Chapter 4

# Pensions: Who Is Learning from Whom?

*Mitchell A. Orenstein*

As the United States (US) faces a massive fiscal crisis and reevaluates its spending on entitlement programs including Social Security, it seems relevant to ask whether the United States can learn from the experiences of other developed countries addressing similar issues (Orenstein 2009; Skocpol 1995; Weaver 2005). Are there lessons from Europe?

In a broad sense, European pension systems mainly provide negative lessons of what not to do. The generous European pension systems that were built up in many countries since the late nineteenth century have been in crisis for years and have been forced to cut back. Many of these systems offered very high income-replacement rates, aiming not only to prevent old-age poverty but also to help middle- and upper-income earners maintain retirement incomes similar to those they enjoyed as workers. However, as the aging of European populations has swelled the number of pensioners and as global economic competition has created pressure to reduce labor costs, this level of state pension provision has become impossible to sustain. The global financial crisis has only intensified this trend, once again showing many European states that they cannot afford as generous pension schemes as they did in the past (Casey 2012; Tinios 2012). The resulting cuts have been truly transformative. Greece and other countries in crisis have been forced to cut back suddenly and dramatically. The pension systems of Germany, Sweden, and other European countries that have experienced more orderly retrenchment have come to resemble that of the United States with its smaller, redistributive state Social Security system and workplace 401(k) system of voluntary individual accounts (Scherman 2012). Indeed, at the broadest, macrolevel of pension system design, it seems that recently Europe has learned more from the United States than vice versa. The overarching lesson from Europe is that, however comfortable and desirable they had become, the European pension systems proved

unsustainable. They also crowded out needed investments in young people and families, which became a growing focus of European welfare states (see Gornick and Hegewisch, chap. 2).

Yet, not all the lessons from Europe concerning pensions are negative ones. On the positive side, as European countries have shifted toward a more free market "liberal" model like that found in the United States in recent years, they have accumulated microlevel experiences in innovative pension system design that could be valuable to the United States. As I discuss below, the US workplace pension system suffers from high fees and low coverage, just as increasing numbers of Americans are being forced to rely on it. America's broken workplace pension system will need to be reformed, and recent European experiences transforming workplace pensions can provide useful lessons for successful reform in the United States. Drawing together these lessons—both negative and positive ones—highlights two overarching points: While Americans tend to believe that Social Security is in crisis, the European experience shows that, quite to the contrary, Social Security is relatively healthy; rather, it is the workplace pension system that is in crisis and could benefit the most from lessons from Europe.

## A Reversal of Direction

The theme of transatlantic learning is not a new one in welfare state research. Historians have shown that the United States drew many lessons from Europe during the development of its welfare state (Rodgers 1998). Probably the most famous account of US lesson drawing from Europe is Daniel Rodgers's 1998 book, *Atlantic Crossings*, in which he details the many different ways in which US Progressives adopted European welfare state models. He argues that during the Progressive Era from approximately 1870 until the Second World War, the United States eschewed its typically parochial view of American exceptionalism and was uniquely open to European influence. With the rise of the United States after the Second World War, American exceptionalism returned with its tendency to look down on the corrupt old continent. But during the Progressive Era, he writes, "Tap into debates that swirled through the United States and industrialized Europe over the problems and miseries of 'great city' life, the insecurities of wage work, the social backwardness of the country-side, or the instabilities of the market itself, and one finds oneself pulled into an intense, transnational traffic in reform ideas" (1998, 3). While a rich and complex transatlantic discourse on policies and institutions existed then and exists today, during the Progressive Era, it was common practice in the United States for policymakers and citizens to look to and learn from European experience.

There is no doubt: European countries were pioneers in welfare state development and most of the lessons traveled west across the Atlantic. In the 1890s, Chancellor Otto von Bismarck made Germany the first country to initiate comprehensive, national old-age and medical insurance systems. He did this to dampen workers' enthusiasm for socialism and tie their interests more closely to the state. Britain and other European countries followed suit within the next two decades, under the advice of contemporary policy entrepreneurs (Dawson 1912). However, progress was much slower in the United States. While the Civil War pension system that channeled cash payments to widows and children of veterans since the 1870s was a precursor to the development of a national welfare state in the United States (Skocpol 1995), it was not until after the Great Depression in 1935 that President Franklin Delano Roosevelt's New Deal established a comprehensive national welfare state including a Social Security pension system with old-age and disability insurance. The United States thus lagged Europe by three to four decades in welfare state development, similar to other new world countries such as Chile.

Rodgers (1998) devotes his book to analyzing many of the different pathways that reform ideas and lessons were transferred from Europe to the United States. First, US social policy academics trained at European universities, particularly in Germany, where they learned from social democratic scholars steeped in a growing critique of British laissez-faire economics. Study in Europe became de rigueur for top scholars at leading universities such as Columbia and University of Pennsylvania. Second, new government agencies such as the Bureau of Labor devoted many of their publications to spreading word of social policy innovations in Europe. Third, political leaders at the local level debated the merits of various European models when considering policies to address social ills of great US cities, seeing them as essentially analogous. Fourth, Rodgers focuses a great deal on particular social policy entrepreneurs and argues that they created the institution of a sociological "grand tour" of Europe, bringing back ideas and lessons.

