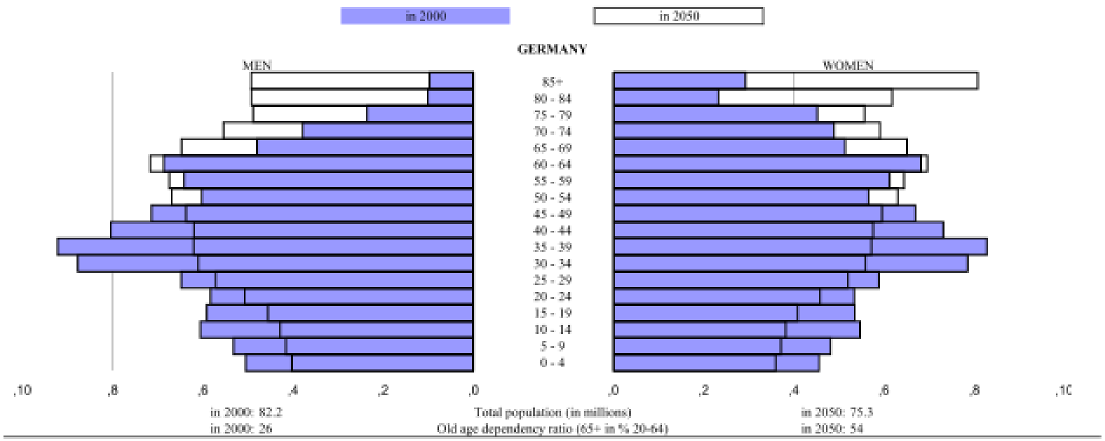
Figure 3.1: Population by age group and gender in 2000 and 2050, in % of total population in each age group, Italy



Source: OECD (2007)

[16] Malta had the lowest female employment rate in the EU-27 (33.7 %). Italy came second from the bottom with a recorded female employment rate of 45.3 % (of the population aged 15-64). Germany registered a female employment rate of 59.6. One of the so-called Lisbon target set by the EU, sets the goal of an average female employment rate for the EU of 60 per cent by 2010. See: http://register.consilium.europa.eu/pdf/en/08/st10/st10614-re02.en08.pdf.

Figure 3.2: Population by age group and gender in 2000 and 2050, in % of total population in each age group, Germany



Source: OECD (2007)

In most areas of social protection (with the Italian health care system being the major exception) the two welfare states under study in this paper have been and still are so-called Bismarckian in nature.[17] There are at least four core characteristics to be highlighted in this respect. First, the pension benefit is linked to employment and earnings rather than citizenship. Thus, the effectiveness of social insurance coverage rests on the achievement of full employment. Italian or German citizenship has traditionally not given an automatic right to a basic state pension. Instead, the compulsory public pension system, i.e. what in the literature is commonly described as the first pillar (see e.g. Hinrichs 2001; Ferrera 2006; Natali 2007; OECD 2007a), has been *social insurance* based and aimed at income maintenance in retirement, i.e. to guarantee pensions equal to a sizeable proportion of a person's previous earnings. In other words, generous replacement rates have been the norm and supplementary pension schemes have, thus, not played a significant role in providing individuals with a retirement income. Second, financing has traditionally relied on the payment of social contributions by the employer and the employees, as well as direct subsidies from the state to cover a share of total costs. Another key feature is financing based on the pay-as-you-go principle. That is to say, the contributions collected is not used to pay for the future pensions of the contributors but rather to finance the pensions of current retirees (see Clark, Munnell et al. 2006: ch. 12).

A third important characteristic of a Bismarckian system design is institutional fragmentation. Insurance coverage is linked to employment status and typically the various occupational groups (such as e.g. civil servants, agricultural workers, or miners) are covered by an occupation-specific, but nevertheless public and compulsory insurance fund. As a consequence, different professional categories are subject to different eligibility criteria and contribution rates. In this respect, Italy represents an extreme case. Before the reform decade of the 1990s, the Italian welfare state comprised a multitude of different schemes operating alongside the "general" INPS scheme", which covered the typical industrial worker. By the early 1990s there were as many as 47 different 1st pillar insurance schemes[18] and as Lynch (2006: 142) points out, "pension benefits vary dramatically

[17] For an elaboration on the theoretical distinction between Bismarckian and Beveridgean models, see e.g. Ferrera (2006), but also Hinrichs (2001), Bonoli (2003)Schludi (2008). In Beveridgean or universal welfare states such as e.g. the UK, poverty prevention as opposed to income maintenance prevails as the core policy objective. Coming from the British "poor law" tradition, a basic, flat-rate pension is universially granted to all citizens and is typically financed from general tax revenues.

[18] See Fererra (2006:ch. 2) for a schematic overview of the range of pension funds (casse pensionistiche) constituting the so-called 1st (i.e. public) pillar of the Italian pension system. The majority of 1st pillar insurance funds are under the administration of the *Istituto nazionale della previdenza sociale* (Inps) for private sector employees or the *Istituto*

depending on the sector of employment, contributory history, age at retirement, and year of retirement." In Germany, the main systemic inequality in the public pension system is between private sector workers and civil servants, who enjoy more generous arrangements both with regard to eligibility criteria as well as replacement rates (see Börsch-Supan and Wilke 2004). Closely related to the institutional fragmentation is the pronounced difference between privileged (and arguably over-protected) *insiders* and precarious and under-protected *outsiders* (Esping-Andersen 2006: 16; Natali 2007). Due to the employment-oriented nature of social insurance, those holding stable employment are *insiders* benefiting from an often generous system of social protection (Rueda 2005). The *outsiders*, i.e. the unemployed and those with atypical work contracts and unstable work histories, often women, do not enjoy the same rights. Given changing employment structures and family patterns such outsiders are becoming more numerous (see Bonoli 2003).

The data we have examined until now have generally treated the retired cohorts as a homogenous group. However, key features in any story told about the Italian welfare state, and arguably the pension system in particular, are "privileged" and "differential" treatment of particular occupational groups and perverse "asymmetries" (see e.g. Ferrera 1986; Boeri and Perotti 2002: ch. 1). This is important because it would be normatively suspect to advocate intergenerational fairness and ignore the intragenerational dimension. Socially just outcomes can only be achieved by considering the two in tandem. The figures below serve to illustrate what the asymmetries in the system mean in practical terms. Average benefits range from a meagre €680 per year for *lavoratori parasubordinati,* i.e. workers on atypical contracts, to €46.569 for journalists. Also worth noting is the fact that almost 30 per cent of Italian retirees receive more than one pension benefit (Lynch 2006: 149). One can assume that those that have succeeded in making pension contributions to more than one pension scheme are primarily persons in the higher income classes, and that this phenomenon, thus, has the likely effect of further exacerbating the income differences upon retirement. The main conclusion to be drawn from these figures is that the Italian pension system does not serve the purpose of reducing labour market and income inequalities upon retirement.

The German public pension system, albeit Bismarckian in nature, is much less fragmented than the extreme Italian case. From an intragenerational point of view, the main cleavage among German pension institutions is between the *Gesetzliche Rentenversicherung* (Statutory Pension Scheme, GRV), which insures the bulk of the German workforce, and the *Beamtenversorgung* (Civil Servants' Pension Scheme) (see Figure 3.4). Civil servants enjoy an extraordinarily privileged position with pension benefits *(Pensionen)* that are much more generous than ordinary pensions (*Renten*). Whereas the GRV, until recent reforms, was designed to replace about 67 per cent of previous net average income over a contributory period of 45 years, the Beamtenversorge used to promise a gross replacement rate of 75 per cent of the last pensionable earnings after only 35 years of service. Figures Figure ***3.3*** and Figure ***3.4*** summarise the main features of the Italian and German pension systems prior to the reforms of the 1990s.

