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The “Great Recession” and Pension Policy Change in European Countries

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1 Introduction

In autumn 2020, the coronavirus disease 2019 (COVID-19) pandemic ravages countries around the world. As yet, the effects on countries’ economic growth, unemployment or public finances are incalculable and will possibly outstrip the consequences of the economic downturn eleven years earlier. Back then, the misery evolved as a kind of cascade, starting with the so-called “sub-prime crisis” in the USA already in the summer of 2007. It also spread to Europe and ended the housing market bubble that had built up in Ireland, Spain and further countries. Ultimately, the “sub-prime crisis” led to a worldwide financial market crisis in autumn 2008 in

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the wake of the “Lehman bankruptcy”. The near-collapse of financial markets was followed by what is now known as the “Great Recession” in 2009 and which, in several European Union (EU) countries, continued during subsequent years. As a consequence, in almost all European countries public budgets were severely out of balance in 2010, invoking (or aggravating) a sovereign debt crisis and a crisis of the common European currency during which a few members of the monetary union came close to insolvency.

Usually, pensions are the largest item of states’ welfare spending and therefore a prime policy area destined for contributing to the restoration of balanced budgets and containing sovereign debt. This chapter deals with the reforms of pension systems directly related to the repercussions of the “Great Recession”. Specifically, we are interested in pension policy changes that occurred in the European countries worst affected and forced to turn to external assistance. In all EU countries, pension reforms had taken place since about the early 1990s, most often motivated by considerations of financial sustainability in view of imminent population aging. The changes predominantly meant retrenchments, refinancing or recalibration of pension systems, rarely expansions. Hence, reforms were designed so as to avoid blame for incumbent governments. The policy instruments applied and the politics of pension reforms during the 1990s and the first decade of the 2000s have been comprehensively analysed (see for example Weaver 1998; Hinrichs 2000, 2011; Myles and Pierson 2001; Whiteford and Whitehouse 2006; Fernández 2010; Kohli and Arza 2011; Immergut and Abou-Chadi 2014).

In the most crisis-ridden EU countries pension reforms gained additional momentum after 2008. The magnitude of policy changes was *large*, particularly when adding up the sequel of alterations. Thus, they caused a substantial and immediate negative impact on the living conditions of present and future retirees and contributed to the general decline in purchasing power, revealing *interdependencies* between the economic crisis and reforms. Moreover, the political process that brought about these changes deviated from previous reform efforts: There was no lengthy process of consensus-seeking and compromise-building. Rather, the post-2008 reforms in crisis-shaken EU countries swiftly passed parliaments, and mostly they were implemented with a *short time lag*. Hence, they can be considered as “rapid policy changes” (Rüb 2012).

In the next section, we will explain the selection of countries and provide a few facts on the economic situation of these countries after 2008. The third section informs about the type of old-age security systems in the countries selected, while the fourth deals with the actual changes that were concluded during the crisis or shortly thereafter. Finally, we will assess some impacts of the reforms.

2 Eight EU Countries in Need of External Assistance

In this contribution, eight countries are scrutinised—four from Southern Europe (Greece, Italy, Portugal and Spain), three Central and Eastern European (CEE) states (Hungary, Latvia and Romania) and Ireland. All of them have implemented pension reforms after 2008 in order to ensure the financial viability of their public schemes in the short- and long-term or to realise notions of intergenerational equity. Most urgently, however, these countries have sought to regain room for fiscal manoeuvre and to obtain financial aid from inter- and supranational organisations (International Monetary Fund [IMF], EU, European Central Bank [ECB]). Seven of the eight countries had to seek such aid in the wake of the financial market crisis (2007/08), which triggered an economic slump and, as one immediate outcome thereof, a sovereign debt crisis. The causal relevance of these events for the post-2008 reforms can be deduced from concrete recommendations issued by the European Commission or detailed reform requirements attached to bailout agreements (“memoranda of understanding”). Intensified reform efforts by deeply indebted Italy were mainly driven by the rising spread over German government bonds’ interest rate, meaning that hard external pressure shaped domestic policy-making there as well (Jessoula 2012, 24–25; de la Porte and Natali 2014).

For some selected countries from the three regions, Figure 30.1 illustrates the substantial negative consequences for national economies and labour markets inflicted by the successive crises.