Even today, lesson drawing from Europe remains commonplace in US universities, where many academics continue to draw inspiration from social policies in European social democracies. One of my professors in graduate school was voicing an everyday reality of the academic world when he once asked disdainfully whether a book I was perusing was "one of those books that argues that the US should be more like Sweden." Nevertheless, in a broader sense, the heyday of lesson drawing from Europe has clearly past. The rise of US dominance in the international system after the Second World War caused a return to a more typical and parochial sense of American exceptionalism that looked down on and eschewed European influence (Rodgers 1998). This rejection of Europe was reinforced by the turn to neoliberalism after 1980. Since that time, the free market liberal (in the US parlance, *conservative*) mainstream of US social policy thinking has criticized progressive thought for being too European and sought to follow a more indigenous business-like model. Indeed, this critique has become part of the Republican attack on President Barack Obama's health care plan. Meanwhile, modern US Progressives

have been unable to gain traction for policies that mimic European social accomplishments. Though there is much evidence of the ways that the United States could learn from Europe in the social and environmental spheres (Hill 2010), many Americans believe that the European social model is threatened with collapse. This view has spread in the wake of the eurozone economic crisis and has further damaged the image of Europe's social and economic models in American eyes (Kelemen, chap. 1).

Another factor that explains the dominance of free market liberals in transatlantic welfare state discourse from 1980 to 2008 is that welfare states seemed to have reached their natural limits and entered an era of retrenchment (Pierson 1994). European and American countries that had expanded welfare guarantees in previous years found them increasingly difficult to finance and entered a period of permanent budgetary austerity—even before the recent economic crisis. The second oil crisis of the 1970s brought a period of cheap oil to a close and halted the dramatic postwar expansion of the Western economies. Globalization forced developed country labor markets to be more competitive versus their less-developed-country peers. Demographic aging caused by declining fertility rates had a strong impact on pension systems in developed countries. These systems had been created under very different demographic circumstances, with high ratios of workers to retirees. As the number of workers per retiree declined, this put the finances of state-managed, pay-as-you-go pension systems under permanent pressure and raised questions about how to manage the baby boom generation's retirement. Free market liberal discourse seemed to provide answers to these problems during a period of permanent austerity.

As a result of these trends, pension innovation that had flowed primarily from Europe to the Americas in the late nineteenth and early twentieth centuries began to flow mainly in the opposite direction since 1980. This reversal in the direction of transatlantic learning is clearly visible through a comparison of the diffusion of first pension systems worldwide and the diffusion of pension privatization—the most important trend in pension system design since 1980—starting in 1981. Whereas the establishment of national pension systems shows a clear regional diffusion pattern stretching from Continental Europe to the United Kingdom (UK), the Americas, and later to Asia and Africa, pension privatization started in Latin America and the United Kingdom and then spread quickly to Central and Eastern Europe (Orenstein 2008). More generally, in recent decades, lessons concerning pension system reform have been flowing with the jet stream eastward across the Atlantic.

## Lessons from the United States for Europe

Since Europe and the United States ended a period of welfare state "development" and entered one of "retrenchment" (Pierson 1994), the US's laggard status came to be seen as a strength and a model for European liberals who sought to pare back overgenerous European pension guarantees. Some of the most dramatic pension reforms in Europe in the 1990s and 2000s resulted in systems that mirrored the US model of a relatively small public pension system combined with voluntary private savings through individual pension savings accounts such as 401(k)s. Perhaps the most dramatic example is Germany's Riester reforms of the 2000s, which transformed Germany's pension system from a Bismarckian one in which upper-middle-class pensioners could expect generous state pensions to a much more modest state pension coupled with voluntary individual savings (Ebbinghaus 2011; Palier 2010). The extent of the pension cuts that Germany has phased in over time is enormous. Replacement rates for pensions are predicted to decline from between 60 and 70 percent of prior earnings to 42 percent when the reforms are fully implemented (Borsch-Supan and Wilke 2003; Organisation for Economic Co-operation and Development [OECD] 2009), a cut of more than a third. This will give Germany the lowest public pension replacement rate for low-income workers in the developed western states of the OECD and nearly 20 percent lower than similar pensions in the United States (OECD 2009). Germans can make up the difference through voluntary savings in subsidized individual accounts, which are expected to produce an additional 17 percent of prior earnings, making up much of the difference between the old and new replacement rates. However, these returns are contingent on savings behavior, take-up, and investment returns. Not everyone will receive one and not everyone will reach that 17 percent level. The old German pension system is gone, at least for future generations of retirees.

Germany is not the only European welfare state to drastically reduce the generosity of its pension system in the 1990s and 2000s, inspired by the free market liberal policies of the United States and United Kingdom. Karl-Gustav Scherman, a former president of the International Social Security Administration, estimates that the 1990s reforms in Sweden will cut average replacement rates in Sweden from around 55 to 65 percent of prior earnings under different scenarios to around 30 to 40 percent by 2050 (Scherman 2009, 2012). Sweden's reforms also created a system of individual pension savings accounts, funded by a 2.5 percent payroll tax contribution. Sweden enacted a so-called *notional defined contribution* system for its income-related pension system that ties benefits closely to contributions. Under this system, replacement rates have dropped further than expected.