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nazionale di previdenza dell'amministrazione pubblica (Indap) for public sector employees. In addition there are numerous independent funds for the self-employed of various professions.

Figure 3.3: Main features of the Italian pension system at the beginning of the 1990s

	Eligibility conditions		Contribution rate	Benefit	
	Old age retirement age	Minimum contribution period for retirement before statutory retirement age		Reference earnings (RC)	Formula
Private sector	55 women 60 men	35 women 35 men	26.22 % of which: 18.93 % employers 7.29 % employees	Last 5 years	Pension = RC*N/40*80 %
Public sector					
Central government	65 Women 65 Men	20 (15) Women 20 Men	7 % employees	Last month	Pension = RC*N/40*94.4 %
Local government	60 Women 60 Men	20 Women 25 Men	7 % employees	Last month	Pension = RC*N/40 *100 %
Self-employed	60 Women 65 Men	35 Women 35 Men	12 %	Last 10 years	Pension = RC*N/40 *100 %

Source: Ferrera and Jessoula (2005)

Figure 3.4: Main features of the German pension system at the beginning of the 1990s

	Eligibility conditions		Contribution rate	Benefit	
	Old age retirement age	Minimum contribution period for retirement before statutory retirement age		Reference earnings (RC)	Formula
Private sector	60 women, unemployed, disabled 65 men (63 for early retirement)	15 women 35 men	18.7 % (in 1990, but frequent adjustments) shared equally by employers and employees. Upper ceiling above which earnings are exempted for contributions (*Beitragsbemessungsgrenze)*	Life time average (earnings points, EP)	EP*yrs of insurance* pension type factor (1 for old age pension, 0.6 for disability)*age factor*current pension value
Civil servants	65 men 60 women (62 for early retirement)	35 yrs	No contributions. Benefits financed out of tax general revenues.	Last gross salary	Last earnings*yrs of service factor= replacement rate of max 75 % of gross earnings
Self-employed	No mandatory insurance, but they can choose to participate in the public system or self-insure.				

Source: Börsch-Supan and Wilke (2004), own compilation

With regard to the redistributive effects of the Italian pension system, Ferrera and Jessoula introduce the concept of "redistributive sliding". More specifically they argue that "social policies, originally crafted as redistributive measures, turned their nature into distributive policies, offering concentrated benefits to selected social groups while dispersing and obfuscating their costs" (Ferrera and Jessoula 2005: 25). Further reinforcing the trend of "redistributive sliding" was the tradition of deficit spending, which is a way of shifting the financial burden of welfare provisions onto future generations. Additionally, the high costs of the pension system is not only due to a low legal retirement age, but also the fact that many workers are allowed to retire much ahead of this age through the provision of "seniority pensions"[19]. In fact, in 2000 the real average retirement age in Italy was 59.1 for men and 58.9 for women (Minestero del Welfare 2002: 22). Particularly public sector employees have traditionally enjoyed a privileged status with an extremely generous benefit formula and the right to retire after only 20 years of contributions[20] (see Figure 3.3). The full implications of seniority pensions in terms of drain on the system became apparent only when the first generation of workers with fully matured pension rights started to retire after the mid-1980s (Lynch 2006: 160). Finally, pension benefit levels are highly skewed in their distribution. At the lower end of the pre-retirement income scale, pension benefits are relatively modest. Conversely, at the other end they are extremely generous (Lynch 2006: 145).

Considering briefly the redistributive properties of the German case, the starting point in the 1990s differs from the Italian as well as other Bismarckian cases due to a uniquely German feature in the benefit calculation formula (see Figure 3.4). The German public pensions system, took onboard the lifetime earnings principle very early on and this particular institutional feature has made the necessary changes to the first pillar of the system less overwhelming than in the case of Italy. The actuarial link between career income and pension benefits that other countries have introduced only with the recent wave of reforms had been institutionalised and publicly accepted long time ago. Important for the generational issues of this paper, "the [benefit] formula is applied to the entire stock of pensioners, not only to new entrants. Hence, the German system is time, not cohort-oriented. This crucial difference to other pension systems – notably the Italian one – makes reform easier if equal burden sharing is an agreed principle among voters" (Börsch-Supan and Wilke 2004: 14).

As we shall see in the following section the efforts to cut costs during the 1990s and beyond have all concentrated on the general computational basis or current pension value, which links workers' earnings and the actual benefits paid to current retirees (Börsch-Supan and Wilke 2004). In sum, making use of the distinction between horizontal and vertical redistribution, one sees that the German pension system has ensured a strong degree of redistribution across the life cycle (i.e. horizontal redistribution). A transfer of resources across income classes (*vertical redistribution*) has been of secondary priority (Alber 1986: 68). Finally, one should note that as in Italy several avenues to retirement before the legal retirement age existed and early retirement has indeed been very common. In West Germany the average retirement age in 1998 was 59.7 and 60.7 years for men and women respectively. In the East the corresponding figures were even lower with 57.9 for men and 58.2 for women. The 1972 reform had introduced important incentives for early retirement and as a consequence there was a sharp drop in the average retirement age after that (Börsch-Supan and Wilke 2004). Needless to say, the frequent use of the early retirement option constituted an enormous drain on the system. In the following sections we shift attention from the structural and institutional features of the pension system to look at the politics of reform to understand how the systems have changed in the way it has.

4. *The Copernican revolution of Italian pensions*

Somewhat jokingly, one could argue that the Italian public pension system fits the image of an elephant moving into a jungle. Just like the real-world animal, it is generally bloated and slow-moving. The major difference seems to be that by the time the previous old age public pension

[19] The so-called seniority pension (*pensione di anzianità*) allows a worker to retire prior to the legal retirement age if a pre-defined number of years of contribution had been reached. The contributory period necessary to be eligible for a seniority pension vary across occupational groups.
[20] This type of seniority pensions were known as "baby pensions".

regime has been actually faced out, it will have had a lifespan far longer than the average elephant…! It can be argued that it is heading "into the jungle" in two respects: Firstly, foreseeing the amount of future pension benefits is more difficult in a define-benefit system, and, thus, at the individual level the new system is associated with a higher degree of uncertainty with regard to future replacement rates (Fornero, Lusardi et al. 2008: 3). Secondly, the reforms have brought a myriad of transitional rules into the system, making the overall picture very messy. That is, harmonisation at the cross-sectoral level has resulted in grossly complicating the inter-generational picture. In addition, one may speculate whether we will simply see a transfer of the key characteristic of the old public system, namely its extreme segmentation along occupational lines, to the growing occupational and private pillars.

The severe institutional crisis of the Italian political system triggered by the so-called *Tagentopoli* scandal in the spring of 1992, and the above-mentioned economic crisis opened an unprecedented window of opportunity for policy reform. The partially technocatic government coalition[21] led by the socialist Giuliano Amato initiated a process aimed at restoring to health (*risanimento*) public finances. Since the costs of public pensions had reached 12.8 per cent of GDP in 1992 and official estimates from the General Accounting Office[22] stated that it could increase to well over 20 per cent by 2040, reform of the public pension system played a central role in this plan. The Amato reform aimed at moving the pension system towards a multipillar framework, opening for supplementary occupational and completely private funds. A regulatory framework, which distinguished between so-called "closed" and "open" pension funds, was introduced.