Obviously, the economic slump was a drastic one, often reversing years of quite impressive growth in countries on the “periphery” of the European Union (with Italy’s sluggish growth rates being a notable

Fig. 30.1 GDP growth rates (bars) and unemployment rates (lines). (Source: European Commission 2019: Statistical Annex of European Economy Autumn 2019, 14, 28)

exception). As a result, official unemployment rates rose and sometimes skyrocketed—and especially so in welfare states not equipped with comprehensive short-time work schemes that proved to be helpful buffers in countries such as Germany (which only experienced a very limited number of lay-offs during the economic downturn). The costs of bailout and rescue packages for banks and industries, additional welfare spending, reduced public revenues and the shrunken economic base almost inevitably led to strong increases in national debt relative to gross domestic product (GDP), as illustrated in Fig. 30.2.

States that had previously managed to reduce sizeable debts to low levels (such as Ireland) quickly found themselves in a situation they knew all too well, while nations that had (re-)attained statehood only a few decades earlier (such as Latvia) were now also forced to issue government bonds on a large scale. Finally, countries that had already built-up high rates of debt (such as Italy) saw those levels rise even further. Consequences would differ, depending on the scale of debt and the trust placed in the affected countries by their creditors, but all these EU member states shared the fate of having to spend more on servicing debt and finding a smaller share of their—already diminished—budgets available for social spending. It thus came as no surprise that they quickly turned to cost-saving measures in this policy field.

Fig. 30.2 Gross public debt (% of GDP). (Source: European Commission 2019: Statistical Annex of European Economy Autumn 2019, 164)

3 Eight Countries: Three Types of Pension Systems

The eight European countries under scrutiny belong to different welfare state regimes. Ireland represents the (Anglo-Saxon) *liberal* cluster, whereas Greece, Italy, Portugal and Spain belong to the *Southern Model* (Ferrera 1996) that has much in common with the conservative-corporatist type. Hungary, Latvia and Romania and further CEE countries are *post-socialist* welfare states. Given a substantial cross-national variation in terms of the welfare state make-up, it is problematic to speak of an (emerging) “Eastern Model” (Hacker 2009).

There is a specific arrangement of old-age security attached to these different welfare state types. Ireland (like the UK) has followed the *Beveridge* model; in other words, state responsibility is limited to universal basic old-age security, while status maintenance is left to (state-regulated) private provision by employers and individuals. However, coverage with supplementary pension schemes is far from comprehensive. In Southern Europe, social insurance schemes of the *Bismarck* type play a pivotal role. Access to and the level of public pensions depends on prior earnings-related contributions. The accruing benefits are meant to ensure status maintenance. Before the recent reforms, however, the

schemes were institutionally fragmented along occupational lines and varied with regard to benefit generosity and easy access to early retirement. Because old-age security constitutes the central component of these welfare states, the structure of expenditure is strongly “age-biased”.

Originally, CEE countries had followed the *Bismarck* model, and certain elements remained intact during communist rule. The social insurance legacy was revitalised after 1990, before Hungary (1998), Latvia (2001) and Romania (2007) adopted a multi-pillar pension system as propagated by the World Bank. They established an additional second pillar that was private, but mandatory for the younger part of the workforce. While the total contribution rate remained unchanged, the share allocated to the pay-as-you-go first-pillar scheme was reduced (and also the accruing pension level). The remaining part was transferred into the second pillar and invested in private pension funds. This systemic change was expected to deliver a higher total benefit level and to promote domestic capital market development.

4 The Post-2008 Pension Reforms

During an economic downturn, the institutional inertia of pension systems—they bridge long time spans and acquired rights of present and future retirees have to be honoured—may turn out to be a positive trait: When market incomes (wages, profits) decline, an unchanged level of pension benefits (and other social transfers) works as an economic stabiliser. However, containing public pension expenditure would contribute to fiscal consolidation and avoid higher contributions from employers and employees which are assumed to be detrimental to increasing employment. There is only a limited set of levers to improve the public schemes’ financial sustainability, namely changing the benefit ratio (the “generosity” in the broadest sense) or improving the system dependency ratio (the quotient of beneficiaries and actual contributors). The concrete options for parametric reforms depend on the established pension system characteristics, and the respective policy changes unfold their objective in the short run or over a longer time span.

Nominal cuts of pensions in payment show the fastest effect, and they happened in Hungary (thirteenth monthly payment), Ireland (for public sector workers and abolition of the Christmas bonus) or several times in Greece (although in a progressive manner). However, corresponding legislation in Latvia, Portugal and Romania was declared unconstitutional. Suspended or less favourable *indexation rules*, which came about in all eight countries, also ease financial troubles of public schemes quite rapidly and, due to the lower base effect, will ripple through subsequent years, thus yielding further savings.