European leaders made these and other changes because they came to believe that they could not afford to sustain their generous pension systems at a time of slow economic growth, demographic aging, and need for human capital investment in younger people. While the results of these reforms will take two to four decades to fully realize, the reality is that the generous European pension systems previous

and current generations knew have been gutted. The new systems put in place converge to a great extent with the previously much-maligned US model. In some cases, they are less generous than the United States (Scherman 2009). The lesson from Europe: The US system has had the right combination all along of a smaller, redistributive state Social Security system supplemented by savings in voluntary individual savings accounts.

Another major way in which the US pension system seems to be leading the way for Europeans is in increasing the retirement age. The European Union's *White Paper* on pension reforms recommended that European countries increase the retirement age as the primary means of reaching fiscal balance. Yet, the United States had already voted in 1983 to raise its retirement age to 67 years. Germany and Spain followed suit, initiating an increase in their retirement ages to 67 in 2007 and 2011 respectively. In 2010, France started to raise its minimum retirement age from 60 to 62.

Perhaps the most important example of Europe learning from the Americas comes from pension privatization, which traveled from Latin America to Eastern Europe in the 1990s and 2000s via the Washington-based international financial institutions (IFIs) and particularly the World Bank. Now, historian Matthias Leimgruber (2008) has pointed to the Swiss roots of the three-pillar World Bank model of pension privatization, and indeed, some of the key ideas behind pension privatization arose from a 1970s reform in Switzerland that created a system of individual pension savings accounts and was transmitted via European insurance and financial circles. However, few European countries followed the Swiss model and it was ultimately refined and popularized in the Americas before being re-exported to Europe—primarily to Central and Eastern Europe—from 1997 to 2004.

Pension privatization was popularized in the Americas because of the close association of the University of Chicago and the dictatorship of Augusto Pinochet in Chile. Free market, liberal welfare state reform ideas pioneered at the University of Chicago in the 1970s were transmitted to Latin America through a United States Agency for International Development (USAID) program to train Chilean economists at leading US universities. This produced a cadre of "Chicago boys" who later held top positions in the Pinochet government in Chile. These economists led the privatization of the Chilean social security system, replacing it with a system of individual pension savings accounts. Pension privatization came to be seen as one of the policies responsible for the dramatic turnaround of the Chilean economy and, as a result, spread throughout Latin America starting in the 1990s. Peru was one of the first countries to adopt the Chilean model in 1992. Argentina followed in 1994. At the same time, pension privatization captured the imagination of the World Bank, which issued a major report in 1994 entitled, "Averting the Old Age Crisis" (World Bank 1994). While not part of the original Washington consensus on development, pension privatization became one of a set of second-stage reforms advocated by the Washington-based IFIs.



The lessons of pension privatization in the Americas were learned quickly in Central and Eastern Europe. More than a dozen Central and East European countries adopted pension privatization in the years between 1997 and 2004, making this region the greatest locus of pension privatization outside of Latin America. Central and East European countries adopted pension privatization in part because the collapse of communism had kicked the political supports out from under the existing systems of social insurance. Trust in trade unions and the state declined precipitously. At the same time, budget deficits grew. The World Bank hired Latin American pension experts to advise on reform in Central and Eastern Europe. The head of the World Bank Institute's pension programs, for instance, was a prominent Argentine reformer. As part of its technical assistance, the World Bank often brought Central and East European opinion leaders on study tours of Chile and Argentina to learn about their reforms, trips that had a significant impact on their opinions. The Bank also often sponsored talks by Jose Piñera, famous Chilean minister of labor who has conducted a worldwide crusade for pension privatization in cooperation with the US-based, libertarian CATO Institute.

Hungary privatized its pension system in 1997 and Poland did so in 1998. A dozen other countries followed suit between 1998 and 2004, in an example of rapid intraregional diffusion. Most of these reforms followed the model set out in the 1994 World Bank report, which advocated a reduced state pay-as-you-go system complemented by a newly designed system of private pension savings accounts. Although these countries also had access to European advisers and European pension system models, these countries did not follow the existent West European models to anywhere near the same extent, attesting to the way in which pension advice emanating from the Americas had become dominant in social policy reform (Appel and Orenstein 2013). It is particularly remarkable that countries of Central and Eastern Europe were adopting Latin American–inspired pension privatization during a period when many of them were otherwise focused on adopting the laws and regulatory regimes (the so-called *acquis communautaire*) required for them to gain membership in the European Union. In other words, despite the fact that Central and East European countries were focused on adopting West European regulatory frameworks in many other fields, they clearly did not find West European pension systems to be attractive models. Part of the reason for the lack of reliance on Europe was that, at the time, European models were themselves under siege. Conversely, many West European leaders looked favorably on the pension privatization experiments in Eastern Europe and sought to use them as a lever to produce reforms at home.