The "closed" funds were thought to form the second, occupational, pillar of the system. Employers' and unions were foreseen a key role in the operation of these funds. On the other hand, the "open" funds, constituting the third pillar, would be managed by financial institutions. In practical terms, the government was confronted with what in the literature has been coined the "double-payment problem" (Pierson and Myles 2001: 313; and also Myles 2006: 150). To get the supplementary funds off the ground, significant contributions were required. However, such a transition is difficult by the already high contribution rates required to finance the 1st pillar. The solution was to require that everyone wishing to subscribe to a supplementary pension transferred their TFR[23] to the relevant pension fund. Nevertheless, supplementary pension schemes are still struggling with modest take-up rates, especially among young workers (Messori and Boeri 2007). Considering the future declining replacement rates promised by the first pillar, this gives reason for concerns (Ferrera and Jessoula 2005: 41).

The underlying rationale for the Amato reform was to ensure the future financial sustainability of the system through stabilising expenditure. Apart from the attempt to introduce a multipillar system, a key measure was to change the generous indexation mechanism, which guaranteed the adjustment of benefits according to wage inflation. Following the reform, benefits would instead be linked to prices, which typically rise at a slower pace in Italy. Especially for an immediate cut in pension obligations, the shift in indexation was important since it applied to current and future pensioners alike. Second, the reform constituted an effort to harmonise the multiplicity of existing rules for private and public sector employees. A noteworthy move to this end was to introduce a gradual removal of baby pensions for public sector employees. The attempts to create a more uniform system can be interpreted as an effort to increase intra-generational fairness. However, another characteristic of the 1992 reform was very long phase-in periods for all measures adopted. Transition periods serve to protect workers' already acquired rights and, thus, served as an

[21] The four-party coalition consisted of the Partito Socialista Italiano (PSI), Democrazia Cristiana (DC), Partito Socialista Democratico Italiano (PSDI) and Partito Liberale Italiano (PLI).
[22] Ragioneria Generale dello Stato (RGS)
[23] Trattamento di fine rapporto (Tfr) - a severance pay, to which all Italian dependent workers are entitled when they end leave their employer.

instrument to obtain the compliance of the unions. Although the government's original reform proposal did not foresee such long transition periods, Amato was prepared to accept a softer phase-in of the new measures. It was the long term that mattered and whether you had a transition of ten or fifteen years did not significantly change the overall picture[24].

The Dini reform of 1995 has been described as a "Copernican revolution" (Ferrera 2006: 94). It transformed the first pillar of the system from a defined-benefit to a notional defined-contribution system (NDC)[25] for all occupational sectors. In the new system the benefit formula is linked to the amount of contributions that a worker has accumulated over her entire working career. In addition, through the so-called *transformation coefficients*, the pension benefits eventually received depend on the actual age at which a worker retires, as well as demographic and macroeconomic projections[26]. Most important from a pensioner's point of view is that benefits are no longer linked directly to previous earnings, and, as a result the first pillar will in the future be considerably less generous with regard to income replacement. However, it seems reasonable to think that those with uninterrupted and well-paid careers are likely to be the ones with the highest pension entitlements. From this perspective, one could argue that first pillar pension benefits continue to be at least indirectly earnings-related.

What is particular about a NDC model is that it is designed to imitate a purely funded, defined-contribution system in which actual benefits depend on the overall amount of contributions paid and investment returns. The pension plans are called "notional" since there is no pool of accumulated pension money, but rather a series of individual claims on future budgets. That is, the system continues to operate on a PAYG basis. Arza (2008: 111) maintains that the transition from an earnings-related to a contribution-oriented system represents a shift towards a more individualised system in which no redistribution across income levels takes place. The redistributive element of the system was left to the new means-tested, but universal and non-contributory *assegno sociale*. Here we see a feature that we recognise from the Beveridgean model. Theoretically, Arza's argument makes sense. However, I have argued that the degree of redistribution across earnings levels provided by the old pension regime was indeed very limited. Hence, it is questionable whether the institutional shift truly represents a new era in terms of intragenerational redistribution.

The Dini reform took issue with some of the most problematic features of the Italian pension system. Among other things, it improved financial sustainability by introducing a flexible retirement – between 57 and 65 years – with the benefit calculation formula improving with age to create an incentive for later retirement. The number of years of contributions to be eligible for seniority pensions was increased from 35 to 40 years. Furthermore, the reform removed some of the most pronounced imbalances in treatment of different occupational groups by for instance raising the contribution rates of the self-employed, which had traditionally enjoyed an advantaged position with respect to the required contributions (see figure 6). In addition, the rights of workers with atypical work histories were improved. The minimum period of contributions to be entitled to a pension was lowered from 20 to 5 years. Thus, the reform was a step in the right direction with regard to intra-generational fragmentation and inequality.

However, from an intergenerational perspective, the Dini reform (law 335/1995) was controversial. Again, a long transition phase was foreseen for the introduced measures. Thus, it was apparent that the costs of restructuring and making the pension system financially sustainable would to a large extent fall on the younger generations (Ferrera 2006: 98). The reform package was extraordinarily explicit in its differential treatment of workers at different stages of their careers. The Italian

[24] Conversation with Giuliano Amato, Rome, 8 April 2009.
[25] See World Bank (2001)
[26] Note that the foreseen periodic adjustment of the coefficients has later been delayed on several occasions.

workforce was divided into three groups. Those who by the end of 1995 had already had 18 years or more of pension contributions behind them would have their future pensions calculated solely according to the rules established by the 1992 Amato reform. Workers with less than 18 years of contributions by the end of 1995 were subjected to a mix of old and new rules. Contributions paid before 1996 would be converted according to old rules, whereas the contributions accumulated later would be linked to the new rules. New entrants to the labour market (i.e. those entering after 1.1.1996) would have their pensions calculated on the basis of the new rules for their entire working careers. Only around 2035 would all the adopted measures have been phased in. Thus, the differential treatment of different cohorts exacerbates the intergenerational inequities in the short to medium term.