Mainly long-term savings will accrue from changes to the *benefit formulae*, affecting only future claimants. In some countries, more insurance years are now required to obtain a “full pension” (Spain, Romania) or to qualify for a public pension at all (Latvia). In particular, tightening the contribution/benefit link as in NDC¹ schemes (Italy and Latvia) or taking into account more insurance years (up to the whole employment career) leads to lower pensions for newly retired people with a perforated or less than complete employment career. Whereas NDC schemes operate with a built-in life expectancy factor (when converting notional “assets”), all Southern European countries have introduced a *sustainability factor* that automatically changes system parameters (normal retirement age, number of insurance years required for a “full pension” or the initial benefit level) upon longevity developments.

Short- and long-term savings may occur from an improved system dependency ratio when older workers are compelled or incentivised to stay on in employment and, correspondingly, claim their pensions for fewer years. To that end, *early retirement* pathways may be closed, entry conditions tightened or decrements imposed when the pension is claimed prematurely. Such changes happened in all eight countries. In addition, a higher *normal retirement* age, depending on the length of the phasing-in period, contributes to the schemes’ financial sustainability. While CEE countries have set the target age at sixty-five, in the other countries the normal retirement age will be sixty-seven or even sixty-eight (Ireland).

¹ NDC is the abbreviation for “notional defined contribution” and denotes a public pension scheme that, although still operating on a pay-as-you-go basis, mimics the working of a fully funded plan with benefits calculated in quasi-actuarial manner in relationship to contributions paid.

Thereafter, it is linked to further life expectancy gains in Greece, Italy and Portugal. These differences between the CEE countries and the rest appear comprehensible in view of further life expectancy at age sixty-five being shorter by about three years in Central and Eastern Europe.

Moreover, all eight countries have made steps towards the *harmonisation* of pension schemes, either by unifying hitherto fragmented schemes in order to lower administrative costs and/or by removing existent privileges for certain occupational groups (such as a lower normal retirement age or higher accrual rates) (see also Natali and Stamati 2014, 323). Predominantly, these equalising reforms focused on public service workers and on women if they were still entitled to a lower pensionable age (however, Hungary and Romania remain exceptions in that respect). In not a single country was the solvency of public pension schemes strengthened by raising the *contribution rate*—at least, not for employers. On the contrary, with a view to stimulating job growth, their rate was (temporarily) lowered in Greece, Ireland, Portugal and Romania, whereas employees have to pay a higher contribution rate in Ireland, Latvia and Portugal.

The pension policy changes enacted in the wake of the Great Recession described so far were not altogether new. The various reform levers had been pulled already during the 1990s and the first decade of the 2000s. However, in many cases the impact was exacerbated or the implementation accelerated (e.g. by shorter phasing-in/out rules). In addition, two developments were new: Ireland, Portugal, Spain, Latvia and Hungary (see below) attempted to gain immediate relief from their debt burden by utilising *public pension reserve funds* as a “piggy bank” (Casey 2014; Hinrichs 2015, 24). These attempts to meet strict deficit criteria imply that—since earned entitlements were not declared void—a larger part of future pension payments is moved to pay-as-you-go funding in all four countries even though exactly the opposite was originally intended.

The second new development concerns the (partial) *reversal of the multi-pillar approach*: The financial market crisis of 2008 had revealed the risks of fully funded components in the retirement income mix. Moreover, in CEE countries it brought to the fore the specific challenge of transition costs that is known as the “double payment problem”: The younger cohorts (plus the middle-aged workers who voluntarily joined the second pillar in larger numbers than expected) were also required to build up

financial assets for the private component of their retirement income out of the diverted share of social insurance contributions (see above). However, for several decades the pension entitlements of present-day retirees and older workers have to be honoured. The lowered contribution revenues of the first pillar were insufficient to meet these obligations (Holzmann and Guven 2009, 170, 230–1) while a rising revenue gap could be covered out of the state budget only as long as it was not under pressure itself. However, this was exactly the case after the economic slump in 2009 and forced the governments in Latvia and Hungary (and elsewhere) to take action. The financial market crisis had shaken the public’s confidence in fully funded pensions, and high administrative costs of the privately managed pension accounts and low returns added to this. It also furthered a rethinking among political actors in CEE countries, leading to a departure from the multi-pillar model. In Hungary (like in Poland or Slovakia—Orenstein 2011; Drahokoupil and Domonkos 2012), the second pillar was completely abolished: Contribution payments into the second pillar were stopped while the contribution revenues of the first pillar were increased accordingly. The already accumulated assets of the second-pillar pension funds were “confiscated” and transferred into the state budget, thereby immediately reducing the deficit and the amount of public debt. The entitlements the participants had earned in the second pillar were shifted to the first pillar, which increased the public pension scheme’s long-term obligations (or rather the “implicit debt”). Latvia and Romania did not go that far. Latvia temporarily lowered the share of the total contribution rate flowing into the second pillar from eight to two percent and increased it to six percent between 2013 and 2016. Since then, the partition remains stable. In Romania, the gradual increase in the second pillar’s share was merely delayed by one year.