## Convergence of the Welfare Worlds

While Central and Eastern Europe experimented with pension privatization, the famously stable welfare state worlds of Western Europe began to hybridize and converge toward the liberal model of the United States and United Kingdom. In 1990, Gosta Esping-Andersen described three worlds of welfare capitalism: a liberal world of minimal safety nets, a Scandinavian world of high universal benefits, and a Continental or Bismarckian world of status-reproducing social insurance. For several decades, scholars verified these findings, showing that despite forces of globalization, European countries remained within their original worlds. Political pacts supporting these models and other institutional sources of *path dependency* won the day and held the models in place. Yet in the 2000s, this consensus began to break down. Scholars increasingly perceived that European welfare states had never been quite as differentiated as the typology suggested. And furthermore, forces of Europeanization seemed to be creating a trend toward hybridization of European welfare worlds (Heidenreich and Zeitlin 2009) with all the major states adopting aspects of the liberal model (Bridgen and Meyer 2011; Palier 2010).

This hybridization or convergence had many sources, but the main one was the adoption of liberal welfare policies in the Scandinavian and Bismarckian countries. Denmark famously adopted *flexicurity* policies that aimed to combine flexibility with security—creating a more liberal labor market supported by job training programs and other social supports. Sweden, as described above, liberalized its pension system through individual accounts. The Netherlands also embraced flexicurity and increased the coverage of and reliance on its preexisting private occupational pension system.

While Scandinavian countries remained distinct in some ways, they clearly adopted many aspects of a liberal economic program starting in the 1990s. Germany and other conservative welfare states were slower to change, but the Schröder reforms of the 2000s marked a watershed. German liberals had been trying to liberalize labor markets and social policies for years, but they finally succeeded under a pro-business Social Democratic government enacting the landmark Hartz reforms. France under Sarkozy got rid of the thirty-six-hour work week and made pension benefit eligibility more restrictive.

For pensions, this liberal trend meant an increased reliance on private savings and reduced state pay-as-you-go pension systems. The examples of Sweden and Germany were mentioned above. Sweden transformed its pension system by adopting a notional defined contribution, or NDC, system to replace its previous income-related benefit and also carved out room for a 2.5 percent payroll contribution to individual pension savings accounts. Germany drastically reduced its state pension system and created a new voluntary private savings scheme beside it. Netherlands and Denmark increased reliance on their preexisting occupational private pension systems. These are not isolated examples, but rather part of a widespread trend in Western Europe (Ebbinghaus 2011).



Much of the impetus for this convergence came from the European Union, which in the 1990s initiated a process for addressing continent-wide issues of pension system balance. This discussion centered around the Economic and Financial Affairs (ECOFIN) Council's attempt to create a dialogue on pension liberalization and the Social Policy (EPSCO) Council's attempt to articulate a defense of the European social model. The ultimate result of these debates was a European Commission 2012 *White Paper: An Agenda for Adequate, Sustainable, and Safe European Pension Systems* (European Commission 2012). The *White Paper* is a useful document because it both sums up the state of pension reform in Europe after thirty years of incremental liberalization and because it establishes common priorities for the future. The main one is to increase the retirement age. As the commission explained in its preparatory *Green Paper* (European Commission 2010, 2) on pension reform, "The recent financial and economic crisis has aggravated and amplified the impact of the severe trend in demographic ageing. Setbacks in economic growth, public budgets, financial stability and employment have made it more urgent to adjust retirement practices and the way people build up entitlements to pensions." Noting a distinct trend over the last decade to "lower the share of public pay-as-you-go pensions in total provision while giving an enhanced role to supplementary, prefunded private schemes, which are often of a Defined Contribution (DC) nature" (5), the commission advocates increases in the retirement age as the most promising option for restoring pension finances. The global financial crisis opened a window for such changes.

## Impact of the Global Financial Crisis

The global financial crisis proved to be a watershed for European pension systems (Casey 2012). It remains unclear whether it will ultimately push Europe further in the direction of learning from the free market, liberal policies of the Americas or reverse this trend. So far, the results are mixed. On the one hand, the global financial crisis halted the impetus toward pension privatization worldwide (Orenstein 2011) and forced countries in Central and Eastern Europe to reevaluate their commitment to private pension systems (Drahokoupil and Domonkos 2012). On the other hand, it created pressure for countries to cut back on public pension spending as a way to address fiscal deficits in particular by raising retirement ages. Table 4.1 provides a summary of recent retirement age increases in selected countries in Western Europe.

Again, looking at these retirement age increases, it is hard to avoid the conclusion that Europe is learning from the United States, rather than vice versa. The United States, for instance, increased its retirement age from 65 to 67 in a

TABLE 4.1 Recent Retirement Age Increases in Europe (selected countries)

| *Country* | *Retirement Age Increase* |
|---|---|
| France | From 60 to 62 |
| Great Britain | From 60 to 65 for women by 2012 |
| | Increasing to 68 starting in 2024 |
| Germany | From 65 to 67 by 2029 |
| Netherlands | From 65 to 66 |
| Spain | From 65 to 67 |
| Switzerland | From 64/65 to 67 by 2030 |

landmark 1983 reform. Germany legislated a similar increase in 2007, twenty-four years later. What lesson should the United States learn from this? The main lesson, it seems, is that the US Social Security system is in better shape that the US debate would suggest. The US approach of combining a modest state pension system with a large private and voluntary system of individual accounts subsidized through the tax system has been validated by recent European reforms.