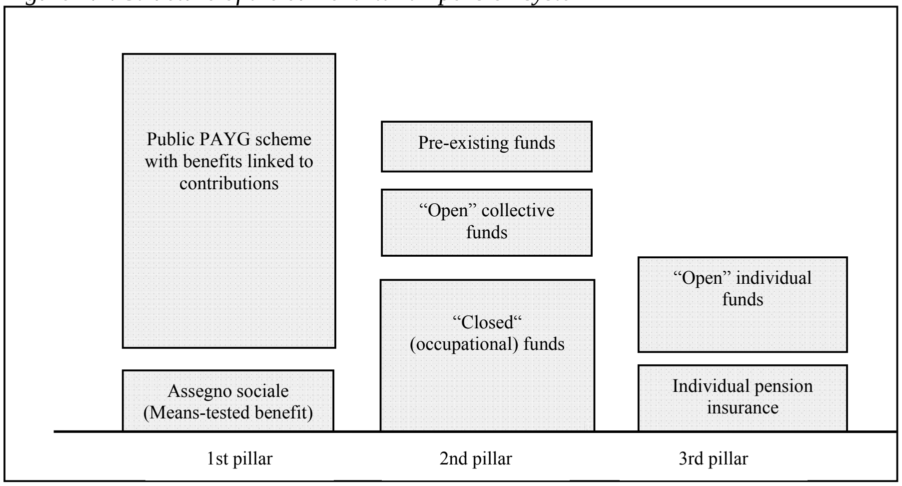
Though the Amato and above all Dini reform packages had produced deep-seated changes to the pension system, the issue of pensions remained on the agenda as it was clear that there were still a number of unresolved problems. Also the first Prodi government and the second Berlusconi government carried out further reforms, in 1997 and 2004 respectively. The most recent in this long series of reform was the agreement negotiated by the second Prodi government in the summer of 2007. In sum, these present a contradictory wave of reforms. The 1997 and 2004 reforms (the last one also known as the Maroni-Tremonti reform) were characterised by another tightening of the conditions of seniority pensions (a measure known as the *scalone* – the big step) and further incentives to improve the slow take-off of the supplementary pillars.

The reform of 2007[27], on the other hand, went in a somewhat opposite direction of the two preceding reform packages, following a different logic. Compared to the projections made on the basis of the previous reform package, the Prodi reform of 2007 comes with an estimated cost of 10 billion euros over the next 10 year period[28]. The explanation is threefold. The *scalone* was made into a *scalino* (stair), i.e. the age at which a worker is entitled to retire with a seniority pension would be raised stepwise from 59 to 61 years. Furthermore, there will be a gradual increase of the *assegno sociale* and, thirdly, workers on atypical contracts received improved conditions compared to those foreseen by the previous reforms. Retirees with an income below a certain threshold would receive an increase in their pension benefit from 2008. From a generational perspective, the softening of the *scalone* was morally questionable. The move benefitted only about 129 000 seniority pensioners and had, as just outlined, a huge price tag. To recapitulate, Figure 4.1 describes schematically the present configuration of the Italian pension system.

[27] For the full text of the protocol that was negotiated between the government and the social partners (including the major unions CGIL, CSIL and UIL as well as the employers' association Confindustria), see http://www.lavoro.gov.it/NR/rdonlyres/1D4AD463-9C21-42E2-99E9-0D1458E53581/0/072307protocollo_welfare.pdf, accessed 11 October 2007.

[28] see http://www.lavoro.gov.it/Lavoro/PrimoPiano/20071012_protocollo.htm#ottobre, accessed 15 February 2008.

Figure 4.1: Structure of the current Italian pension system



Source: Ferrera (2006: 61)

How can the *political* dynamics of these large reforms be characterised? Italian politics underwent several simultaneous changes during the 1990s, and it is rather difficult to detect a constant pattern in the relative strength of the different actors. Rather what seems to stand out is a somewhat oscillating power relationship between the government and the unions. The bargains behind some of the reform efforts have been characterised by union assertiveness, whereas others have seen the government exerting more strength (Natali 2007: 160). Even so, the initial driver behind the reform process was neither a set of political actors, nor the travelling of specific policy ideas or supranational pressure, but rather the urgent need to find solutions to specific problems. Put briefly, the situation in 1992 was extraordinary, with seemingly strong external as well as internal reform pressures. Politically one saw a break with the past. There was a general shift in the logic of policy-making as the executive assumed importance relative to parties in parliament. The political parties that had dominated the politics of the First Republic were in crisis, many central politicians disappeared from the scene, and the party landscape was being reformed. Economically Italy was under pressure from the EU to restore its finances and membership in the Economic and Monetary Union represented an additional incentive to act quickly. Irrespective of the supranational dimension, however, the Italian budget, of which the pension system was an essential part, was in such a state that it was nevertheless obvious to everyone that something had to be done (Ferrera and Gualmini 2004: 66). Alarming projections from the INPS and the General Accounting Office and a speculative attack on the lira, the national currency, further underlined the immediate need for action, (Ferrera and Jessoula 2005: 31).

In fact, contrary to e.g. Ferrera and Gualmini (2004: 10) who argue that pressures from the European level were crucial in quieting possible sources of resistance, Giuliano Amato, at the time holding office as *Presidente del Consiglio* (prime minister), tones down the importance of Europe. On the question whether the Maastrich agreement served as a lever for reform, Amato's answer is not to be misunderstood:

> "No, it was the kind of presentation of the [European] Union as the, let's say, the mother-in-law that asks us to do these things, but no more than that. Because, generally the European Union as the external constraint that you have to abide to, is particularly efficient when there are no visible domestic reasons to do something. When there is a reason, domestically understood and accepted to do something, well, this [i.e. Europe] is an added reason, but not so crucial. In my case there was the domestic reason, the difficulty of public finance. So, Europe […] was not something that affected my action, because my problem was more directly and immediately the market"[29].

[29] Conversation with Giuliano Amato, Rome, 8 April 2009.

In the particular economic and political context it was possible for the technocratic Amato government to make the first step on the road towards a more financially sound pension system in 1992. Some commentators have seen this as the beginning of a virtuous policy cycle (Ferrera and Gualmini 2004: 68). The emphasis on problem pressure as a reform trigger does not mean that I see the reform process as free from more traditional "political" variables. The exact measures undertaken were, in effect, the outcome of informal negotiations between the social partners and the government. Following the Tangentopoli scandal the political parties in parliament had been discredited and the government could enter in direct negotiations with the trade unions and *Confindustria* (Ferrera and Gualmini 2004; Ferrera and Jessoula 2005). Despite some severe trade union protests in the autumn of 1992, concertation continued until an agreement was reached.

A new majoritarian electoral system was introduced in 1993, and the first "political" cabinet[30] elected by means of the new electoral rules, came to power in May 1994. The government coalition was led by Silvio Berlusconi and his party *Forza Italia*, but importantly it also included the *Lega Nord*. Berlusconi was determined to continue down the same path of fiscal austerity, which had been initiated by Amato. However, his political strategy was differed from that of the Amato government in that he adopted a much more unilateral approach vis-à-vis the unions. The reform proposal[31] tabled by Berlusconi led to massive protests by the unions which felt that their concerns had not been taken into account. Workers were expected to make sacrifices to achieve the ends of lower pension expenditures and financial stability without being offered any compensation. Thus, in mid-October the same year, thousands of workers went on general strike and on 12 November millions of workers took to the streets in Rome to protest against the pension reform.

As a consequence of the massive protests, Berlusconi's very heterogeneous government coalition, and thus shaky parliamentary majority, faded. Especially for the Lega Nord which has many supporters among unionised industrial workers in the north, it became increasingly unsustainable to be part of a government that chose a hard line against the unions (Antichi and Pizzuti 2000: 90). The *Lega* opposed Berlusconi's proposal to rapidly raise the retirement age and adjust downward the annual multiplier used in the calculation of benefits. It accused the majority within the government for not seeking agreement with the unions, and eventually broke out of the government coalition (Schludi 2005: 115). The clash over pensions ultimately caused the government to resign on 22 December 1994. In addition to showing that listening to the demands of labour is crucial for the successful implementation of welfare reform, Berlusconi's defeat also gives a hint as to the continued importance of the pension issue in Italian politics (Ferrera and Jessoula 2005: 35; Natali 2007: 161).