After a period of often drastic reforms aimed at cost-cutting in the wake of the crisis cascade unfolding since 2007, European countries have often not continued on this track, but halted certain efforts or even took measures to reverse them during recent years. With the economic situation generally improving and political pressure from “reform victims” mounting (and sometimes legal issues arising as well), they saw themselves able and compelled to provide for higher and/or more accessible pension benefits especially for vulnerable groups such as low-income

earners (Moury and Afonso 2019). For instance, Greece passed legislation essentially revoking additional cuts decided on in 2016, Portugal and Italy significantly eased early retirement, Romania decided to substantially increase the replacement rate of the public pension scheme and Spain postponed the implementation of a “sustainability factor”.

5 Reform Impact and Outlook

Comparing projections for public pension spending today and, in the decades, to come (e. g., see European Commission 2009, 2018), it becomes apparent that many countries had been facing substantial increases in the share of GDP to be spent on public pensions, but that these projected increases have often been decreased drastically probably owing to far-reaching reforms. In many cases, this has led to “pension burdens” lying at levels below those witnessed today. Expected pension spending may now again be slightly higher than a few years ago due to interim expansionary reforms (as is the case in Italy and Spain, for instance), but the general tendency remains largely unchanged. Obviously, constant or even decreasing spending on pensions in ageing societies means that adequacy is at risk and old-age poverty may rise, given that compensation by means of funded occupational or private schemes is often not available or depends on highly volatile assets such as stocks. As it became obvious during past economic downturns and may very well be the case in the wake of the COVID-19 crisis, funded pension systems are often hit especially hard in times of economic crises, leading to harsh cuts and often not providing for getting the pensioners affected by them “back on track” in later years. While Organisation for Economic Co-operation and Development (OECD) countries were remarkably successful in reducing the share of the elderly living in poverty during the last decades, in many cases pushing this rate below the general poverty rate (OECD 2015), this tendency now seems far from certain. It is not only due to (prospective) replacement rates generally being lower than they were in the 2000s, but also because theoretical replacement rates often have very little to do with actual pension levels achieved by individuals. With

traditional careers continually spent with just one or very few employers becoming less common and some “modern”, non-standard types of employment leading to no proper pension credits at all, there is a growing risk of pensioners receiving very low benefits. That risk is aggravated by the fact that many welfare states have tightened the links between wages/contributions and resulting pensions. In consequence, gaps caused by unemployment, low wages and the like now tend to be evened out less systematically than previously. Consequently, countries such as France, Italy or Portugal, despite still offering rather generous replacement rates, witness about a third of their pensioners receiving a mere minimum pension.

To be sure, inadequate public pensions and frail or non-existent funded schemes may in some cases be counterbalanced by home ownership (which is particularly common in Eastern and Southern Europe) or a growing rate of inheritance benefitting younger cohorts, although these assets do not provide for steady incomes. On the other hand, younger and future pensioners tend to be victims of a tendency towards insufficient benefit indexation which governments have found to be a very efficient tool for cost-cutting that is conveniently unknown to most people affected. While their initial pension benefits received at the time of retirement may very well suffice, this would then change over time through a process of “creeping impoverishment”. What is more, medical progress, ongoing population ageing and societal change make medical and care services more expensive and necessary, in turn leading to higher contribution rates or co-payments depleting pension income or even savings.

Overall, pension reforms enacted in the years since 2008 have often made systems more financially sustainable, but in many cases also endangered their adequacy and social sustainability, in other words, legitimacy and acceptance. Recent reforms in a range of countries have led to certain improvements, but mostly focused on pensioners immediately or shortly to be affected and not so much on ensuring old-age benefits that will reliably prevent poverty and perpetuate living standards upon and throughout retirement for younger cohorts as well. Whether and how these goals can be reached against the backdrop of the ongoing COVID-19

pandemic cutting deeply into labour markets (and thus pension credit accrual) as well as state and social insurance budgets and devaluating assets essential for funded schemes, remains to be seen. In any case, governments should keep in mind that pension payments not only provide for individual income but also work as “automatic stabilisers” compensating for shrinking demand in times of economic crisis. A lesson learned from the last recession is that immediate and far-reaching pension cuts do harm to both pensioners and economic recovery and should be refrained from.

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