Meanwhile, in Europe, the crisis has ruined the finances of state-managed, pay-as-you-go pension systems. No country was affected more than Greece. Greece had a famously profligate pension system, with replacement rates that far outpaced most European countries. It replaced, on average, nearly 100 percent of prior income. During the crisis, it was pared back by some 15 percent or more due to a variety of measures (Tinios 2012). Greece eliminated thirteenth- and fourteenth-month pensions for civil servants and reduced pensions in payment, a very unusual reform due to its high political costs. Greece was certainly late to reform its pension system in a liberal direction, but it was ultimately forced to do so, proving the necessity of at least some convergence toward the liberal model. Other European countries also cut back their public pay-as-you-go pension systems in the wake of the crisis. Romania enacted a 15 percent cut to pensions in payment only to have these reinstated by the constitutional court. The Baltic States also cut pensions in payment as part of an internal devaluation intended to keep them on a path to Euro membership. The depth of pension cuts depended on whether countries had scaled back pensions in an orderly fashion during good times and on the extent of the crisis.

The financial crisis also upset the momentum toward pension privatization. Central and East European countries that had privatized their pension systems were forced to reduce the percentage of payroll tax contributions channeled to individual accounts. Budgetary pressures and European Union fiscal deficit rules made it difficult to finance so-called transition costs of switching to the new system (Drahokoupil and Domonkos 2012). Postcrisis debt will inhibit pension privatization even in developed countries for years to come. Also, the World Bank stopped



advocating pension privatization due to internal recognition of problems with the new private systems (Orenstein 2011). Hungary renationalized its privatized pension system altogether, seizing the assets held in private pension savings accounts and using them to pay down debt (Simonovits 2012). Poland is now considering such a measure. However, in most countries of Central and Eastern Europe, privatized pension systems are expected to survive, but at a lower level of funding than initially recommended by the World Bank. In 2011, the Czech Republic became the first European country since 2004 to privatize its pension system, but it did so with a much smaller, voluntary contribution to private accounts than its Central and Eastern European precursors. Again, the basic model continues to be the liberal welfare states of the United States and United Kingdom.

One general lesson the United States can draw from Europe is that the US Social Security system is in relatively good health. The US Congressional Budget Office (CBO) estimated in 2012 that the finances of the system would be secure through 2086 with a modest increase in the social security tax rate of 1.95 percent. Without that, its long term expenditures will exceed revenues by 10 percent (CBO 2012). Whereas domestically, the US Social Security system has endured decades of attacks from critics alleging that the system is on the brink of collapse, the health of Social Security is relatively good. In large part, this is due to the prescient 1983 reform engineered by Alan Greenspan (representing President Ronald Reagan) and New York Senator Daniel Patrick Moynihan. This bipartisan reform increased the retirement age, increased social security taxes, and made it possible to finance the retirement of the baby boom generation by creating a *social security trust fund* to save money for that purpose. While a new bipartisan reform is required to keep the system healthy in future decades, the United States had the prescience to enact these reforms early, while most European countries did not. The US Social Security system has also proved more durable than many of its European counterparts largely because of its basic design. Social Security provides a lower average replacement rate than many high-end European systems once did, around 40 percent (though much higher for low-income workers). It is also highly redistributive, geared toward poverty prevention. This type of modest system has stood the test of time, whereas the larger European pension systems that sought not only to prevent poverty but also to guarantee much higher retirement incomes for middle-class and upper-income workers have proven more vulnerable.

## Lessons from Europe for the United States

While at the macrolevel, Europe has learned from the United States and other free market, liberal welfare states, at the microlevel, the new systems that the Europeans have designed to achieve goals of private savings contain important lessons for the United States.

The United States, like Europe, has gone through wrenching changes in its workplace pension system recently as employers have shifted from guaranteed *defined-benefit* pensions to uncertain 401(k) accounts, placing enormous risk on the shoulders of individual employees. With the retirement of the baby boom generation and the increased stress on Social Security, benefits are likely to be cut. The implication: Individuals will rely on workplace pensions even more. The problem is that the workplace pension system in the United States is not up to the challenge. Only a minority of workers are covered by a workplace pension. The vast majority of Americas rely solely on Social Security. While the workplace pension system benefits from enormous tax breaks, these tax breaks go primarily to those who need them least—the wealthy. The maximum tax breaks go to those who deposit the legal maximum of $17,500 per year into an individual pension account. Moreover, much of the money that goes into the workplace pension system never comes out in the form of pensions. First, between one-quarter to one-half of all funds are paid out in fees. Despite the large size of many US funds, the fees charged are up to five times higher than necessary, providing huge profits for financial firms but robbing pensioners of income. Second, there are many ways that people can tap their savings in 401(k) accounts; for instance, when buying a new home, changing jobs, or dealing with life emergencies. In some circumstances, people pay a penalty, but they still have access to these funds. Third, individuals are notoriously poor at making investment decisions. They often buy high and sell low. The result: Only about a third of Americans report significant retirement income coming from workplace pensions. Yet an increasing proportion of people will require additional income if social security benefits are cut. The US workplace pension system is in desperate need of reform.