Succeeding the Berlusconi government was another technical government led by the former Director of the Bank of Italy and Minister of the Treasury in the Berlusconi government, Lamberto Dini. The cabinet was of a technical character and largely made up of ministers without close political ties. This made it easier to take a more consensual approach and to enter into more wholehearted negotiations with the social partners. Particularly union concerns were carefully listened to. An agreement between the trade unions and the government was signed on the 8 May 1995 after three months of constructive negotiations between the two parties. The most important achievement for the unions was the protection of the so-called "acquired rights" of older workers, by the introduction of long phase-in periods of cost containment measures such as the tightening of eligibility condition for seniority pensions and the transition to a defined-contribution pension system.

[30] After the two technocratic governments of Amato and Ciampi, 1992-1994.
[31] The proposal included cuts in seniority pensions and in the benefits of workers with more than 15 years of contributions, as well as making the indexation mechanism less generous (see Ferrera and Jessoula 2005: 34).

Notable is the modest role played role by business interests, which were represented by *Confindustria*. Despite its refusal to endorse the pact between the government and the unions, the reform proposal found sufficient parliamentary support so that a new pension law (335/1995) could be passed in August the same year. Natali calls this "a truly negotiated" agreement between the government and the unions (Natali 2007: 162). Also the negotiations leading to the minor pension reform passed by the first Prodi government in 1997 followed a pattern of concertation between the unions and the government. What blocked a more radical reform were rather disagreements within the government coalition itself (Ferrera 2006: 100). The *Rifondazione Cominista* (Communist Refoundation) opposed the most important proposal of the Onofri commission, which the government had charged with the task to thoroughly assess the existing labour market and social policy framework and to make policy recommendations. Their most fundamental recommendation was to implement all the measures of the Dini reform plan much more quickly.

The academic literature on the pension reforms taking place after the turn of the millennium is still rather scarce. However, some tentative comments can be made. In May 2001 Berlusconi won the elections with his *Casa della Libertà*[32] alliance. Several things had changed since his first experience as chief of the Italian executive. As opposed to in 1994, Berlusconi now benefited from a large majority in both chambers of parliament and a much more cohesive and stable coalition. In addition, the opposition led by Prodi's *Ulivo* (olive tree) coalition, emerged fragmented and weak after the election defeat (Ferrera and Gualmini 2004: 151). Then, when it comes to welfare state reform both Ferrera and Gualmini (2004: 156), as well as Natali (2007) argue that the Berlusconi II reformed the relationship between the government and the social partners. One saw a move from concertation or corporatist agreement to "social dialogue", and the political parties seemed to have taken on a more important role. That is, the trend of concertation with the social partners that had characterised the reforms of the 1990s was not completely reversed. However, in the process producing the Maroni-Tremonti reform in 2004 (law 243), the negotiations with the social partners began only after the broad lines of the reform plan had already been defined by the government.

During the Berlusconi II years, one also saw an increasing divide between the three unions, CGIL. CISL and UIL. An example of the increasing tensions between the unions in this period was the social agreement *Patto per l'Italia* (Pact for Italy)[33] signed in July 2002. The accord was endorsed by the government, Confindustria, the CISL and the UIL, but not by the CGIL. This is not, however, to say that the unions did not influence the content of the final reform proposal. They successfully put pressure on the government to drop its proposal to lower the employers' share of pension contributions for dependent workers. Also on the issue of how to use a worker's *trattamento di fine rapporto* for investment in supplementary pension funds they persuaded the government to revise the original reform plan.

As noted above, the most recent modifications to the pension system approved in 2007 represented a different logic from the previous reforms in that it contained a set of expansive, i.e. cost increasing, measures. All the social partners were active in putting pressure on the government to take their interests into account. The reform proposal that the government presented to parliament was the outcome of extensive negotiations with the trade unions, and an accord was signed on 23 July 2007. Later also Confindustria expressed their approval of the accord and a law implementing the provisions agreed upon in the summer was passed in December 2007. The 2007 reform package

[32] In addition to Berlusconis party *Forza Italia*, the *Casa della Libertà* consisted of Gianfranco Fini's right-wing party *Alleanza Nazionale*, the *Lega Nord* led by Umberto Bossi and the *UDC* (Unione Democratico di Centro) associated with Pier Fernando Casini.

[33] This was an agreement that concerned among other things labour market reform, commitments to support lower income workers and pensioners, initiatives for development of the South (see Ferrera and Gualmini 2004: 159; Natali 2007: 165).

can arguably be described as a return to concerted action, resembling more the reform processes of the 1990s than Berlusconi's recent "social dialogue" approach.

What might explain this apparent shift? Intuitively two factors seem particularly important. First, given the very fragile nature of the broad government coalition led by Romano Prodi, strategically it arguably made more sense to opt for a more consensual approach. The coalition consisted of as many eight parties[34] and especially the *Rifondazione Comunista* had proved to be a reform obstacle in the past (recall the above-mentioned resistance to the recommendations made by the Onofri Commission during the first Prodi government). This was arguably a wise move from Prodi, because in the negotiation process *Rifondazione* actually behaved in a way that made them appear far less cooperative than the trade unions. In addition, the coalition majority in the Senate was very narrow with only 2 seats. Thus, to get a reform through parliament, Prodi could not afford abstentions or no-votes from his own camp. Second, one should be reminded that the Prodi government was a centre-left coalition that was substantially closer to labour than business interests. Hence, it is not so surprising that in the end, when looking at the policy content of the accord, with its expansionary character, the trade unions achieved an outcome that they have reason to be satisfied with.

Even though for some analysts the 2007 reform process may be interesting in its own right, the more relevant question for the broader audience is what the road to reform just outlined suggests about how policies change and about the relationship between politics, policies and institutions (see the recent volume edited by Pirrone 2008). In particular, three interesting observations stand out. The nature of the reform suggests that even in times of "permanent austerity", to use Pierson's language, it is still tempting for politicians to use pension policy to make attractive promises to a potential electorate. Pensions are tangibles that many voters have a direct stake in and, hence, it becomes tempting for politicians to use pension rules as bait to catch voters. Secondly, the reform illustrates how policies can shape politics. Trying to use what many saw as a tough policy measure pushed through by Berlusconi's centre-right government in 2004 to his advantage, Prodi, in the electoral campaign, had promised to change the *scalone*. This is turn, seemed to have given him less room for manoeuvre – both within his own fragile coalition, which as noted also included the far-left party *Rifondazione Comunista*, and with the trade unions – once he entered office. Both the Rifondazione and the unions were keen on seeing the *scalone* abolished[35]. In this respect, Prodi's concerted action approach seems to some extent to have been forced upon him. That is to say, he arguably did not have much choice but to listen carefully to the demands of the unions and also *Rifondazione* given his pre-election strategy. Thirdly, the reform is a classic example of how Italian social policies move forward by fits and starts, i.e. with few regularities present, and the new millennium does not signal a change to this special feature.

5. Pension politics in a unified Germany: Gradual but transformative change

By the early 1990s the preconditions for efficient reform were more favourable in Germany than in Italy. There are two reasons for this: First, since the path breaking 1957 reform, the benefit calculation formula had always been based on income over the entire working career and not only the last or best years. Second, already from the 1970s the German system had embarked on a gradual reform path in the direction of less generous public benefits in the future (Blome, Keck et al. 2008: 344). The contribution rate had been raised several times, and a series of cost containment

[34] Democratici di Sinistra (DS), Democrazia è Libertà – La Margherita (DL), Partito della Rifondazione Comunista (PRC), Rosa nel Pugno (RnP), Italia dei Valori (IdV), Federazione dei Verdi (FdV), Popolari UDEUR (UDEUR), Comunisti Italiani (CI).