It is exactly here that recent European experience provides some important lessons for the United States. As Weaver (2005) points out, a number of European countries have recently offered increased employer or voluntary or mandatory private pensions and many of the new program designs offer lessons for the United States. Sweden, for instance, has achieved low fees and a unique mix of individual choice and government regulation in its individual account system by using a single national clearinghouse for pension fund investments. Swedish accounts are unique. Rather than being marketed directly to individuals (as in the UK or US), individuals inform the government clearing house which funds they would like to select and that agency directs their contributions to the fund and issues statements. Fund companies do not know who their clients are, thus they cannot mis-sell their products using high-pressure sales tactics or tack on excessive fees. Sweden also created a default fund for people who do not wish to choose their own fund from some 700-plus options. This fund has low fees, creating competitive pressures on other fund fees, a sort of *public option* in pension choice. Sweden provides a unique counterpart to the US system of unregulated free choice marred by high fees and poor investment decisions.



The United Kingdom has recently adopted a system of automatic enrollment, where employees are automatically enrolled in a pension savings plan when they take a new job. Since employees seldom change their pension choice once it is made, this automatic enrollment is expected to create a much higher coverage rate for private pensions than in the United States. Automatic enrollment in pension savings plans was one of the recommendations made by Cass Sunstein, former head of the Office of Information and Regulatory Affairs in the Obama administration, in the book, *Nudge* (Thaler and Sunstein 2009), which seeks to apply principles of behavioral economics to public policy. The Netherlands and Denmark also have valuable experiences in extending an existing workplace pension system to the entire population, thus covering nearly everyone. Once the United States acknowledges the crisis of its workplace pension system, the next step will be to review options for reform emanating from Europe.

A growing number of European countries similarly have supplemented Social Security programs by making preexisting systems of workplace individual pension savings accounts mandatory. This approach was taken by the Netherlands starting in 1947, Switzerland in the 1960s, and Demark in the 1990s. Australia and New Zealand, English-speaking settler states like the United States, have also adopted this model. Australia introduced a major reform of its pension system in the 1990s, and New Zealand introduced its KiwiSaver program in 2007, which inspired the United Kingdom to legislate a similar National Employment Savings Trust (NEST) pension savings program in 2008 (OECD 2007). The experiences of English-speaking countries, such as Australia, New Zealand, and the United Kingdom, are the most relevant examples for the United States to follow, since these countries share a similar cultural heritage, reflected in their smaller Social Security systems, lesser reliance on the state, and greater trust in market provision.

The Netherlands has mandated workplace pensions since they were introduced in 1947, and many of them have been fully funded. Switzerland mandated workplace pensions after a 1972 referendum. In Switzerland, making workplace pensions mandatory began as a move by insurers and conservative politicians to prevent the formerly communist Labor Party from expanding the Social Security–type system (Leimgruber 2008; Rein and Turner 2001). Denmark moved toward mandatory workplace pensions in 1991 in an effort to provide adequate pensions for blue-collar workers. Eighty-two percent of Danes now are covered by a workplace pension (Green-Pedersen and Lindbom 2006). Until recently, the Dutch, Danish, and Swiss models were seen as outliers to the European norms, since these countries had smaller Social Security–type pension systems. However, a growing number of European and other countries have adopted this approach to pension reform.

In addition to the European models of mandatory workplace pensions, Australia's 1992 pension reform has provided an influential global model. The timing of Australia's new pension system coincided with the global trend toward

pension privatization. Its design had a distinctly pro-market flavor that took inspiration from the Chilean model. The idea to mandate workplace pensions in Australia came out of negotiations between employers and trade unions. Trade unions wanted better pensions for workers and in 1986 agreed to accept lower wage increases in exchange for setting up a workplace pension system of so-called *superannuation* funds, funded by a 3 percent employer contribution. In 1992, the Australian government made this system mandatory and increased the contribution amount from 3 percent in 1992 to 7 percent in 2001 and 9 percent starting in 2002. Eighty-nine percent of all Australian workers are enrolled in one of the many workplace pension systems. Between 1990 and 2002, workplace pension funds experienced high returns of approximately 8 percent per annum, insuring the popularity of the program. However, it remains to be seen how lower returns may affect the system. Workplace pensions in Australia are very lightly regulated, with no guaranteed returns. A wide variety of funds offer a range of products with little government control and administrative fees are high, meaning that the funds may not necessarily provide the returns needed to support a secure retirement.

New Zealand passed its KiwiSaver pension system in 2006 and implemented it starting in 2007. Like Australia, New Zealand has a small state retirement pension paid for entirely by general tax revenues (rather than a special payroll tax contribution, as in the US and most other countries). Everyone is eligible to receive the state pension if residency requirements are met. Given the relatively small size of the benefits, however, many New Zealanders need to save to have an adequate pension; yet only 15 percent of employees were previously enrolled in a workplace pension system. This provided the impetus for the KiwiSaver program. Since 2007, all new employees are automatically enrolled in a KiwiSaver account to which they contribute 4 percent of earnings. Their investments are channeled to a default pension investment fund, unless they select another option, and they have eight weeks to opt out of the system if they choose to do so. Employers may also contribute to the accounts and receive a tax break on contributions. The New Zealand reform is unique in not requiring employer contributions as well as in making enrollment automatic, but optional (Toder and Khitatrakun 2006).

KiwiSaver proved inspirational in the United Kingdom, where successive Labor governments sought to re-reform the pension system after Thatcher's 1986 reforms that privatized part of the system in a misbegotten effort that produced substantial government liability when private companies oversold the benefits of switching to private pensions. The United Kingdom, like the United States, provides a relatively low level of Social Security pensions, which became increasingly insufficient as the population aged. A 2007 law increased protection for poorer pensioners while creating new opportunities for pension savings in the future. In 2008, the United Kingdom government proposed a new pension savings system that drew upon the KiwiSaver model of mandatory enrollment with an option for employees to opt out.



It proposed a mandatory contribution of 8 percent of earnings between 5,035 and 33,540 pounds (up to a maximum of 3,600 pounds per year) to an individual pension savings account. At least 3 percent of this contribution would be paid for by employers, with the rest paid by employees (and the government through tax breaks). The United Kingdom decided to phase in the contribution levels starting in 2013 with the 8 percent level to be reached in 2018. Pension savings accounts would be easily portable and a great deal of emphasis is placed on fair regulation of these funds, given the previous experience of the mis-selling of Thatcher-era funds. Employers with existing workplace pensions could maintain their current scheme if it was found to be more generous in a straightforward test. The government would work with the pension industry to design pension savings funds, place strict limits on fees, and insure low costs. Fees are meant to be limited to 0.3 percent of funds under management, but an initial 1.8 percent fee was enacted to fund the setup costs of the system. Lessons from these experiences concerning the design of workplace pensions may prove invaluable as the United States confronts how to reform its workplace system Social Security faces possible cuts.

In sum, the current 401(k)-based workplace pension system in the United States has serious problems. While employers have moved away from defined-benefit pension systems that guaranteed income based on previous salary and provided generous pensions to employees with long tenures at large firms, 401(k)-type workplace pension systems have had poor results in terms of creating an adequate retirement income for most Americans (Munnell and Sunden 2004). People do not contribute enough to their individual pension savings accounts, called *401(k)s* after a clause in the US tax code; they often cash out the balances when they leave their employers; they make poor investment decisions, for instance keeping too much in company stock; and they will most likely make poor decisions at retirement, taking lump sum payments instead of annuities. As a result, balances in most 401(k) accounts are too low to provide adequate benefits in retirement. The system needs to change now that more Americans are dependent on these accounts.

European and other international experience shows that the most promising way forward for US pension reform is to make enrollment in a workplace pension mandatory and create a new *public-option* pension savings fund that will prove attractive to both employees and employers. Generous, preexisting workplace pension schemes could opt out if they prove that their benefits will be equal or higher than the new savings system. This approach achieves the promise of benefit adequacy by limiting cuts to Social Security and mandating workplace pensions for all. Such a reform can be funded by replacing the tax breaks provided to the existing workplace pension system, which have increased dramatically in recent years. In doing so, the European pension systems could provide important lessons in how to achieve this, with an eye to low costs, flexibility, and targeting underserved populations.

## Conclusion

In conclusion, the transatlantic flow of ideas has reversed since the Progressive Era, when social policy ideas flowed from the Old World to the New. Since 1980, in pensions at least, Europe has mainly learned from the Americas. This is because of broader political economic trends that resulted in the dominance of neoliberal policy worldwide. European social welfare systems have been pressured to converge to a more liberal model. The pace of this change accelerated during the global financial crisis, as European welfare states were forced to slash future social expenditures in part by increasing the retirement age to US or nearly US levels (67 years of age). Nevertheless, the United States can still clearly draw lessons today from European countries' experiences with pension reform. The lessons the United States can draw from Europe are mostly at the programmatic level in terms of finding the right balance between public and private pensions and learning from innovative new designs for voluntary, mandatory, and workplace private pensions that have been created in Europe. The transatlantic flow of ideas on pensions will always be with us, and the United States will be forced to consider its own reforms soon given the inadequacy of our 401(k)-based workplace pensions. When that time comes, Europe's recent experience with emulating and improving upon the US model should be kept in mind.

## References


Appel, H., and M. A. Orenstein. "Ideas versus resources: Explaining the flat tax and pension privatization revolutions in Eastern Europe and the former Soviet Union." *Comparative Political Studies* 46, no. 2 (2013): 123–52.

Bridgen, P., and T. Meyer. "The impact of the new public and private pension settlements in Britain and Germany on citizens' income in old age." In *Converging worlds of welfare? British and German social policy in the 21st century*, edited by J. Clausen, 180–217. Oxford, UK: Oxford University Press, 2011.