[35] This is also confirmed by Giuliano Amato, who was Minister of the Interior under Prodi, from 2006-08. Conversation 8 April 2008.

measures had been implemented already in the 1970s. In fact, German public pension expenditures went down during the 1980s. The trend was aided by a temporarily falling age dependency ratio[36]. Overall, although not in any way representing a fundamental system change, these policy adjustments represented an early beginning to a very gradual, but significant path shift. Then, in Germany too the understanding that a more wholesale reform was necessary was further consolidated when towards the end of the 1980s forecasts showed that in the absence of a reform the pension contribution rate would exceed 36 per cent of gross income by 2030 at the peak of the ageing boom (Hinrichs 2006).

There was broad political consensus that costs had to be contained and in 1989 the Pension Reform Act 1992 (aka Blüm I Reform) was passed. As far as the politics of the reform process is concerned, it can be argued that the policy-making pattern was similar to that identified for the pre-1990 period. In fact, just as in the 1972 reform, the act was a result of cross-party agreement between the Christian Democrats (CDU/CSU), the Liberals (FDP) and the Social Democrats (SPD). It is worth noting that the SPD supported the reform despite having a blocking majority in the Bundesrat, the German second parliament chamber. That is to say, institutionally they were in a position to veto the reform should they have wished to do so. This signifies similar policy preferences of the major parties and also that, similar to the Italian case, problems were perceived to be severe and in need of an immediate solution.

Although the reform implemented some non-negligible modifications, once the reform can be described as incremental as once again the main structure of the system was maintained (Hinrichs 2006: 54; Schulze and Jochem 2007: 682). The key reform measures were:

- A shift from gross to net wage adjustment of pension benefits.
- A permanent reduction of benefit level if opting for early retirement (to be implemented from 2001).
- Provisions to retire before the age of 65 to be completely phased out by 2012. This implied an increase in retirement age for women, unemployed and disabled.
- Federal subsidy was increased to 20 per cent of annual total pension expenditures.

The reform has generated considerable savings if compared to the projections made on the basis of the old rules. The change in indexation mechanism prevented after-tax pensions from growing faster than the net income of wage earners. Importantly, this modification was inter-generationally neutral as it took effect immediately and applied to current and future pensioners alike[37]. What the reform did not do, was to reform the promise of a net replacement rate of 70 per cent for a pensioner with a standard career[38]. With regard to the redistributive effects of the reform, from a generational perspective, the long phase-in period in the cutbacks to early retirement options should be noted. Furthermore, the fact that older workers would still able to enjoy the more generous early retirement of the old legislative framework effectively strengthened the impression of the younger cohorts as reform "losers". Also the increase in the federal subsidy can be interpreted in "redistributive terms". Since the federal contribution to the general public pension insurance scheme is financed by general tax revenue and income taxation is generally progressive, it follows that an increase in the federal subsidy enhances the potential for redistribution across income within the system. Those with higher incomes will contribute more than lower income earners. From an inter-generational perspective, on the other hand, as long as pension income is taxed on preferential terms vis-à-vis wage income, the federal grant will still have to be paid mainly by the working age population.

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[36] The number of elderly declined in the early 1980s, but this was a temporary trend that had to do with the demographic effects of World War I (Alber 1986: 86).

[37] Here we observe a close parallel to the 1992 Amato reform in Italy. We recall that immediate savings were achieved by altering the automatic adjustment mechanism.

[38] So-called *Eckrentner* with a 45 years of contributions and average earnings.

With reunification many things changed in Germany - economically as well as politically (see e.g. Hockerts 2007). The employment situation in the East was rather grim and there was a soaring number of unemployed claiming an early retirement pension at 60. In addition, the higher labour market participation rate among women in former East Germany led to higher benefit claims, which in turn put further pressure on the pension system. Also in the West unemployment and consequently early retirement at 60 were on the rise. These developments undoubtedly accelerated the pressure for another reform, and the next concrete step in the reform process took place in 1996. Against the opposition of the SPD, the Kohl government proposed a bill[39] to among other things shorten the phase-in period of the tightening of early retirement arrangements incorporated in the 1992 Act. The core objective of the reform was to consolidate the financial sustainability of the public pension system, and a quicker phasing out of the early retirement option was considered a means to that end. In addition, non-contributory entitlements (such as in the case of unemployment or sickness) were cut. Also the unions were strongly opposed to the new law, and in June 1996 around 350,000 people took to the streets in a demonstration organised by the trade union confederation, the DGB, to express their dissatisfaction with the new policy measures.

Several commentators see the developments in 1996 as the first sign of a break with the consensus tradition in German pension policy making (Schludi 2005; Hinrichs 2006: 54; Schulze and Jochem 2007: 683). Interestingly, although policy-making became more characterised by political conflict, it did not bring the reform process to a halt. On the contrary, the stepwise transformation of the old institutional pension architecture continued and, as we shall see, the subsequent reforms have implemented even more radical policy changes leading to what many have characterised as a paradigm shift (e.g. Schmäl 2003; Hinrichs 2006). The continuation of the reform process despite the sharpened nature of political debate may be seen as an indication that key actors nevertheless perceived pensions as so a serious policy problem that they were prepared to even pay a (political) price to push through a solution. Hence, it can be argued that it was the problem pressure that was the fuel that kept the reform engine running.

More generally, stepping back for a second to think about what these developments may tell us about social policy making in Germany, I would agree with Schmidt, who already in a publication from 2000, i.e. even before the adoption of the more groundbreaking Riester reform, concluded that "social policy in Germany is capable of reforming itself" (Schmidt 2000: 161). In some respects this opinion differs from the commonly articulated view that Germany, due to among other things the complex federal political system with its many veto points, is generally adverse to policy reforms. However, Schmidt goes on to argue that although policy reform is possible, changes are normally incremental and tend to exhibit a high degree of path dependency. Above all, he argues, this pattern is owed the competition between more than one *Sozialstaat* party and to the country's federal structure which leads parties into "permanent election campaigns"[40]. Radical structural changes to popular welfare state institutions are assumed to come only at high political costs and, thus, reforms that truly represent a new policy direction are very difficult to orchestrate (Schmidt 2000: 164). With the benefit of hindsight, I argue that the subsequent turn of events, which I will deal with next, to some extent challenge the logic of Schmidt's argument. In the next reform steps we see that some profound changes were made to the founding principles and the institutional architecture of the German pension system.

[39] Growth and Employment Promotion Act 1996 (*Wachstums- und Beschäftigungsgesetz*)

[40] Bundestag elections take place every 4 years, whereas the legislative periods of the European Parliament and the state parliaments (*Landtage*) have a duration of 5 years. However, the timing of the state elections varies across the country. This means that the composition of the upper chamber on the federal level, the Bundesrat, may well change in the middle of a Bundestag legislature. Hence, the characterisation of parties running "permanent election campaigns" seems apt.