Börsch-Supan, A., and C. B. Wilke. *The German public pension system: How it was, how it will be.* Working Paper No. 2003-041. Ann Arbor: Michigan Retirement Research Center, 2003. http://www.mrrc.isr.umich.edu/publications/papers/pdf/wp041.pdf.

Casey, B. H. "The implications of the economic crisis for pensions and pension policy in Europe." *Global Social Policy* 12, no. 3 (2012): 246–65.

Congressional Budget Office. *The 2012 long-term projections for Social Security: Additional information.* Publication Number 4520. Washington, DC: Congress of the United States, Congressional Budget Office, 2012.

Dawson, W. H. *Social insurance in Germany 1883–1911.* London: T. Fisher Unwin, 1912.

Department for Work and Pensions. *Pensions and ageing society.* London: GOV.UK. https://www.gov.uk/government/topics/pensions-and-ageing-society.

Drahokoupil, J., and S. Domonkos. "Averting the funding-gap crisis: East European pension reforms since 2008." *Global Social Policy* 12, no. 3 (2012): 283–99.

Ebbinghaus, B., ed. *The varieties of pension governance: Pension privatization in Europe.* Oxford, UK: Oxford University Press, 2011.

Esping-Andersen, G. *The three worlds of welfare capitalism.* Princeton, NJ: Princeton University Press, 1990.





European Commission. *Green paper towards adequate, sustainable and safe European pension systems.* COM (2010) 365 final. Brussels: European Commission, 2010.

———. *White paper: An agenda for adequate, safe and sustainable pensions.* COM (2012) 55 final. Brussels: European Commission, 2012.

Green-Pedersen, C., and A. Lindbom. "Politics within paths: Trajectories of Danish and Swedish earnings-related pensions." *Journal of European Social Policy* 16, no. 3 (2006): 245–58.

Heidenreich, M., and J. Zeitlin, eds. *Changing European employment and welfare regimes: The influence of the open method of coordination on national reforms.* New York: Routledge, 2009.

Hill, S. *Europe's promise: Why the European way is the best hope in an insecure age.* Berkeley: University of California Press, 2010.

Leimgruber, M. *Solidarity without the state: Business and the shaping of the Swiss welfare state, 1890–2000.* Cambridge: Cambridge University Press, 2008.

Munnell, A., and A. Sunden. *Coming up short: The challenge of 401(k) plans.* Washington, DC: Brookings Institution Press, 2004.

Organisation for Economic Co-operation and Development. "Public pensions and retirement savings." *OECD Economic Surveys*, no. 8 (2007): 51–78.

———. *Germany: Highlights from OECD pensions at a glance 2009.* Paris: OECD, 2009.

Orenstein, M. A. *Privatizing pensions: The transnational campaign for social security reform.* Princeton, NJ: Princeton University Press, 2008.

———. "Learning from international experience." In *Pensions, social security, and the privatization of risk*, edited by M. A. Orenstein, 108–27. New York: Columbia University Press, 2009.

———. "Pension privatization in crisis: Death or rebirth of a global policy trend?" *International Social Security Review* 64, no. 3 (2011): 65–80.

Palier, B. *A long goodbye to Bismarck: The politics of welfare reform in continental Europe.* Amsterdam: Amsterdam University Press, 2010.

Pierson, P. *Dismantling the welfare state? Reagan, Thatcher, and the politics of retrenchment.* Cambridge: Cambridge University Press, 1994.

Rein, M., and J. Turner. "Public-private interactions: Mandatory pensions in Australia, the Netherlands and Switzerland." *Review of Population and Social Policy* 10 (2001): 107–53.

Rodgers, D. *Atlantic crossings: Social politics in a progressive age.* Cambridge: Harvard University Press, 1998.

Scherman, K. G. *The Swedish NDC system: A critical assessment.* Paper presented to the 2nd Colloquium of the Pension, Benefits, and Social Security Section of the International Actuarial Association. Helsinki, Finland, May 2009.

———. "The Swedish public pension under stress." *Global Social Policy* 12, no. 3 (2012): 336–39.

Simonovits, A. "Re-nationalizing the mandatory private pension pillar in Hungary." *Global Social Policy* 12, no. 3 (2012): 334–36.

Skocpol, T. *Protecting soldiers and mothers: The political origins of social policy in the United States.* Cambridge: Harvard University Press, 1995.

Thaler, R. H., and C. R. Sunstein. *Nudge: Improving decisions about health, wealth, and happiness.* New York: Penguin Books, 2009.

Tinios, P. "Greece: Extreme crisis in a monolithic unreformed pension system." *Global Social Policy* 12, no. 3 (2012): 332–34.

Toder, E., and S. Khitatrakun. *Final report to Inland Revenue: KiwiSaver evaluation literature review.* http://www.urban.org/publications/411400.html (December 2006).

Weaver, R. K. *Social security smörgåsbord? Lessons from Sweden's individual pension accounts.* Brookings Policy Brief Series 140. http://www.brookings.edu/research/papers/2005/06/saving-weaver (2005).

World Bank. *Averting the old age crisis: Policies to protect the old and promote growth.* Washington, DC: World Bank Publications, 1994.