Coming back to the reform process more concretely, the next major reform, known as the Pension Reform Act 1999 or the Blüm II reform, was passed in 1997 after considerable controversy between the two major parties as well as the social partners. At this stage it was evident that one could no longer speak of a "pension consensus" in German politics (Schludi 2005; Hinrichs 2006; Schulze and Jochem 2007). Only after protracted negotiations in various committees and considerable political manoeuvring the CDU/CSU led government coalition managed to find a way out of the institutional obstacle course to make their reform proposal into law. One important tactical move to enhance the probabilities of getting the necessary parliamentary approval for the reform was to separate out the financial part of the proposal, which required consent not only in the *Bundestag*, but also in the upper chamber, the *Bundesrat*. After several rounds of negotiations between government and opposition as well as between the two chambers, agreement the financial part of the package was eventually agreed upon in the December 1997. Even if the government eventually succeeded in adopting the reform package, the achievement came at a considerable cost, which showed itself in the 1998 federal elections. Schludi (2005: 143) points out that the pension cuts brought about by the reform "can hardly be overestimated as a key factor in the disastrous defeat of the Kohl government."

Also in terms of reform contents, Blüm II represented significant innovation compared to previous policies in that it implicitly moved the system away from the traditional "living standard principle". That is, the central element of the reform was the introduction of the so-called "demographic factor" in the pension indexation formula, which would lead to a *de facto* reduction of the replacement rate in the future. The demographic factor was a function of life expectancy at 65 to be used in the calculation of the initial benefit and its subsequent adjustment. In addition, the revenue from a 1 percentage point increase in the VAT was meant to finance a further increase in the federal pension grant.

After taking office in 1998, the SPD governing together with the Greens suspended the demographic factor, only to replace it with a more complicated formula[41] three years later through the Pension Reform Act 2001 (aka the Riester Reform). The projected long-run effect of the new formula did not differ substantially from that of the demographic factor (Hinrichs 2001: 59). The new formula reflects two objectives. First, it aims to keep the contribution rate below a ceiling of 20 per cent until 2020 and below 22 per cent until 2030. The second objective is to keep the standard replacement above 64 per cent (or 67 per cent according to the new definition of net wage) until 2030. Another noteworthy novelty introduced by the 2001 reform was the introduction of a tax-financed, universal and means-testedsocial pension *(Grundsicherung)*. A minimum basic or social pension had hitherto been absent in Germany. Third, and perhaps most importantly with regard to the logic of German pension policy, was the attempt to institutionalise occupational and private pensions through a package of subsidies and tax privileges to encourage investments in occupational and private pension plans.

Important to note is the fact that supplementary savings were not made mandatory (see Börsch-Supan and Wilke 2004; Mattil 2006 for a more detailed overview of the different incentives). As a consequence, take-up rates will remain incomplete, and this in turn have implications for distribution of income in old age. One risks increased inequality as not everyone will be able to forego current consumption to invest in their retirement income (Hinrichs 2006). All in all, the move represents a fundamental shift in the overall structure of the German pension system. That is, with the Riester Reform the door to a multipillar framework had finally been opened also in Germany. In this respect, one can argue that although the modifications to the first pillar (if seen in isolation) have been less radical or overwhelming in Germany than in Italy, overall, a

[41] See Börsch-Supan and Wilke (2004: 31) for an explication of the new formula.

transformative structural change of old age social security provision has taken place (Hinrichs 2006).

Politically we see that there was a government coalition of a different colour behind the Riester reform package. Nevertheless, the political process had many similarities to that leading up to the preceding Blüm II reform. Again the reform package was divided into two pieces of legislation; one containing measures that required the approval of both parliamentary chambers, and another for which a majority of the votes in the Bundestag would be sufficient. The part that needed approval only in the Bundestag was passed without too many problems. The second part of the package proved much more problematic as there disagreements not only along government-opposition lines, but also between different wings of the SPD. In the end, after negotiations in the so-called Mediation Committee[42], the government achieved the smallest possible *Bundesrat* majority in favour of the proposal (Schulze and Jochem 2007).

It soon became evident that to meet the objectives of the Riester Reform with regard to contribution and replacement rates, further reform measures would be required. Towards the end of 2002 after having been confirmed with a narrow margin in the federal elections, the Red-Green coalition set up a reform commission chaired by the economist Bern Rürup. The adverse macroeconomic situation at the time, with an unexpectedly high unemployment rate and low economic growth, enhanced the sense of necessity of reform. The last reform steps so far were undertaken in 2004 with the Rürup reform (aka RV-Nachhaltigkeitsgesetz) and in 2007 with the so-called RV-Altersanpassungsgesetz (Pension Insurance Retirement Ages Act). The most important feature of the Rürup reform was the new sustainability factor (*Nachhaltigkeitsfaktor*), which was to be included in the benefit indexation formula and reflects the ratio of pensioners to contributors. By doing so, the size of an individual's pension benefit is also coupled to developments in the labour market. In practical terms, the sustainability factor ensures a less generous adjustment of the public pension promise resulting in lower pension payments in the long-run. Important to note is that current and future retirees (albeit with modifications during a transition period) thereby share the costs of an increasing age dependency ratio. In addition, in a second step, shortly after passing the *Nachhaltigkeitsgesetz*, the government also introduced a gradual switch from taxing contributions to deferred taxation. The taxation of contributions will be phased out by 2025 (Mattil 2006) and by 2040 pension benefits will be fully subject to income taxation – only with the deduction of general tax allowances.

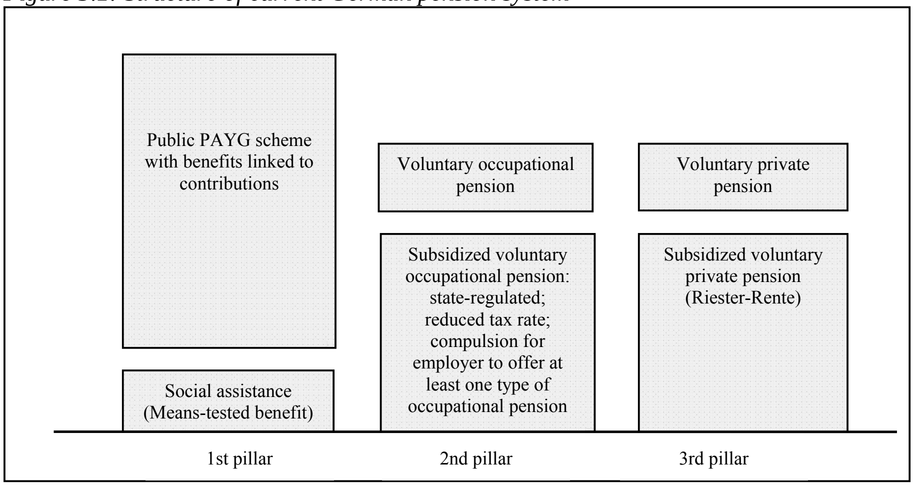
The Rürup reform had a somewhat easier journey through parliament than the two preceding reforms since this time approval in the *Bundesrat* was not required. However, the pattern of a more conflictual and politicised policy-making process was once again confirmed. As usual the trade unions expressed their discontent. The same did the opposition parties, the CDU/CSU and FDP. Not surprisingly the trade unions were unhappy with the cut in the benefit level. Employers on the other were disgruntled that the retirement age was not raised as suggested by the Rürup commission. Also the CDU/CSU and the FDP sided with the employers on this issue.

Finally, the 2007 Act, adopted by the Grand Coalition (CDU/CSU/SPD), introduces a gradual increase of the standard retirement age to 67 years by 2029. The first cohort to be affected is the one with individuals born in 1947. For those born after 1964 the legal retirement age will be 67. Early retirement at 65 will be possible without a reduction in the benefit level if the contributory period (including care and child-rearing periods) total at least 45 years. The increase in the statutory retirement age is another example of the incremental but persistent nature of policy change in Germany. The measure was proposed already by the Rürup Commission proposal, but due to the contentious nature of such a move, the SPD/Green government had decided against such a change.

[42] *Vermittlungsausschuss* in German. This committee consists of 16 members of each chamber and can be called by the *Bundesrat* to mediate on bills after the Bundestag has voted.

One can argue, however, that the Rürup reform discussions had already prepared the ground for the eventual acceptance for this move. Figure 5.1 illustrates graphically the reformed German pension system.

Figure 5.1: Structure of current German pension system



Source: Schulze and Jochem (2007: 674), own adaptation

Overall, Germany shows a mixed reform record with regard to the differential treatment of age cohorts. Since the change in the logic of the benefit calculation formula has been less drastic than in Italy, the generational break is not as clear-cut. The reason for this is that the lifetime earnings principle has been a characteristic of the German public pension system all along. Moreover, adjustments in the indexation formula affect new retirees as well as current ones. Nevertheless, as outlined in this section, also the German reform measures have contained a myriad of transitional arrangements with different rules applying to different cohorts. The stepwise introduction of a reduction to the benefit level at early retirement and tightening of early retirement eligibility criteria, as well as the recently adopted (very) gradual augmentation of the legal retirement age are only two examples. In sum, the German reform process bears signs of having been much more "age-balanced" or intergenerationally fair than has been the case in Italy. However, there is no doubt that new entrants to the German pension system will pay a higher price for their retirement income than past and current generation retirees have done.

6. Concluding remark

There is little doubt that we have seen fundamental system change in both the Italian and the German case. In both countries there has been a strong sense of problem pressure and urgency to make the pension system fit for the future. Economic crisis and population ageing have been the main factors fuelling this perception, which, in turn, has pushed key political actors into a problem-solving mode. Tough policy choices have been made, sometimes even with a high political cost attached, and the new institutional architectures show a high degree of similarity. Nevertheless, the reform dynamics, i.e. timing and political process, have been clearly contingent on each country's institutional legacies and particular structural conditions. Overall, it is the *interaction* between the actors and the aforementioned variables that produce the observed institutional change. Since this complex mix is different in the two countries, we see divergent results. Importantly, then, on the outcome side of the equation, we have seen that Germany is the better performer out of the two countries. Especially in Italian case a particularly worrying trend in the move from a single-pillar to a multi-pillar system is the low participation rate among young workers in supplementary pension schemes. In Italy the extremely high contribution rate (33 per cent in 2008) to the 1st pillar renders extensive additional savings more difficult. Also the Germans pay high contributions (shared equally between employers and employees), but they are nevertheless more than 10 per cent lower than in Italy giving more room for the investment in additional pension insurance.

Noting that for current labour market entrants, Italian public pension benefits is going to provide a much lower replacement rate than was the case under the old system, one immediately sees why it is problematic if young workers do not start investing in supplementary pensions. That is, with lower replacement rates offered by the public scheme and without participation in any supplementary scheme, one has reason to fear that many will end up with an inadequate income once they reach retirement. This, in turn, might have obvious adverse consequences for the economic well-being of the aged in the future, namely today's youth. Low income earners, workers on non-permanent contracts and the unemployed seem particularly vulnerable. It is highly questionable whether these groups will manage to make provisions for adequate private pension savings. We also know that these types of workers are increasing in number. In the most extreme case scenario, one risks the reversal of one of the greatest achievements of the modern welfare state, namely allowing people to retire with the assurance that they will continue to enjoy an adequate degree of economic security.

In summary, since 1992 the system has become less fragmented, and despite the 2007 reform, the Italian pension system has undoubtedly moved in a financially sounder direction overall. Given the rapidly ageing Italian population, this has been a *sine qua non* for the future of the Italian welfare state. Also the efforts to strengthen the rights of workers with atypical careers, as was done in the 2007 reform, were timely. However, the challenge of financing has been shifted to the individual level and the degree of risk pooling remains limited. In terms of intragenerational equality, one can assume that the well-off will make sure to take out private pension insurance. But there are reasons to be concerned for those who do not belong to this category. From an intergenerational perspective, once the new system has matured, the burden of financing PAYG pensions should in theory be spread more evenly across current and future generations. However, with the long transition periods, the delay in the introduction of the updated transformation coefficients and the current mix of old and new rules, we are still talking many years and billions of euros out of the pockets of today's youth before this is a reality. The most startling example here was the 2007 Welfare Protocol that extended the life of the peculiar and extremely generous seniority pension arrangement. In 2009 a worker is entitled to a seniority pension if the sum of her age and years of contribution to equal 95[43]. This can be compared to the considerably less generous German seniority pension rule, which, as we recall, requires an age of 65 with 45 contribution years.

In some respects the conclusions drawn in the Italian case, apply also to Germany. Several of the new rules, as is typical of pension reform, are phased in only gradually the current generation retirees is less affected by the pension cutbacks than will be today's youth. Due to the reforms, future retirees will have to get by with less generous benefits from the 1st pillar, i.e. the public system. People are meant to compensate for these lower benefits by investing in either occupational or private pensions. The policy tool to encourage such behaviour has also in the German case been a package of tax incentives. With regards to redistribution, the point to note about tax measures is that the greatest beneficiaries will be those with the highest earnings. Hence, one may speculate that they contribute to *perverse* redistribution (i.e. from the have-nots to the haves) in the sense that they tend reinforce rather than decreasing economic inequality in old age. Even so, on several accounts, the Germans are better off than the Italians. They have had an advantageous starting point and the changes implemented have been less dramatic. Due institutional legacy of the lifetime earnings principle, the differential treatment of current and future generations of retirees has been much less explicit. Furthermore, in stark contrast to Italy, coverage of private pension schemes is actually

[43] In addition, the requirement is minimum 35 years of contribution and minimum age of 59.

quite extensive in Germany. Particularly for lower-income groups, Germany stands out as particularly successful compared to other OECD countries (see OECD 2009b).

What has emerged from this comparison of these two Bismarckian pension systems is that the way new multipillar institutional design are implemented is crucial for the intergenerational impact of reforms. There is always a time lag between adoption of the reform and its full implementation. In fact, as Bonoli and Palier (2008: 22) point out, [i]t is unreasonable to change the rules determining pension eligibility and levels of pension for people who are only a few years away from retirement". Furthermore, they argue that "[c]urrent workers need time to adapt their savings and work habits to new pension rules" (Bonoli and Palier 2008: 22). In many respects it is hard to disagree with Bonoli and Palier's argument. Workers close to retirement have for their entire professional career paid contributions to the system in the understanding that they would get a certain level of benefits in return from the state when they retire. One can think of it as an implicit insurance contract. Changing the eventual insurance payment when the risk against which you are insured occurs, would be a clear breach of contract on the part of the insurer. However, normatively, from a young person's perspective, one could arguably question whether it is that obvious that those soon-to-be pensioners should be largely immune to changes when the next generation pensioners will have to shoulder significant cuts. This is a question that merits further reflection by the policy makers.

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